INSTITUTIONAL INVESTOR EDUCATIONAL FOUNDATION

Breakfast Briefing: Appraisal as an M&A Investment Strategy

March 2014

Appraisal as an M&A Investment Strategy – March 2014

Briefing Workbook

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INSTITUTIONAL INVESTOR EDUCATIONAL FOUNDATION

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Appraisal as an M&A Investment Strategy – March 2014

PARTICIPANTS

Jay Eisenhofer

Jay Eisenhofer, co-founder and managing director of Grant & Eisenhofer P.A., has been counsel in more multi-hundred million dollar cases than any other securities litigator, including the $3.2 billion settlement in the Tyco case, the $895 million United Healthcare settlement, the $450 million settlement in the Global Crossing case, the historic $450 million pan-European settlement in the Shell case, as well as a $400 million settlement with Marsh & McLennan, a $303 million settlement with General Motors and a $300 million settlement with DaimlerChrysler. Mr. Eisenhofer was also the lead attorney in the seminal cases of *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, where the U.S. Court of Appeals required shareholder proxy access reversing years of SEC no-action letters, and *Carmody v. Toll Brothers*, wherein the Delaware Court of Chancery first ruled that so-called "dead-hand" poison pills violated Delaware law.

Mr. Eisenhofer has served as litigation counsel to many public and private institutional investors, including, among others, California Public Employees Retirement System, Colorado Public Employees Retirement Association, the Florida State Board of Administration, Louisiana State Employees Retirement System, the Teachers' Retirement System of Louisiana, Ohio Public Employee Retirement Systems, State of Wisconsin Investment Board, American Federation of State, County & Municipal Employees, Service Employees International Union, Amalgamated Bank, Lens Investment Management, Inc. and Franklin Advisers, Inc.

Mr. Eisenhofer is consistently ranked as a leading securities and corporate governance litigator and he has been named by Lawdragon to its list of the top 500 lawyers in America for the past two years. *The National Law Journal* has selected Grant & Eisenhofer as one of the top ten plaintiffs' law firms in the country for the last eight years, earning the firm a place in *The National Law Journal's* Plaintiffs' Firms Hall Of Fame.

Mr. Eisenhofer has written and lectured widely on securities fraud and insurance coverage litigation, business and employment torts, directors' and officers' liability coverage, and the Delaware law of shareholder rights and directorial responsibilities. Among the publications he has authored: "The Shareholders Activism Handbook" Aspen Publishers; "Proxy Access Takes Center Stage – The Second Circuit's Decision in *AFSCME Employees Pension Plan v. American International Group, Inc.*" *Bloomberg Law Reports*, Vol. 1, No. 5; "Investor Litigation in the U.S. - The System is Working" *Securities Reform Act Litigation Reporter*, Vol. 22, #5; "*In re Walt Disney Co. Deriv. Litig.* and the Duty of Good Faith Under Delaware Corporate Law" *Bank & Corporate Governance Law Reporter*, Vol. 37, #1; "Institutional Investors As Trend-Setters In Post-PSLRA Securities Litigation" *Practicing Law Institute,* July, 2006; "*In re Cox*

Jay Eisenhofer, Continued

Communications, Inc.: A Suggested Step in the Wrong Direction," *Bank and Corporate Governance Law Reporter*, Vol. 35, #1; "Does Corporate Governance Matter to Investment Returns?" *Corporate Accountability Report*, Vol. 3, No. 37; "Loss Causation in Light of Dura: Who is Getting it Wrong?" *Securities Reform Act Litigation Reporter*, Vol. 20, #1; "Giving Substance to the Right to Vote: An Initiative to Amend Delaware Law to Require a Majority Vote in Director Elections," *Corporate Governance Advisor*, Vol. 13, #1; "An Invaluable Tool in Corporate Reform: Pension Fund Leadership Improves Securities Litigation Process," *Pensions & Investments*, Nov. 29, 2004; and "Securities Fraud, Stock Price Valuation, and Loss Causation: Toward a Corporate Finance-Based Theory of Loss Causation," *Business Lawyer*, Aug. 2004. Mr. Eisenhofer has also authored a number of articles on illiquid and rouge hedge funds, including "Time for Hedge Funds to Become Accountable to Fiduciary Investors," *Pensions & Investments*, April 30, 2012; and "Hedge Funds of the Living Dead," *New York Times Dealbook*, June 4, 2012.

Mr. Eisenhofer serves as a member of the NYU Law School Advisory Board for the Center on Civil Justice, and as co-chair for the Securities Litigation Committee of the American Association for Justice. He is a graduate of the University of Pittsburgh, and a 1986 *magna cum laude* graduate of Villanova University School of Law, Order of the Coif. He was a law clerk to the Honorable Vincent A. Cirillo, President Judge of the Pennsylvania Superior Court and thereafter joined the Wilmington office of Skadden Arps Slate Meagher & Flom. Mr. Eisenhofer was a partner in the Wilmington office of Blank Rome Comisky & McCauley until forming Grant & Eisenhofer P.A. in 1997.

Alan Glatt

Alan Glatt is the managing partner of Protocol Capital Management, a global consultancy and capital placement firm. Prior to establishing Protocol Capital Management, Mr. Glatt was a Partner with Alpha Equity Management ("AEM"), an alternative investment firm specializing in quantitative statistical arbitrage and 130/30 strategies. In 2007, Trusco Capital Management, the $75 billion dollar asset management division of SunTrust Bank ("STI") purchased a significant minority interest in AEM. Subsequently, Mr. Glatt sold his remaining interest in the firm.

Mr. Glatt has over 25 years of experience in financial services and began his career with Smith Barney Harris Upham, in the institutional sales area. He next worked as a vice president in the Institutional and Individual Service Group at Donaldson, Lufkin & Jenrette ("DLJ"). In 1991 he joined Morgan Stanley in the Private Client Group and left as a principal of the firm in 2002. In late 2002, he joined Mariner Investment Group, as the President of Mariner Wealth Management.

He serves on the Foundation boards on Southampton Hospital, Henry Street Settlement, The Dartmouth Fellows Committee and the St Andrews Gala 600th executive board.

Geoffrey C. Jarvis

Geoffrey Jarvis, a director at Grant & Eisenhofer, focuses on securities litigation for institutional investors. He had a major role in *Oxford Health Plans Securities Litigation* and *DaimlerChrysler Securities Litigation*, both of which were among the top ten securities settlements in U.S. history at the time they were resolved. Mr. Jarvis also has been involved in a number of actions before the Delaware Chancery Court, including a Delaware appraisal case that resulted in a favorable decision for the firm's client after trial. At the present time, he has primary responsibility for a number of cases in which Grant & Eisenhofer clients have opted-out of class actions, and has also played a lead role in class actions against Tyco, Alstom and Sprint.

Mr. Jarvis received a B.A. in 1980 from Cornell University, where he was elected to Phi Beta Kappa. He graduated *cum laude* from Harvard Law School in 1984. Until 1986, he served as a staff attorney with the Federal Communications Commission, participating in the development of new regulatory policies for the telecommunications industry. He then became an associate in the Washington office of Rogers & Wells, principally devoted to complex commercial litigation in the fields of antitrust and trade regulations, insurance, intellectual property, contracts and defamation issues, as well as counseling corporate clients in diverse industries on general legal and regulatory compliance matters. Mr. Jarvis was previously associated with a prominent Philadelphia litigation boutique and had first-chair assignments in cases commenced under the Pennsylvania Whistleblower Act and in major antitrust, First Amendment, civil rights, and complex commercial litigation, including several successful arguments before the U.S. Court of Appeals for the Third Circuit.

Mr. Jarvis authored "State Appraisal Statutes: An Underutilized Shareholder Remedy," *The Corporate Governance Advisor*, May/June 2005, Vol. 13, #3, and co-authored with Jay W. Eisenhofer and James R. Banko, "Securities Fraud, Stock Price Valuation, and Loss Causation: Toward a Corporate Finance-Based Theory of Loss Causation," *Business Lawyer*, Aug. 2004

Nick Matthews

Nick Matthews leads Kinetic Partners' global forensic practice. He joined the London practice as a partner in 2006, moving to Cayman in 2008, from where he returned in November 2010. Previously, Nick was a principal at a Big Four firm in London.

Nick qualified as a Chartered Accountant in 1993 while working as an auditor, before spending 18 months in Los Angeles, California. Nick has 16 years of forensic accounting, litigation support and liquidation experience, with an emphasis on financial services clients. He had led significant international projects, involving teams in the UK, Europe, Caribbean and the USA. A particular focus of Nick's work has been financial crime advisory services.

Now focusing exclusively on clients in the investment management sector, including hedge fund and traditional asset managers, investment banks, insurers and regulators, Nick specialises in forensic investigations, litigation support and liquidation services, working closely with clients, legal advisors and independent experts. Nick also leads Kinetic Partners' FATCA team.

Nick is a member of the Kinetic Partners Executive Board.

Geoffrey Stern

Geoffrey Stern is the Managing Partner and CIO of Muirfield Capital Management, an asset management firm dedicated to alternative investment strategies. Geoff is the Co-Portfolio Manager of Muirfield Value Partners, a fund dedicated to investing in US Appriasal Rights opportunities. He has over 30 years of M&A and investment experience. Additionally, Mr. Stern successfully led the litigation to force the liquidation of Highland Crusader Fund, a $1.5 billion distressed debt hedge fund that had suspended investor redemptions in 2008 - one of the few successful litigations by a hedge fund investor.

Prior to fouding Muirfield Mr. Stern was the Co-Head of Mergers and Acquisitions at Prudential Securities. From 1981 to 2000, Geoff was an M&A Investment banker at Donaldson, Lufkin & Jenrette where he was a founding member of DLJ's highly successful M&A group, and a partner level M&A banker from 1988 to 2000 and member of DLJ's Fairness and Valuation Committee.

Geoff has extensive transactional experience representing Companies, Boards of Directors and independent committees in mergers, acquisitions and going-private transactions. His deal experience includes the management led buy-out of IBP, Inc, representing Carl Icahn in Texaco and Phillips Petroleum Recapitalizations, the management led buy-out of Kemet, Inc, and representing Coniston Partners in Storer Communications .

He holds an MBA from the Anderson School of Business, UCLA and a BA from Haverford College.

Alberto Thomas

Alberto Thomas is a founding partner of Fideres, a firm specialised in supporting investors and their legal advisors to recover what is rightfully theirs in complex financial disputes. In particular, Fideres works closely with litigation funders and law firms to aggregate claims to reach critical mass by identifying and approaching investors in particular products to offer participation in group actions.

Prior to founding the business, during a career spanning across 15 years, Alberto covered several management roles in large investment banks in London and New York. Alberto has an engineering degree from Ecole Central Paris and from Politecnico of Turin

Grant & Eisenhofer

The Use Of A Statutory Appraisal Proceeding As An Investment Strategy

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Increase Premium for Securities Offered Below Fair Value

- It often is possible to utilize the appraisal rights process to generate significant returns. The goal is to purchase securities of companies being acquired in transactions in which shareholders have been offered a sub-par cash interest for their shares.

Seek to Generate Superior Returns

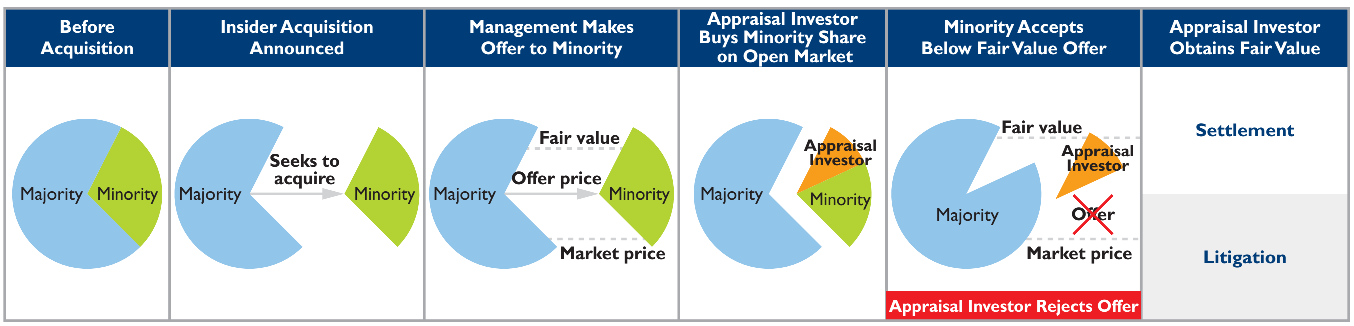
- The average case should take approximately 6 to 24 months to monetize. Typically the worst case scenario is that the appraisal investor would receive the deal price, but the expectation is to receive a premium over the deal price along with interest.

Enforce Shareholder Appraisal Rights

- We believe that "insider acquirers" often have a greater incentive to offer and pay minority shareholders substantially less than fair value. It is possible to generate superior returns by enforcing appraisal rights through utilization of the judicial process.

Scenario 1: Typical Acquisition

Scenario 2: Acquisition With The Involvement of An Appraisal Investor



Opportunity

Most Qualified Team

The G&E team consists of some of the field's most proven professionals. We have effectively litigated a number of high profile shareholder cases and was responsible for successfully litigating In re Tyco International, Ltd. Securities Litigation, No. 02-1335-B (D.N.H. 2002), which resulted in the single largest recovery from a corporate defendant ($3.2 Billion).

Attractive Risk Reward: High Returns

An analysis of appraisal awards granted over the past 20 years implies simple median investment returns in excess of 80% and some awards have been granted at over 400% above the merger price. Since the majority of appraisal actions are resolved in settlement under seal and are not reported, we believe that because the time to resolution of such cases is much shorter than the cases that are tried and reported, the returns on an annualized basis in settled cases are generally greater. Typically the worst case scenario is that investors receive the deal price plus statutory interest of Fed Funds Rate plus 5%.

The Delaware Code	The Delaware Code requires that a shareholder be paid "fair value" for shares subject to appraisal. Fair value requires that the corporation be valued as it is operating at the time of the transaction. Prior to the advent of Appraisal rights, a single investor could block a merger. Appraisal laws were enacted to provide an alternative remedy to those shareholders who felt they were not receiving fair value for their shares in a cash merger transaction.
Fair Value	Fair Value is typically derived by using the valuation criteria described more fully below. Fair value is not limited to the market value of the shares – i.e., what they would fetch on the open market. The determination of fair value does not include any element of value arising from the accomplishment or expectations of the merger. Importantly, determining fair value is not a function of fiduciary duty by the Company's Directors. Rather, it is simply whether the shareholders received fair cash consideration for their equity.
Appraisal Proceedings	Appraisal proceedings do not require allegations of wrongdoing on the part of acquirer or target company or its executives, or any claim that such persons breached any duty or otherwise acted improperly. Appraisal cases are strictly valuation based claims focused solely on whether shareholders received fair value for their shares in cash merger transactions. While the vast majority of Appraisal cases settle under seal before any public announcement or trial, those that do go to court are typically short, narrowly focused proceedings. The actual trials typically last a few days.
The Delaware Courts	The Delaware courts are experienced in the application of Appraisal law and have seen hundreds of cases over the years. The court determines value using several valuation methodologies. All of these methodologies include both subjective and objective valuation criteria.

1. **Discounted Cash Flow** – The three components of the DCF methodology typically sanctioned by Delaware courts include: i) Cash flow projections, ii) Terminal value, iii) Discount rate.[1]

2. **Comparable Companies Methodology** – Value is derived from utilizing appropriate valuation multiples from selected comparable public companies.

3. **Comparable Transactions** – Comparable valuations are derived from valuations in private transactions for on-going businesses.

1 A few other select states have similar statutes and procedures.

The following are examples of the power of the appraisal process.[1]

An appraisal rights action against The Coleman Company Inc. resulted in the awarding of a 455% premium. The case was brought by a minority shareholder who refused to accept the deal consideration. The defendants had claimed the company was worth less than $6 per share and the Court ultimately concluded that fair value exceeded $32 per share.[2]	**455%** premium
Shareholders brought an appraisal and fiduciary duty action against Emerging Communications, Inc. when the company was taken private through a tender-offer followed by a cash-out merger. The litigation concluded with the Court valuing the company's shares at $38.05 per share versus the offer price of $10.25 per share, an increase of 271%.[3]	**271%** premium
A group of shareholders of eMachines, Inc. brought an appraisal action in response to a merger offer from one of eMachines' Directors. The Court valued the shares of the Company 55% higher than the merger consideration.[4]	**55%** higher
American Continental Lines was acquired by Platinum Equity. Case went through trial to judgment in 27 months. Petitioner received a premium of 16 percent over the deal price plus interest, for a total premium of 32 percent and an annualized rate of return of 14.2 percent.[5]	**32%** total return and annualized return of **14.2%**
Common stockholders of The Orchard Enterprises, Inc. were cashed out at a price of $2.05 per share by Orchard's controlling stockholder. Case went through trial to judgment in 24 months. After full appraisal proceeding, court awarded $4.67 per share (premium of 128 percent), plus interest at the statutory rate for 25 months.[6]	**128%** premium plus interest

1 These examples are described for explanatory purposes only. There is no guarantee that you will be able to achieve investment results comparable to those described herein.
2 *Prescott Group Small Cap v. The Coleman Co., Inc.*
3 *In re Emerging Communications, Inc. S'Holders Litig.*
4 *Towerview LLC v. Cox Radio, Inc.,*
5 *IQ Holdings, Inc., v. American Commercial Lines Inc.*
6 *In re Appraisal of the Orchard Enterprises, Inc*

- **Carter-Wallace, Inc.**

  Involved appraisal of a consumer products/pharmaceutical company. The case was pursued through trial to judgment. The Delaware Court of Chancery awarded the shareholders an amount that was approximately 47% above the deal price including interest awarded. Payment occurred 36.5 months after the deal closed. This resulted in an annualized rate of return of 15.5%.

- **Chaparral Resources**

  Involved appraisal of a company that owned an oil field in Kazakhstan. After trial, a settlement was reached that paid a premium of 56% above the deal price. Payment occurred 16 months after the deal closed. This resulted in an annualized rate of return of 42%.

- **Appraisal of a Medical Supply Company**

  A confidential settlement was reached prior to the filing of an appraisal petition. The premium obtained was 29.4% above the deal price. Payment occurred 5 months after the deal closed. This resulted in an annualized rate of return of 71%.

- **A Large International Telecommunications Company**

  Involves appraisal of a telecommunications company in the Republic of Georgia. An award of 100% resulted in a 50% annualized return over a two year litigation period.

- **An Internet Company**

  Involves appraisal of an internet company in the U.S. The case was resolved in two months for a 15% premium over the deal price. This resulted in an annualized return of 90%.

1	Size of the premium of a bidder's offer price over the pre-bid price of the relevant security
2	Acquirer's motivation
3	Acquirer's relationship to the target (Management, Majority/Minority)
4	Outcome of independent valuation analyses based solely on publicly available information
5	Expected outcome of reviewing internal corporate valuation materials
6	Size of the overall transaction

1 Submit Claim → 2 Evaluate Credit Risk → 3 Due Diligence / Review Proxy / Establish Basis → 4 Commitment

1

Submit Claim

- Review cash M&A deals
- Gauge probability of deal closing
- Conduct detailed credit analysis to determine company's credit worthiness

2

Evaluate Credit Risk

- Appraisal Investor becomes a general creditor of acquiring company
- Important to understand the creditworthiness of the acquirer
- Alleviate risk by focuing on industries that have steady and stable cash flows
- Important to conduct detailed credit analysis on each company before initiating a position

3

Due Diligence / Review Proxy / Establish Basis

- Conduct detailed due diligence using industry consultants
- Review all company filings, street research, and documents related to deal

4

Commitment

- Calculate optimal position size based on the cash portion of total deal value
- Buy minority shares in open market

5 Perfect Appraisal Rights	6 Submit Claim	7 Litigation Process	8 Evaluate Settlement / Trial Options

5 Perfect Appraisal Rights

- Vote "No" on the deal and decline to tender shares
- Instruct Prime broker to deliver letter to surviving entity informing them of intent to seek Appraisal

6 Submit Claim

- Submit appraisal petition within 120 days of transaction closing date
- Deliver Subpoena for discovery of all corporate and valuation related documents related to the deal

7 Litigation Process

- Retain independent valuation expert to perform valuation analysis, prepare detailed report, and testify at trial as necessary
- Conduct thorough review of all corporate documents received via the discovery process
- Build case based on the Acquirers own internal projections for combined entity and any "Smoking Gun" evidence

8 Evaluate Settlement / Trial Options

- Conduct settlement negotiations with surviving entity (typically 80% of cases settle at this stage)
- If settlement talks fail, complete preparation for trial and litigate case through to completion

Virtually all states provide some form of appraisal remedy, with two statutory approaches dominating – the Delaware appraisal statute and the Model Business Corporation Act ("MBCA"). With Delaware serving as the state of incorporation for more than half of the public companies in the United States, Delaware General Corporation Law ("DGCL") is likely to govern most appraisal actions. However, outside of Delaware, many states have adopted the MBCA.

Appraisal proceedings do not require allegations of wrongdoing on the part of acquirer or target company or its executives, or any claim that such persons breached any duty or otherwise acted improperly.

Appraisal Rights Under Delaware Law

- Section 262 of the DGCL governs the appraisal remedy for Delaware companies.
- In order to pursue an appraisal action, the shareholder must own the shares on both the date of the demand and the date upon which the merger is consummated.
- Merger transaction must include consideration other than shares of the surviving corporation or a listed stock and cash for fractional shares.
- The shareholder must make a written demand to the corporation indicating that the shareholder wishes to exercise his, her or its appraisal rights, and that demand must be received by the corporation prior to the vote on the merger.
- Appraisal rights are available even where a shareholder buys shares with knowledge of the proposed merger, so long as all other requirements of the statute are satisfied.
- When the requirements under Section 262 are satisfied, the "dissenting stockholder has an absolute right to an appraisal" under the DGCL.
- The filing of the appraisal Petition and compliance with the requirements of Section 262 establish the existence of an appraisal claim. There is no need to prove wrongdoing.

Appraisal Rights Under The MBCA

- Under the MBCA, appraisal rights are available:
  - In mergers where shareholder approval is required and the relevant shareholder is entitled to vote on the merger, and;
  - In connection with a share exchange where the shareholder is entitled to vote on the exchange.
- Under the MBCA, appraisal rights are available where the acquirer holds 20% or more of the shares of the target company.
- The MBCA requires that a shareholder wishing to assert appraisal rights: (1) must deliver to the corporation before the vote is taken, written notice of intent to demand payment if the proposed action is effectuated; and (2) must not vote, or cause or permit to be voted, any shares of such class or series in favor of the proposed action.
- The procedures under the MBCA are:
  - Notice of an event that triggers appraisal rights must be sent to shareholders detailing the requirements and deadlines to perfect the appraisal remedy.
  - The corporation shall pay in cash to those shareholders pursuing their appraisal rights the amount the corporation estimates to be the fair value of their shares, plus interest.
  - A shareholder dissatisfied with the amount must demand in writing that the corporation pay that shareholder's fair value estimate for the shares, plus interest (less any payment the shareholder has received).
  - If a shareholder's demand remains unsettled, the corporation shall commence a proceeding within 60 days after receiving the demand and petition the court to determine the fair value of the shares and accrued interest.
  - Should the corporation fail to timely commence this proceeding, it shall pay in cash to each shareholder the amount the shareholder demanded, plus interest.

State Appraisal Statutes: An Underutilized Shareholder Remedy

Geoffrey C. Jarvis[1]

There are many occasions upon which the shareholders of a corporation are deprived of their ownership interest in that corporation, against their will, either through merger, recapitalization or as the result of some other corporate transaction. Even when shareholders do not believe that the transaction involves any illegal or improper actions on the part of management or the controlling shareholder, they may still be entitled to a premium over the deal price. Such a premium may be available through the use of a statutory appraisal proceeding.

Indeed, empirical evidence from appraisal cases over the last twenty years shows awards of over 400 percent above the deal price are not uncommon and that the median premium exceeds 80 percent. Further, in Delaware, by statute, interest awards are five percent above a federal funds rate for the period during which the proceeding was pending.

Right To Appraisal and Applicable Procedures

Section 262 of the Delaware General Corporate Law ("DGCL") governs the appraisal remedy for Delaware companies and provides an appraisal right in a transaction where the shareholders receive cash in return for their shares, but not where a shareholder received shares of another corporation.[2] The right to pursue an appraisal is available to any stockholder of a Delaware corporation who (1) holds shares of stock on the date of the making of a demand for appraisal; and (2) continuously holds such shares through the effective date of the merger or consolidation; (3) has neither voted in favor of the merger or consolidation nor consented thereto in writing; and (4) files a demand for appraisal with the corporation prior to the shareholder meeting where the transaction is to be voted upon.[3] Where the above requirements under Section 262 are satisfied, the "dissenting stockholder has an absolute right to an appraisal."[4]

Once an appraisal action is commenced, there is no motion to dismiss. The filing of the Petition and compliance with the requirements of Section 262 establish the existence of a claim.[5] Because of the narrowly focused nature of the appraisal remedy, appraisal litigation is usually less time-consuming, expensive and onerous than litigation where the primary goal is to determine whether a defendant did, or did not, commit an illegal or improper act. Thus, it is often possible for an appraisal case to be tried within 12 to 24 months after the petition for appraisal is filed, as opposed to 3 to 5 years in other types of complex litigation.

"Fair Value"

The Delaware Code requires that a shareholder be paid "fair value" for the shares subject to appraisal.[6] Fair value requires that the corporation be valued as it is operating at the time of the transaction. The shareholder then receives his, her or its interest in the going concern as represented by its percentage shareholding (if it owns 10 percent of shares it gets 10 percent of the value).[7]

Fair value is **not** the market value of the shares – *i.e.*, what they would fetch on the open market. Further, the determination of fair value does not include any value that may be created as the result of the transaction that caused the appraisal, such as new management's plans, for example. The appraisal is of the company exactly as it was being run.[8]

In valuing a company, there are a number of different methods that can be used. The various valuation methodologies include the discounted cash flow ("DCF") methodology, the "comparable companies" methodology, and the "comparable transactions" methodology. Although the DCF methodology is often used by Delaware Courts, no one methodology is required and the goal is to use the methodology that best captures the going concern value of the entity being appraised.

It is important to note what an appraisal proceeding does not involve. It does not require allegations of wrongdoing on the part of the corporation or its executives or any claim that they breached a duty or somehow acted improperly. The only issue is the value of the shareholder's stake in the corporation.

Conclusion

Investors should be fully aware of the possibility of an appraisal action in determining whether to vote for and ultimately accept the proceeds of any transaction in which they are being cashed-out of their investment. In those cases where there is an allegation of self-interest in the transaction, there is a good prospect for a recovery that is in excess of the deal price. Moreover, such a recovery can be obtained more expeditiously and efficiently than other forms of litigation and without any accusation or determination of fault by the defendant company, its management or its controlling shareholders. Thus, full awareness of the requirements and potential value of appraisal litigation should be part of very investor's process of evaluating potential cash-out transactions.

1 Geoffrey C. Jarvis is a director for the leading investor rights law firm Grant & Eisenhofer P.A. He can be reached at gjarvis@gelaw.com.

2 DGCL §§ 262(b)(1), (2).

3 *Id.* at § 262(a).

4 *Kaye v. Pantone, Inc.*, 395 A.2d 369, 375 (Del. Ch. 1978).

5 *Id.* at 375.

6 8 Del. C. § 262.

7 *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 553 (Del. 2000); see also *Tri-Continental Corp v. Battyne*, 74 A.2d 71) (Del. 1950) ("the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger.").

8 8 Del. C. § 262(h).

Grant & Eisenhofer's fund flash

YOUR MONTHLY UPDATE ON FUND LAW TRENDS AND DEVELOPMENTS

Statutory Appraisal in the Spotlight

As 2013 comes to a close, the degree to which the legal and investment communities saw the reemergence of the statutory right to appraisal—in the M&A context, the right of a corporation's minority shareholders to have a fair stock price determined by a judicial proceeding or independent valuator, thus obligating the acquiring corporation to repurchase shares at that price and preventing an acquisition for less than the company is worth—is only now coming into focus.

Many eyes were on Carl Icahn's fight opposing Michael Dell in Dell's campaign to take the company he founded private. Even after Icahn relented, he announced, and then abandoned, a plan to reject Dell's offer price and instead seek appraisal of his 156.5 million shares of Dell. Months later, in October, hedge funds holding 14 million shares of Dole Foods Co. announced plans to reject the offer price in Dole's buyout by its CEO and founder David Murdock. The hedge funds stated that they were turning to the courts for an independent appraisal of the value of their shares, which represented more than 25% of all Dole shares not owned before the buyout by Murdock.

These very public moves, as well as several other notable disputes (*e.g.*, BMC Software, Inc.) have highlighted the statutory right of appraisal as a viable remedy for dissenting stockholders who believe the offered deal price is lower than the fair value of their stock.

In fact, in a strategy that has come to be known as "appraisal arbitrage," investors are increasingly buying shares in companies likely to be cashed out at an amount lower than the company's intrinsic value, and then seeking a higher valuation through appraisal actions. Investment funds are now expressly formed to execute this strategy, and have actively been filing appraisal petitions in select transactions. These funds are benefitting from a 2007 Delaware court ruling (also involving Icahn) in *In re Appraisal of Transkaryotic Therapies, Inc.*, which held that investors need not have owned stock prior to the record date for voting on the transaction in order to seek an appraisal of their shares. In other words, investors can essentially wait until right before the shareholder meeting regarding the deal to buy shares and then later seek appraisal. At least two funds, Merion Capital and Muirfield Capital, are currently operating in this space.

The right to seek appraisal of one's shares is based on the laws of the state in which the target company is incorporated, which more often than not in the case of a large corporation is Delaware. Following is a review of the statutory right to appraisal under Delaware law, as well as recent case law demonstrating the ways in which it can benefit dissenting shareholders.

Right To Appraisal and Applicable Procedures

Section 262 of the Delaware General Corporate Law ("DGCL") governs the appraisal remedy for Delaware companies and provides an appraisal right in transactions

(continued...)

where the shareholders are to receive cash in return for their shares (but not where a shareholder receives shares of another corporation). Stockholders do not need to allege any wrongdoing on the part of the corporation, its officers or directors. Rather, the right to pursue an appraisal is available to any stockholder of a Delaware corporation who (1) holds shares of stock on the date of the making of a demand for appraisal; (2) continuously holds such shares through the effective date of the merger or consolidation; (3) has neither voted in favor of the merger or consolidation nor consented thereto in writing; and (4) files a demand for appraisal with the corporation prior to the shareholder meeting where the transaction is to be voted upon. Where all the requirements under Section 262 are satisfied, the "dissenting stockholder has an absolute right to an appraisal."[1]

"Fair Value"

The Delaware Code requires that shareholders be paid "fair value" for their shares subject to appraisal. Fair value requires that the corporation be valued as it is operating at the time of the transaction. Fair value is not the market value of the shares – *i.e.*, what they would fetch on the open market. Further, the determination of fair value does not include any value that may be created as the result of the transaction that caused the appraisal, such as new management's plans.

There are a number of different valuation methods that can be employed in share appraisal actions. The approach most often taken by the Delaware courts is the discounted cash flow ("DCF") method. The DCF analysis is premised on the assumption that the value of all of a corporation's assets is equal to the current value of the expected cash flow from those assets in the future. DCF involves determining how much cash a company can generate in the future and then determining (using a "discount" rate) the current value of that future cash.

Other approaches are the "comparable companies" and "comparable transactions" valuation methods. The comparable companies approach entails the review of publicly traded competitors in the same industry, looking at particular indicators of economic performance such as profits or revenues, determining similar indicators for public companies where the value of the company is known, determining how such indicators of performance compare to the price of the stock of the company (such as the ratio of the price of its stock to revenues), and finally the application of those ratios to the subject company to arrive at a value. A comparable transactions approach is similar to a comparable companies analysis, except that, rather than using ratios derived from ongoing businesses, it uses multiples of valuation metrics (earnings, revenue, etc.) calculated as the ratio of the transaction price to those metrics.

Although the DCF method is widely used by Delaware Courts, no one methodology is required and the goal is to use the valuation approach that best captures the going concern value of the entity being appraised. Courts should not defer conclusively or presumptively to the merger price to determine fair value even if the transactional process is unchallenged; instead they must conduct an independent evaluation using all relevant factors. Where, however, other methodologies are inapplicable and the sales process was thorough, effective, and free of self-interest or disloyalty, the merger price has been relied on as the most reliable indicator of fair value.

Delaware law also provides for accrual of interest on appraisal awards at a statutory rate of 5% above the Federal Reserve discount rate, compounded quarterly. Interest begins accruing on the effective date of the merger through the date of payment of the award. Stockholders are entitled to this statutory rate of interest unless good cause is shown, such as where the stockholder has brought the appraisal action in bad faith. The availability of interest can serve to offset the shareholder's loss of use of capital during the appraisal process.

Examples of Appraisal Results

As one would expect, the best results in appraisal actions continue to occur where there is a substantial shareholder, director or officer on both sides of the transaction. For example, earlier this summer, in *Towerview LLC v. Cox Radio, Inc.*,[2] Cox Radio had merged into a subsidiary of its parent company, which owned 78% of the corporation's outstanding stock. The court awarded $5.75 per share in the appraisal action, $0.95 more than the merger tender price of $4.80 per share - a premium of almost 20%. Notably, last summer, in *In re Appraisal*

(continued...)

of the Orchard Enterprises, Inc.[3] minority stockholders were cashed out by a controlling stockholder at a price of $2.05 per share. After trial, the court appraised each share at $4.67, ***a 127% increase***. These results make sense since, presumably, insiders are not buying out the public unless those insiders have information suggesting they can make a profit by doing so.[4]

Appraisal actions are not limited to insider deals, however, as demonstrated by *Merion Capital LP v. 3M Cogent, Inc.*,[5] a recent case where the offer price for the arms-length negotiated merger was $10.50 per share, and the appraisal proceeding resulted in an increase in value to $10.87 per share.

Fund Take-Away

Appraisal actions solely involve the valuation of the stockholder's shares, and can be brought irrespective of any breach of fiduciary duty that may or may not have occurred in connection with the transaction. Investors should be fully aware of the possibility of an appraisal action in determining whether to vote for and ultimately accept the proceeds of any transaction in which they are being cashed out of their investment. Finally, it is noteworthy that the hedge funds in *Dell, Dole* and *Cogent* increased the value of their holdings *after* the buyout transactions were announced.

December 19, 2013

Endnotes

1. *Kaye v. Pantone, Inc.*, 395 A.2d 369, 375 (Del. Ch. 1978).
2. *Towerview LLC v. Cox Radio, Inc.*, 2013 WL 3316186 (Del. Ch. June 28, 2013).
3. *In re Appraisal of the Orchard Enter., Inc.*, 2012 WL 2923305 (Del. Ch. July 18, 2012).
4. Other notable cases from recent history include *Borruso v. Communications Telesystems International*, 753 A.2d 451 (Del. Ch. 1999), where the 95% owner of a telecommunications company squeezed-out the minority at a price of $.02 per share. As a result of an appraisal action, the court awarded $.6253 per share, or ***a premium of 3,000%.*** Another example is *Cede & Co., Inc. v. MedPointe Healthcare, Inc.*, 2004 WL 2093967 (Del. Ch. Aug. 16, 2004).In *Cede & Co*, even though the sale was to two unrelated parties and was pursuant to a bidding process, the Delaware Court of Chancery nonetheless awarded the shareholders who sought appraisal a value that, after interest, was ***approximately 47 % above the deal price***.
5. *Merion Capital LP v. 3M Cogent, Inc.,* 2013 WL 3793896 (Del. Ch. July 8, 2013).

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§11.01 INTRODUCTION

There are many occasions upon which the shareholders of a corporation are deprived of their ownership interest in that corporation against their will, either through merger, recapitalization, or as the result of some other corporate transaction. When such transactions are viewed by the shareholders as being inequitable, the traditional response is to seek to block the transaction by arguing that a company's management has breached its fiduciary duties to the shareholders because it followed inequitable procedures or did not seek the "best" offer.[1] A remedy often overlooked by shareholders, however, is the use of appraisal statutes to obtain the "fair value" of the shares that have been taken.[2]

Appraisal statutes provide several significant benefits over other claims a shareholder could pursue to obtain redress in connection with a transaction that provides insufficient value for the shares being taken. First, the appraisal remedy does not involve any claim of wrongdoing.[3] On the contrary, the sole issue is to determine the value of the shares. In any transaction, the purchaser is offering a price that is expected to make a profit. Some of that profit will be intrinsic to the corporation, and some may be the result of changes in management. The appraisal remedy is simply a matter of business and economics—how much of that "profit" that the purchaser hopes to obtain really belongs to the shareholders? Second, because of the narrowly focused nature of the appraisal remedy, appraisal litigation is usually less time-consuming, expensive, and onerous than litigation in which the primary goal is to determine whether a defendant did, or did not, commit an illegal or improper act. The key to an appraisal action is making sure that the requirements for seeking an appraisal have been met and then proving that the fair value of the shares is higher than the deal price. Both of these, and related issues, are addressed in more detail below.

§11.02 RIGHT TO APPRAISAL

Although virtually all states provide some sort of appraisal remedy, two statutory approaches dominate—the Delaware appraisal statute and the Model Business Corporation Act ("MBCA").

[1] *See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (when the sale of a company becomes inevitable, the duty of the board of directors changes from preservation of the corporate entity to maximization of the company's value at a sale for the shareholders' benefits); *In re The MONY Group Inc. S'holder Litig.*, 2004 WL 769817 (Del. Ch. Apr. 14, 2004) (evaluating claim that board acted inequitably and for purpose of frustrating shareholder franchise in setting record date for purpose of determining stockholders entitled to vote on approval of merger agreement).

[2] *See infra* §11.04[A], (addressing the concept of "fair value").

[3] *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. Supr.,1988) (lower court correctly denied the motion to amend and enlarge the appraisal action to include a claim for rescissory relief for conspiracy, illegality, fraud, and breach of fiduciary duty, as a determination of fair value does not involve an inquiry into claims of wrongdoing in the merger).

More than half of U.S. public companies are incorporated in Delaware, including 63% of the Fortune 500, and in 2009, over 73% of all companies that went public for the year incorporated in Delaware.[3.1] Thus, the Delaware General Corporation Law ("DGCL") is likely to govern most shareholders seeking appraisal. Outside Delaware, many states have adopted the MBCA, making it the other (next to Delaware) major source of appraisal jurisprudence. This discussion will focus largely on the procedures applicable under Delaware law and the MBCA, and because of the much more developed case law, valuation methodologies under Delaware law.[4]

[A] Delaware Law

Section 262 of the DGCL provides appraisal rights to nonconsenting shareholders who own shares in a corporation that is the subject of a merger or consolidation effected pursuant to enumerated sections of the DGCL, including Section 251.[5] Such rights usually are only available in a merger in which the holders of the shares of the merged entity receive cash in return for their shares.[6] The appraisal remedy is available only for shares of stock in a corporation, and does not apply, for example, to unexercised stock options.[7]

The right to pursue an appraisal is available to "[a]ny stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand [for appraisal]" and who "continuously holds such shares through the effective date of the merger or consolidation … and who has neither voted in favor of the merger or consolidation nor consented thereto in writing.…"[8] Thus, the shareholder must own the shares on both the date of the demand and the date upon which the merger is consummated.

Moreover, in order to qualify for appraisal rights, the shareholder must make a written demand to the corporation indicating that the shareholder wishes to exercise his, her, or its appraisal rights, and that demand must be received by the corporation prior to the vote on the

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[3.1] Delaware Division of Corporations, 2009 Annual Report (available at *http://corp.delaware.gov/2009ar.pdf*).

[4] Procedures under the DGCL and MBCA differ significantly, but the methodologies used to actually value companies are the same, regardless of the statutory regime. Because Delaware has much more developed valuation case law, the focus here will be on Delaware valuation decisions. The concepts in these decisions, however, are universally applicable.

[5] 8 Del. C. §262(b). Mergers effectuated pursuant to Sections 251, 252, 254, 255, 256, 257, 258, 263 and 264 of the DGCL may be the subject of an appraisal action. *Id.* Section 262(b)(3) further states that "[i]n the event all of the stock of a subsidiary Delaware corporation party to a merger effected under §253 or §267 of this title is not owned by the parent immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation." Thus, appraisal rights apply in the case of a short-form merger under Section 253, *Id. See also supra* §10.03[C][3].

[6] 8 Del. C. §§262(b)(1), (2). Section 262(b)(1) establishes the so-called "market-out" exception, which denies appraisal rights where the shares of a company subject to merger are listed on a national exchange (NYSE, NASDAQ, AMEX, etc.) or are widely held (more than 2,000 holders). Section 262(b)(2) then establishes an exception to the market-out exception that restores appraisal rights where shareholders are required to take any consideration other than stock in the newly created corporation. Requiring a shareholder to accept cash, bonds, property, or similar consideration would trigger appraisal rights. 8 Del. C. §262(b)(2).

[7] *Lichtman v. Recognition Equipment, Inc.*, 295 A.2d 771 (Del. Ch. 1972); *Andaloro v. PFPC Worldwide, Inc.*, 830 A.2d 1232 (Del. Ch. 2003) (upholding *Lichtman*).

[8] 8 Del. C. §262(a).

merger.[9] The requirement that the demand be received by the time of the vote is strictly construed and is only very rarely waived.[10] Moreover, the demand must be made by the "holder of record," as opposed to the actual beneficial owner of the shares.[11]

Because Section 262 is statutory in nature, and was designed to provide a remedy for the elimination of the traditional right of any shareholder to block a merger,[12] appraisal rights are available even when a shareholder buys shares with knowledge of the proposed merger, so long as all other requirements of the statute are satisfied.[13]

If the above requirements under Section 262 are satisfied, the "dissenting stockholder has an absolute right to an appraisal."[14] Any sale of the shares prior to the transaction, or any kind of vote for or approval of the transaction, however, will result in the loss of the appraisal remedy.[15]

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[9]8 Del C. §262(d).

[10]*See Nelson v. Frank E. Best Inc.*, 768 A.2d 473, 478–479 (Del. Ch. 2000) (petition untimely when filed on a Monday because demand period expired on a Sunday); *Raab v. Villager Indus.*, 355 A.2d 888 (Del.), *cert denied*, 429 U.S. 853 (1976) (demand only signed by one spouse was rejected); *Tabbi v. Pollution Control Indus., Inc.*, 508 A.2d 867 (Del. Ch. 1986) (demand received only minutes after a meeting had commenced was disallowed), *overruled on other grounds by Enstar Corp. v. Senouf*, 535 A.2d 1351 (Del. 1987). *But see In re Engle v. Magnavox Co.*, No. 4896, 1976 WL 2449, at *6 (Del. Ch. Apr. 21, 1976) (a shareholder attempted to personally attend a shareholder meeting to voice opposition to a proposed merger, but his plane was delayed for mechanical reasons. The court held that this was sufficient to justify treating the late demand as timely).

[11]8 Del. C. §262(a).

[12]*Chicago Corp. v. Munds*, 172 A. 452, 455 (Del. Ch. 1934) ("At common law it was in the power of any single stockholder to prevent a merger. When the idea became generally accepted that, in the interest of adjusting corporate mechanisms to the requirements of business and commercial growth, mergers should be permitted in spite of the opposition of minorities, statutes were enacted in state after state which took from the individual stockholder the right theretofore existing to defeat the welding of his corporation with another. In compensation for the lost right a provision was written into the modern statutes giving the dissenting stockholder the option completely to retire from the enterprise and receive the value of his stock in money. Most of the statutes provide that what the unwilling stockholder who refuses to accept an interest in the consolidated enterprise shall be paid is the 'value' of his stock. It is so in Delaware, Connecticut, Idaho, Massachusetts, Missouri, North Carolina, New York and Vermont. 'Fair value' is the phrase used in Maryland, Rhode Island and Tennessee, 'fair cash value' in Arkansas, Florida, Louisiana, Minnesota, Nevada, Ohio and Virginia. These expressions, it seems to me are practically synonymous.")

[13]*Salomon Bros. Inc. v. Interstate Bakeries Corp.*, 576 A.2d 650 (Del. Ch. 1989) (holding that stockholder who purchased shares with notice of merger plans was not foreclosed from seeking appraisal).

[14]*Kaye v. Pantone, Inc.*, 395 A.2d 369, 375 (Del. Ch. 1978).

[15]*Tabbi v. Pollution Control*, 508 A.2d 867, 873 (persons who were record stockholders as of the record date for the vote on the merger, and who filed a timely demand for appraisal, but who were no longer stockholders of record as of the merger date were not entitled to appraisal); *Lewis v. Corroon & Reynolds Corp.*, 57 A.2d 632 (1948) (shareholder need not vote against transaction, but cannot vote in favor of it), *overruled on other grounds by Zeeb v. Atlas Powder Co.*, 87 A.2d 123 (Del. 1952); *Neal v. Alabama By-Prods. Corp.*, 1988 WL 105754 (Del. Ch. Oct. 11, 1988) (holding appraisal demand by beneficial holder of stock invalid because demand was not by or on behalf of record holder as required by §262); *Engel v. Magnavox Co.*, 1976 WL 1705, at *5 (Del. Ch. Apr. 22, 1976) (holding that stockholder's submission of blank proxy constituted vote in

[B] Appraisal Rights Under the MBCA

Under the MBCA, appraisal rights are available in the following situations: (1) consummation of a merger to which the corporation is a party (i) if shareholder approval is required for the merger and the shareholder is entitled to vote on the merger, except that appraisal rights are not available with respect to shares that remain outstanding after consummation of the merger or (ii) if the corporation is a subsidiary and the merger is a short form merger; (2) consummation of a share exchange to which the corporation is a party as the corporation whose shares will be acquired if the shareholder is entitled to vote on the exchange, other than with respect to shares that are not exchanged; (3) consummation of a disposition of assets if the shareholder is entitled to vote on the disposition; (4) an amendment to the articles of incorporation that reduces the number of shares of a class or series owned by the shareholder to a fraction of a share if the corporation has the obligation or right to repurchase the fractional share; (5) any other amendment to the articles of incorporation, merger, share exchange or disposition of assets to the extent provided by the articles of incorporation, bylaws or a resolution of the board of directors; (6) consummation of a domestication if the shareholder does not receive shares in the foreign corporation with as favorable terms and that represent the same percentage interest of voting rights; (7) consummation of a conversion to nonprofit status; or (8) consummation of a conversion to an unincorporated entity.[16] Significantly, similar to Delaware, appraisal rights are not available when the stock is publicly traded on a national exchange (NYSE, NASDAQ, American Stock Exchange), has at least 2,000 shareholders, and the outstanding shares of such class or series has a market value of at least $20 million.[17] Nor are appraisal rights available for the holders of shares that are covered securities under Sections 18(b)(1)(A) or 18(b)(1)(B) of the Securities Act of 1933, or are issued by an open end management investment company and may be redeemed at the option of the holder at net asset value.[17.1] Unlike Delaware, which restores appraisal rights to shareholders required to take any consideration other than stock, the above limitations do not apply when shareholders are required to accept for their shares anything other than *cash* or qualifying stock.[18] On the other hand, there is an exception, not present in Delaware, for corporate actions involving "interested persons," defined as a person or affiliate of a person who: (1) held 20% or more of the shares of the acquired company, (2) had the power to cause the appointment or election of 25% or more of the board of directors; or (3) was a senior executive or director of the corporation or its affiliate and will receive, as a result of the corporate action, a financial benefit not generally available to other shareholders (with certain exceptions).[18.1] In the case of such an "interested" transaction, the shareholder will have appraisal rights.[19] Thus, even when a transaction involves a public or widely held company, when the transaction is tainted by possible insider influence, the MBCA allows the shareholder to seek an appraisal.[20]

Further, like Delaware, the MBCA requires that a shareholder who wishes to assert appraisal

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favor of merger and therefore barred appraisal); *Scott v. Arden Farms Co.*, 28 A.2d 81 (Del. Ch. 1942) (holding that voting trustee's vote in favor of merger precluded stockholder from seeking appraisal).

[16]MBCA §13.02(a).

[17]MBCA §13.02(b)(1)(ii).

[17.1]MBCA §13.02(b)(1)(i), (iii).

[18]MBCA §13.02(b)(3) (emphasis added).

[18.1]MBCA §13.02(b)(i), (ii).

[19]MBCA §13.02(b)(4).

[20]MBCA §13.02(b)(4).

rights with respect to any class or series of shares (1) must deliver to the corporation before the vote is taken written notice of the shareholder's intent to demand payment if the proposed action is effectuated; and (2) must not vote, or cause or permit to be voted, any shares of such class or series in favor of the proposed action.[21]

§11.03 APPLICABLE PROCEDURES

[A] Initiation of the Appraisal Action

[1] Delaware

Under Section 262(d) of the DGCL, the corporation undertaking an action that provides appraisal rights must notify shareholders that such rights exist "not less than 20 days prior to the meeting" at which the transaction at issue will be approved.[22] The notice must include a copy of the text of the appraisal statute and must provide instructions to shareholders as to how to make an appraisal demand under Section 262.[23]

A qualifying shareholder who has properly made a demand may submit a petition seeking appraisal within 120 days after the effective date of the merger.[24] Any petition not filed within 120 days is ineffective, although a defective petition sometimes can be cured after the relevant date.[25] For example, when a timely petition for appraisal (filed within the 120-day period) was filed by the beneficial owners of the shares of a corporation, the court in *Weinstein v. Dolco Packaging Corp.*[26] allowed the shareholder to amend the petition to add the name of the record holder.

In making its initial demand, the shareholder need not seek appraisal for all its shares,[27] but once it has made its demand, the shareholder has no right to file an appraisal petition as to only a portion of the shares as to which appraisal was initially demanded.[28] Upon receipt of the petition, litigation commences. There is no right to payment of any amount to the shareholder or into escrow prior to a final judgment in the appraisal action.

Once an appraisal action is commenced, there is no mechanism for a motion to dismiss or similar procedural device to determine whether a valid claim exists. The filing of the petition and

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[21]MBCA §13.21.

[22]8 Del. C. §262(d).

[23]8 Del. C. §262(d). *See Raab v. Villager Indus.*, 355 A.2d 888 (Del.), *cert. denied*, 429 U.S. 853 (1976) (holding that "Delaware corporation, engaged in [Section 262] proceedings, henceforth shall have an obligation to issue specific instructions to its stockholders as to the correct manner of executing and filing a valid objection or demand for payment under the Statute, as construed by Delaware courts, including: (1) the general rule that all such papers should be executed by or for the stockholder of record, fully and correctly, as named in the notice to the stockholder; and (2) the manner in which one may purport to act for a stockholder of record, such as a joint owner, a partnership, a corporation, a trustee, or a guardian.").

[24]8 Del. C. §262(e).

[25]*Schneyer v. Shenandoah Oil Corp.*, 316 A.2d 570 (Del. Ch. 1974).

[26]C.A. No. 15000, 1997 WL 118399 (Del. Ch., Mar. 11, 1997).

[27]*Colonial Realty Corp. v. Reynolds Metals Co.*, 185 A.2d 754 (Del. Ch. 1962), *aff'd*, 190 A.2d 752 (Del. 1963).

[28]*Lichtman v. Recognition Equip., Inc.*, 295 A.2d 771 (Del. Ch. 1972).

compliance with the requirements of Section 262 establishes the existence of a claim.[29]

In April 2009, the Governor of Delaware approved new amendments to DGCL §262 regarding the right to an appraisal.[29.1] The amendments clarify that the record date related to appraisal proceedings is the record date that determines which shareholders are entitled to receive notice of the meeting.[29.2] The amendments to DGCL §262 became effective on August 1, 2009.[29.3] The amendment was part of an overall strategy to permit companies to provide separate dates for notice and voting. The Delaware legislature also amended other portions of the corporate law—including DGCL §§211(c), 219(a), 222, and 228—to provide for separate notice and voting record dates.[29.4]

[2] MBCA

The procedures under the MBCA are very different from those in Delaware. First, like Delaware, wherever there is a corporate action that triggers appraisal rights, the corporation must send a very specific notice to shareholders detailing the requisite requirements and deadlines to perfect the appraisal remedy. In a substantial departure from Delaware, however, the notice must include the corporation's estimate of the fair value of the shares.[30] For all shareholders who have filed the requisite information to perfect their appraisal rights, the corporation shall pay in cash to those shareholders the amount the corporation estimates to be the fair value of their shares, plus interest.[31] Further, payment to each shareholder must be accompanied by (1) financial statements of the corporation that issued the shares to be appraised and (2) a statement of the corporation's estimate of the fair value of the shares, which estimate must equal or exceed the corporation's estimate provided in the notice to shareholders. A shareholder who is dissatisfied with the amount of the payment must notify the corporation in writing of that shareholder's estimate of the fair value of the shares and demand payment of that estimate plus interest (less any payment the shareholder has received).[32] Failure to provide this information waives the appraisal right.

If a shareholder makes demand for payment that remains unsettled, the corporation shall commence a proceeding within 60 days after receiving the payment demand and petition the court to determine the fair value of the shares and accrued interest. If the corporation does not commence the proceeding within the 60-day period, it shall pay in cash to each shareholder the amount the shareholder demanded, plus interest.[33] Each shareholder made a party to the proceeding is entitled to judgment for the amount, if any, by which the court finds the fair value of the shareholder's shares, plus interest, exceeds the amount paid by the corporation to the shareholder for such shares.[34] The court shall assess the costs of the action against the corporation, except that the court may assess costs against all or some of the shareholders demanding appraisal, in amounts the court finds equitable, to the extent the court finds such shareholders acted arbitrarily, vexatiously, or not in good faith.[35] The court also can award

[29] *Kaye v. Pantone, Inc.*, 395 A.2d 369, 375.

[29.1] H.R. 19, 145th Gen. Assem., Reg. Sess. (Del. 2009) (available at *http://legis.delaware.gov/LIS/lis145.nsf/vwLegislation/HB+19/$file/legis.html?open*).

[29.2] 8 Del. Code §§262 (b)(1) and (d)(1) (2010).

[29.3] *Id.*

[29.4] *Id.*

[30] MBCA §13.22(b)(2)(iii).

[31] MBCA §13.24.

[32] MBCA §13.26.

[33] MBCA §13.30(a).

[34] MBCA §13.30(e).

[35] MBCA §13.31(a).

attorney fees against parties.[36]

[3] Pre-Hearing Discovery

Section 262(h) of the DGCL allows discovery, at the court's discretion, although pretrial discovery is routinely granted.[37] Under the MBCA, "[t]he shareholders demanding appraisal rights are entitled to the same discovery rights as parties in other civil proceedings."[38]

Although discovery is universal in appraisal actions, the scope of discovery often is contested. Under DGCL Section 262, "the only litigable issue is the determination of the value of the appraisal petitioners' shares on the date of the merger."[39] Thus, the discoverability of post-merger events is often in dispute. For example, in *In re Lane v. Cancer Treatment Centers of America, Inc.*,[40] the court permitted discovery that reflected pre-merger financial data and, over respondents' objections, "that reflect[ed] post-merger data for the one-year period following the date of the merger."[41] The court found that "[t]he post-merger data may be 'known or susceptible of proof' on the date of the merger and thus, may be relevant … to the valuation of plaintiffs' shares as of the date of the merger."[42]

As a general rule, "where the particular circumstances of the situation make the discovery request appear to be reasonably calculated to lead to the disclosure of information from which admissible evidence as of the date of the merger could well be developed, the discovery should be permitted even though the post-merger information itself would in all probability constitute inadmissible evidence."[43] In the *Cede & Co. v. Technicolor, Inc.* litigation, the court addressed the situation where a minority shareholder was forced out in a leveraged buyout, in which the assets of the coporation itself were used to eliminate the minority interest. Holding that discovery properly extended into post-merger events, *Technicolor* court explained that

> I do not feel that one should be permitted to enter into a plan to utilize

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[36]MBCA §13.31(b).

[37]8 Del. C. §262(h); *Nelson v. Frank E. Best, Inc.*, CA No. 16329, 201 WL 34054611 at *2 (Del. Ch. Jan 12, 2001) (denying motion for protective order and finding that "as no good reason exists for discovery not to proceed in the appraisal action at this time"); *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1187 n.8 (Del. Supr. 1988) ("*Technicolor I*") (recognizing the potential for investor harm in cash-out transactions, court held that petitioner was entitled to discovery in the appraisal proceeding to obtain information on future earnings that may have impacted value on the day of the merger).

[38]MBCA §13.30(d).

[39]*Technicolor I*, 542 A.2d 1182, 1187.

[40]CA No. 12207, 1994 WL 263558 at *4 (Del. Ch. May 25, 1994).

[41]CA No. 12207, 1994 WL 263558 at *4 (Del. Ch. May 25, 1994).

[42]CA No. 12207, 1994 WL 263558 at *4 (Del. Ch. May 25, 1994).

[43]*Cede & Co v. Technicolor, Inc*, CA No 7129, 1984 WL 8247 at *6 (Del. Ch. Oct. 22, 1984); *see also Kaye v. Pantone, Inc.*, CA No. 5466, 1981 WL 15072 at *2 (Del. Ch. Oct. 6, 1981) (allowing "discovery which reasonably relates to the issue of the value of the … shares" and concluding that "in an appraisal action the court should have at hand all relevant documents so that it can consider all indicia of value in deciding which standard of appraisal to use, even if the particular fact is ultimately not relied upon."); *Ross v. Proco Management, Inc.*, CA No. 6146, 1983 WL 17991 at * (Del. Ch. May 25, 1983) (allowing discovery of a contract to sell assets two years after a merger); *Kahn v. Household Acquisition Corp.*, CA No. 6293, 1983 WL 103279 at *1-2 (Del. Ch. April 26, 1983) (allowing discovery of second merger nearly one year after the initial merger).

> the assets of a corporation that he does not own so as to eliminate its minority shareholders against their will and then use the discovery rules to hide behind the bar of the date of the merger to prevent such shareholders, when they are later attempting to develop admissible evidence on a valuation issue as to which they presumably have the burden of proof, from reasonably examining into the manner in which the plan was carried out.[44]

[B] The Appraisal Hearing

All appraisal proceedings, under both the MBCA and the DGCL are tried before the court.[45] There is no right to a jury trial.[46] The rules of evidence in effect in the jurisdiction in which the court sits are applicable.[47]

[1] Proving the Shares Entitled to Appraisal

In order to prevail in an appraisal action, the petitioner has the burden of proving that it has met all the requirements of Section 262, including that it is a shareholder of record, there was no vote in favor of the merger, and the demand was properly signed and timely served on the corporation.[48] The requirements of Section 262 are strictly construed, and an appraisal demand will fail even when the failure by the petitioner impacts no rights of the respondent corporation. Thus, in *Nelson v. Frank E. Best Inc.*,[49] petition for appraisal was due on a Sunday. Because the court was closed, the petitioner's attorney filed on the following Monday. The petition was deemed untimely because it was not filed by the deadline.

Similarly, in *Tabbi v. Pollution Control Indus., Inc.*,[50] the court addressed issues related to a number of persons seeking appraisal. As to one petitioner, the court found that a demand for appraisal, sent via a delivery service, and that was delivered late, minutes after a meeting to approve the merger had commenced, was untimely and was disallowed.[51] Another stockholder who was divorced prior to the merger could not demonstrate that he was the record holder on the date of the divorce, even though his attorney sent a letter to the court indicating such ownership,

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[44]*Technicolor*, 1984 WL 8247 at *6.

[45]MBCA §13.30(d); 8 Del. C. §262(h).

[46]MBCA §13.30(d); 8 Del. C. §262(h).

[47]*Cede & Co. v. Technicolor, Inc.*, 758 A.2d 485, 487 (Del. 2000) (applying Delaware rules of evidence in an appraisal proceeding); MBCA §13.30(d) (granting court plenary jurisdiction, applying civil discovery rules, and allowing taking of evidence).

[48]*Carl M. Loeb, Rhoades & Co. v. Hilton Hotels Corp.*, 222 A.2d 789, 792 (Del. 1966) (burden of proof on shareholder to demonstrate that requirements of Section 262 were met); *Zeeb v. Atlas Powder Co.*, 87 A.2d 123, 128 (Del. Ch. 1952) ("burden of proof on the stockholder for when the authority of an agent is in issue the burden rests on him who asserts the existence of the agency.").

[49]768 A.2d 473, 478–479 (Del. Ch. 2000).

[50]508 A.2d 867.

[51]508 A.2d 867, 870. *See also Steinhart v. Southwest Realty & Devel. Co.*, Civil Action No. 583 1978 WL 2494 at *2 (Del Ch. May 31, 1978) (stockholder conceded that he received notice and even though his demand was late because it was misdelivered by the post office, he was not entitled to appraisal. His wife, however, who did not herself receive adequate notice, was entitled to appraisal).

and his claim was disallowed.[52]

In *Raab v. Villager Indus.*, while the court held that "[t]he requirements of §262(b) are to be liberally construed for the protection of objecting stockholders, within the boundaries of orderly corporate procedures and the purpose of the requirement," the court nonetheless rejected a demand for appraisal signed by only one spouse when the shares were held jointly.[53] The court further held that a demand for appraisal signed by the beneficial owners of shares, but not by the trustee who was the record holder, or by the owner's broker, but not the owner, were ineffective, and appraisal rights were denied.[54]

However, where a record owner perfects its rights for appraisal, a beneficial owner who acquires stock after the record date, but before the merger date, need not show that the previous beneficial owner of the stock actually voted against the merger.[54.1] In *In re Appraisal of Transkaryotic*, it was not known whether the prior beneficial owner of the stock actually voted against the merger. The court, however, held that "because the actions of the beneficial holders are irrelevant in appraisal matters, the inquiry ends here. Cede, the record holder, properly perfected appraisal rights under §262." Thus, the court held that a beneficial owner could pursue an appraisal remedy, so long as the record owner perfected appraisal rights.

But, in *In re Engle v. Magnavox Co.*,[55] the Court of Chancery recognized that if a shareholder is prevented from making a timely demand for exceptional reasons, beyond his or her control, equity demands that the shareholder not be deprived of the right to appraisal. In *Engle*, a shareholder attempted to personally attend a shareholder meeting to voice opposition to a proposed merger, but his plane was delayed for mechanical reasons. The court held that this was sufficient to justify treating the late demand as timely: "In view of his efforts, and the fact that he was prevented from making his objection known by reasons beyond his control, I do not feel that he should be deprived of his right to an appraisal, if otherwise properly perfected, solely because objection was not received from his broker prior to the vote."[56]

In the case of a short term merger, the DGCL requires that minority stockholders who seek appraisal must submit a written demand to the surviving corporation within 20 days after the mailing of a statutorily required notice informing stockholders that the merger had occurred.[56.1] In *Roam-Tel Partners v. AT&T Mobility Wireless Operations Holdings, Inc.*,[56.2] parent AT&T Mobility implemented a short term merger with its subsidiary St. Cloud Cellular Telephone Company, with AT&T emerging as the surviving company.[56.3] AT&T sent out the required statutorily notice, informing minority stockholders of St. Cloud of their option to seek appraisal or return the included forms (a transmittal letter and accompanying stock certificates) to receive the merger consideration.[56.4] Minority share owner ARAB originally not to seek appraisal and sent AT&T the paperwork signifying its desire to receive the merger consideration, changed its mind upon hearing that other stockholders were seeking an appraisal. Two days prior to the deadline for making an appraisal demand, ARAB sent AT&T a letter informing AT&T of its

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[52] *Tabbi*, 508 A.2d 867, 872.

[53] 355 A.2d 888, 891–892.

[54] 355 A.2d 888, 892–894.

[54.1] *See In re Appraisal of Transkaryotic*, No. Civ. A. 1554-A, 2007 WL 1378345, at * 3 (Del. Ch. May 2, 2007).

[55] CA No. 4896, 1976 WL 2449 (Del. Ch. April 21, 1976).

[56] 1976 WL 2449 at *6.

[56.1] 8 Del. C. § 262(d)(2).

[56.2] C.A. 5745-VCS, 2010 WL 5276991 (Del. Ch. Dec. 17, 2010).

[56.3] *Id*. at *1.

[56.4] *Id*.

demand, and on the deadline for making such a demand, sent AT&T by overnight mail the uncashed check it had received as the merger consideration.[56.5] In a case of first impression, the Delaware Court of Chancery held that:

> In a case, as here, where a minority stockholder perfects its right to an appraisal within the statutory election period and does not accept the merger consideration in the sense that it does not exercise dominion over that merger consideration, that stockholder is entitled to participate in an appraisal action notwithstanding the fact that it made a previous, but promptly revoked, waiver of such right to an appraisal. Absent actual or other prejudice to the surviving corporation, the appraisal statute is best implemented by giving stockholders the full 20 days to decide whether to demand appraisal.[56.6]

Although recognizing that "the right to an appraisal is a narrow statutory right"[56.7], the court likened the 20 day statutory election period in short-form mergers to the period of time preceding a stockholder vote on a long-form merger, during which time stockholders may alter or revoke its proxy or consent prior to the actual vote.[56.8] It also took into consideration the relatively quick sequence of events that take place in a short form merger. Consequently, "[i]n the absence of prejudice to the corporation, these factors counsel against truncating an already brief 20 day election period and counsel in favor of allowing stockholders the full 20 days to make a final decision whether to seek appraisal."[56.9]

[2] Proving Value of the Shares

Unlike the situation involving proof of whether the requirements of Section 262 have been satisfied, "[i]n a statutory appraisal proceeding, both sides have the burden of proving their respective valuation positions by a preponderance of evidence."[57] In meeting their burdens, the parties should provide evidence that would "include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[58] Because both sides have a burden of proof, if neither side presents adequate evidence, the court may not rule against either side on a burden of proof grounds, as the law explicitly requires the court to appraise the value of the shares. Thus, in *Cavalier Oil v. Harnett*,[59] the court found that the parties had offered inadequate evidence of a key point and held that:

> In an ordinary litigation, the matter might be resolved by applying traditional burden of proof rules. If the Court had found that neither side

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[56.5] *Id.* at *2.

[56.6] *Id*. at *1. The court also expounds at length on the doctrines of waiver and estoppel, in its finding that ARAB had revoked its waiver of the right to an appraisal. *Id*. at *9-11.

[56.7] *Id*. at *5, citing *Applebaum v. Avaya, Inc.*, 812 A.2d 880, 893 (Del.2002).

[56.8] *Id.* at *13.

[56.9] *Id.* at *13.

[57] *M.G. Bancorp., Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999); *Gonsalves v. Straight Arrow Pubs., Inc.*, 701 A.2d 357 (Del. 1997).

[58] Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983).

[59] CA Nos. 7959, 7960, 7967, & 7968, 1988 WL 15816 at *20 (Del. Ch. Feb. 22, 1988), *aff'd* 564 A.2d 1137 (Del. 1989).

> had adequately established [a critical fact], it could rule against the party having the burden of proof. However, that approach is not permissible in a §262 appraisal. The statute directs that the Court "shall appraise" the fair value of the dissenting shareholders' shares. Where, as here, a discounted cash flow method is employed, a terminal value is an indispensable ingredient of that technique. Therefore, §262 requires that, where possible, the Court independently determine that valuation component, even where the parties themselves have tried and failed.

The various considerations that go into valuation are discussed in detail below.[60]

[3] Appellate Review

In Delaware, appraisal decisions are appealable as of right to the Delaware Supreme Court. Because an appeal from an order of the Chancery Court is not automatically stayed by the bringing of an appeal, a respondent corporation that has been ordered to pay a judgment must apply to the court for a stay pending appeal, which requires the posting of a supersedeas bond.[61] Because the goal of the bond is to act as security for the judgment, it should be in an amount approximately equal to the amount of the judgment,[62] although the amount of the bond is at the discretion of the trial court.[63]

Once the appeal is perfected, the Court of Chancery's determination under the appraisal statute has traditionally been granted "a high level of deference."[64] This deference reflects a recognition that appraisal cases tend to be factually intensive and often involve competing valuation methodologies[65] and that the Court of Chancery's fact-finding role in appraisal cases often requires the court to cope with "widely divergent views reflecting partisan positions" in value-fixing tasks.[66]

§11.04 VALUATION OF SHARES

[A] Fair Value

Both Delaware and MBCA require that a shareholder be paid "fair value" for the shares subject to appraisal. In Delaware, fair value

> measures "that which has been taken from [the shareholder], *viz.*, his proportionate interest in a going concern." In the appraisal process the corporation is valued "as an entity," not merely as a collection of assets, or by the sum of the market price of each share of its stock. Moreover,

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60 *See infra* §§11.04[A]–11.04[E].

61 Del. Ch. Rule 62(d); Del. Sup. Ct., Rule 32.

62 *Levien v. Sinclair Oil Corp.*, CA No. 1883, 1975 WL 1952 at *6 (Del. Ch. Aug. 12, 1975) ("the supersedeas bond acts as security for the original judgment, but it does not amount to a judgment itself").

63 Del. Sup. Ct., Rule 32.

64 *Gonsalves*, 701 A.2d 357, 360; *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1219 (Del. 1992).

65 *Gonsalves*, 701 A.2d 357, 360.

66 *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1222–1223.

> the corporation must be viewed as an on-going enterprise, occupying a particular market position in the light of future prospects.[67]

Thus, the Delaware Supreme Court has stated:

> By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.[68]

For the purposes of an appraisal, fair value is *not* fair market value—*i.e.*, what the shares would fetch on the open market.[69]

Under the MBCA, fair value is defined as the value of the corporation's shares determined (i) immediately before the effectuation of the corporate action to which the shareholder objects; (ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and (iii) without discounting for lack of marketability or minority status.[70] Like Delaware, courts interpreting the MBCA have rejected the notion that "fair value" is synonymous with "fair market value."[71]

[B] Valuation of a "Going Concern"

Under Section 262 of the DGCL, "the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation."[72] The Supreme Court has observed: "When a stockholder buys stock it is to be supposed that he buys into a corporation as a going concern. He does not buy on the theory that he is about to participate in a contemplated liquidation of the corporation's assets."[73] Thus, in *Paskill Corp. v. Alcoma Corp.*, the Supreme Court of Delaware held that

> [t]he underlying assumption in an appraisal valuation is that the

[67] 607 A.2d 1213, 1228 (citations omitted).

[68] *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950).

[69] *Union Ill. 1995 Inv. Ltd. Partnership v. Union Fin. Group*, 847 A.2d 340, 355 (Del. Ch. 2004) ("In an appraisal action, this court has broad discretion to determine the fair value of the shares of the petitioners. This is done in a jurisprudentially specific manner that is policy-based and that is different from that which would be undertaken to find the 'fair market value' of the petitioners shares.") (footnote omitted).

[70] MBCA §13.01(4).

[71] *See Pueblo Bancorp. v. Lindoe, Inc.*, 63 P.3d 353, 363 (Colo. 2003); *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950); *Wenzel v. Hopper & Galliher, P.C.*, 779 N.E.2d 30, 38 (Ind. Ct. App. 2002); *First W. Bank Wall v. Olsen*, 621 N.W.2d 611, 617 (S.D. 2001); *Matthew G. Norton Co. v. Smyth*, 112 Wash. App. 865, 51 P.3d 159, 163–165 (2002); *HMO-W, Inc. v. SSM Health Care Sys.*, 234 Wis. 2d 707, 611 N.W.2d 250, 255 (2000).

[72] 8 Del. C. §262(h).

[73] *Chicago Corp. v. Munds*, 172 A. 452, 455 (Del. 1934).

> dissenting shareholders would be willing to maintain their investment position had the merger not occurred. Consequently, this Court has held that the corporation must be valued as an operating entity. Accordingly, the Court of Chancery's task in an appraisal proceeding is to value what has been taken from the shareholder, *i.e.*, the proportionate interest in the going concern.[74]

In determining the fair value of the going concern of a corporation, "one of the most important factors to consider is the 'nature of the enterprise' that is the subject of the appraisal proceeding."[75] Thus, Delaware law is clear that a corporation must be valued "as an operating entity by application of traditional value factors, weighted as required, but without regard to post-merger events or other possible business combinations."[76] Elements of value (positive or negative) that arise only if a merger is completed, even if arising by virtue of agreements that are separate from the merger itself, cannot be considered in determining the value of the company for appraisal purposes. Indeed, only elements of value that constitute the *operating reality* of the corporation on the day of the merger may be considered in determining value.[77]

In *Allenson v. Midway Airlines Corp.*, the minority shareholders of Midway Airlines were "cashed out" in a merger for nominal consideration of $.01 per share. These minority shareholders asserted appraisal rights claiming that certain creditor concessions, negotiated by the acquiring corporation, added value to Midway Airlines and thus the nominal consideration did not reflect the "fair value" of the company. The Court of Chancery disagreed. In rejecting the minority's claims, the court noted that the concessions would only add value to Midway Airlines in the event that the merger went forward, and therefore this element of value did not exist apart from the merger, and could not be considered when determining the fair value of Midway Airlines as a going concern if the merger did not happen.[78]

Further, under Delaware law, it is improper to consider transaction costs incurred as a result of a merger that gives rise to appraisal rights when calculating the fair value of the subject corporation.[79] For example, in *Gilbert v. MPM Enterprises, Inc.*, the Court of Chancery observed:

> Petitioner also objects to Respondent's inclusion of transaction costs, which represent the costs of the merger and which were assessed against any payment received by MPM's shareholders. Respondent has failed to explain why these costs, unique to the merger transaction, should be reflected in an appraisal valuation that focuses on the value of the company as a going concern. Accordingly, I decline to consider these costs as well.[80]

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[74] 747 A.2d 549, 553 (Del. 2000); *see also Tri-Continental Corp v. Battyne*, 74 A.2d 71 (Del. 1950) ("the stockholder is entitled to be paid for that which has been taken from him, *viz.*, his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger.").

[75] *Paskill*, 747 A.2d 549, 554–555.

[76] *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989).

[77] *See Allenson v. Midway Airlines Corp.*, 789 A.2d 572 (Del. Ch. 2001).

[78] *Allenson v. Midway Airlines Corp.*, 789 A.2d 572, 585 (Del. Ch. 2001).

[79] *Gilbert v. MPM Enters., Inc.*, 709 A.2d 663, 673 (Del. Ch. 1997), *on reargument*, 1998 WL 229439 (Apr. 24, 1998), *aff'd*, 731 A.2d 790 (Del. 1999).

[80] 709 A.2d 663, 673.

In *Cede & Co. v. Technicolor, Inc.* ("Cede IV"),[81] however, the Delaware Supreme Court addressed what elements of value can be appraised in the context of a two-step merger, reaching a conclusion seemingly at odds with the holding in *Allenson* and *Gilbert*. In *Cede IV*, the Court evaluated a cash-out merger in which financier Ronald Perelman proposed to implement a plan in which he would sell various assets of Technicolor, Inc. The dissenting stockholder argued that because the Perelman plan governed the operation of Technicolor on the merger date, that plan had to be taken into account in projecting net cash flow for purposes of arriving at Technicolor's statutory fair value. The Chancellor rejected this argument, but the Supreme Court reversed, holding:

> In a two-step merger, to the extent that value has been added following a change in majority control before cash-out, it is still value attributable to the going concern, *i.e.*, the extant "nature of the enterprise," on the date of the merger.… [V]alue added to the going concern by the "majority acquiror," during the transient period of a two-step merger, accrues to the benefit of all shareholders and must be included in the appraisal process on the date of the merger.… That narrow exclusion [of elements of value arising from the accomplishment or expectation of the merger] does not encompass known elements of value, including those which exist on the date of the merger because of a majority acquiror's interim action in a two-step cash-out transaction.[82]

The holdings in *Allenson, Gilbert*, and *Cede IV* can be reconciled by reference to the period when the costs or benefits at issue would occur. In *Allenson* and *Gilbert*, the Court determined that the costs/benefits would only occur in the event the merger took place and thus were not part of the "going concern" and should not be subject to appraisal. In *Cede IV*, on the other hand, Perelman had announced his proposed plan and it arguably would go forward even if the cash-out merger did not take place. Thus, it was subject to appraisal.

This issue was addressed by the Court of Chancery in *Cede & Co., Inc. v. MedPointe Healthcare, Inc.*[83] In *MedPointe*, Carter-Wallace Inc., a diversified company with both consumer product and pharmaceutical businesses, was sold to two buyers in two, linked transactions. The consumer business was sold to one buyer for cash and immediately thereafter the remainder of Carter-Wallace was merged into MedPointe. Petitioners argued that, because it was uncontroverted that the sale of the consumer division and the merger were linked and that neither would go forward without the other, both the consumer and pharmaceutical divisions should be subject to appraisal and that certain costs incurred (taxes, etc.) as a result of the sale of the consumer division should not reduce the appraisal value of Carter-Wallace. The Court disagreed, holding that

> Although Petitioners' argument is appealing, the Court, in applying the appraisal statute, is constrained by it to value the Carter-Wallace entity that was merged. The challenge for the Court is to determine the fair value of the going concern at the time of the Merger. By the time of the Merger, Carter-Wallace had sold the Consumer Products Division; it had incurred the capital gains tax liabilities and it had incurred the transaction costs. In short, the Court in an appraisal action values the stock that is

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[81] 684 A.2d 289 (Del. 1996).
[82] 684 A.2d 289, 298–299.
[83] 2004 WL 2093967 (Del. Ch. Aug. 16, 2004).

> merged with regard to its "operative reality" as of the Merger.[84]

Thus, *MedPointe* reinforces the concept that the entity at issue will be appraised exactly as it exists at the moment of the merger that creates the appraisal rights.

[C] Valuation Methods

Prior to 1983, appraisal proceedings in Delaware relied exclusively on a valuation technique knows as the "Delaware Block Method,"[85] a method that

> is a combination of three generally accepted methods for valuation: the asset approach, the market approach, and the earnings approach. Under the Delaware Block Method, the asset, market and earnings approach are each used separately to calculate a value for the entire corporation. A percentage weight is then assigned those three valuations on the basis of each approach's significance to the nature of the subject corporation's business. The appraised value of the corporation is then determined by the weighted average of the three valuations.[86]

In 1983, the Delaware Supreme Court issued its decision in *Weinberger v. UOP, Inc.*,[87] in which it adopted "a more liberal, less rigid and stylized, approach to the valuation process than has heretofore been permitted by our courts."[88] The Court found that valuation methodologies other than the Delaware Block Method could be employed and determined that courts should "employ a more liberal approach" that would "include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[89] The Court determined that

> the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but *must be considered* by the agency fixing the value.[90]

Values derived in the open-market through arm's-length negotiations often can offer a reliable indication of fair value for appraisal purposes.[91] The law in Delaware, however, is now clear that "[u]nder Section 262, the fairness of the price on the open market is not the overriding consideration.…"[92] In *M.P.M. Enterprises, Inc. v. Gilbert*, the Supreme Court affirmed a decision

[84] *Id.* at *8.

[85] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 940 (Del. 1985) (noting that in 1983 "we ruled that the Delaware Block formula was no longer the exclusive mechanism of value precluding other generally accepted techniques.").

[86] *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 555 (footnotes omitted).

[87] 457 A.2d 701 (Del. 1983).

[88] 457 A.2d 701, 704.

[89] 457 A.2d 701, 713.

[90] 457 A.2d 701 (emphasis in original).

[91] *Applebaum v. Avaya, Inc.*, 812 A.2d 880, 889–890 (Del. 2002) (endorsing a "well-informed, liquid trading market" as a means of determining fair value).

[92] *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790, 797 (Del. 1999).

by the Court of Chancery giving no weight to valuation information from the merger at issue, which was between two unrelated parties, and other offers to purchase the corporation.[93] The Supreme Court concluded that

> the trial court, in its discretion, need not accord any weight to such values when unsupported by evidence that they represent the going concern value of the company at the effective date of the merger or consolidation.[94]

Thus, in following the *Weinberger* requirement that a court consider "proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court," three valuation approaches have generally been used by the Delaware Courts in appraisal actions: (1) the discounted cash flow methodology; (2) the comparable company approach, and (3) the comparable transactions approach.[95] Each of these is discussed below.

[1] The Discounted Cash Flow Methodology

Corporate finance theory holds that the stock price of a company reflects the market's estimation of the company's future cash flows, discounted back to the present at the company's cost of capital.[96] This approach to valuation is broadly agreed upon by financial economists and is

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[93]731 A.2d 790, 797.

[94]731 A.2d 790, 796.

[95]*Dobler v. Montgomery Cellular Holding Co., Inc.*, 2004 WL 2271592 at *8 (Del. Ch. Sept. 30, 2004) (indicating propriety of all three methods), *rev'd in part on other grounds*, 880 A.2d 206 (Del. 2005); *Doft & Co. v. Travelocity.com, Inc.*, 2004 WL 1152338 (Del. Ch. May 20, 2004) (accepting the comparable company approach); *Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963 (Del. Ch. Feb. 10, 2004) (using the DCF approach); *Union Ill.1995 Inv. L.P. v. Union Fin. Group, Ltd.*, 847 A.2d 340 (Del. Ch. 2003) (appraising the company's stock by considering the value of the merger price, minus synergies, because this was the best evidence of fair value); *Taylor v. Am. Specialty Retailing Group, Inc.*, 2003 WL 21753752 (Del. Ch. July 25, 2003). (computing the value as the average of the DCF approach and the comparable company approach); *Gentile v. Singlepoint Fin.*, 2003 WL 1240504 (Del. Ch. Mar. 5, 2003) (adopting the comparable transactions approach).

[96]Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 Mich. L. Rev. 613, 616 n.11 (1988) ("Efficient market prices which reflect all available information relevant to the value of the stock are thought to measure rationally the 'worth' of stocks as financial instruments in terms of the present value of their expected future earnings, discounted for nondiversifiable risk."); *see also* Richard Brealey & Stewart Myers, *Capital Investment and Valuation*, 77 (McGraw Hill, 2003) ("The value of a stock is equal to the stream of cash payments discounted at the rate of return that investors expect to receive on comparable securities"); De Bondt & Thaler, *Anomalies: A Mean-Reverting Walk Down Wall Street*, J. Econ. Persp., Winter 1989, at 189 (equating the intrinsic value of a stock with a "rational forecast of the present value of future dividend payments"); Jacobs & Levy, *On the Value of 'Value*,' Fin. Analysts J., July–Aug. 1988, at 47–48 (using the present discounted value of dividends to represent the "fair" or "intrinsic" value of a share of common stock); Malkiel, *Is the Stock Market Efficient*? 243 Science 1313, 1316 (1989) (describing the standard "rational" model of share pricing as one of determining the present discounted value of the future stream of dividends).

the basis for substantial portions of modern corporate finance books.[97] Discounted cash flow ("DCF") analysis is typically used to determine the value of a company by calculating the present value of its future cash flows. The DCF analysis is premised on the assumption that the value of all of a corporation's assets is equal to the present value of the expected cash flow from those assets while they are held by the corporation.[98]

Courts in Delaware and elsewhere accept a DCF analysis.[99] Thus, "[t]he DCF approach 'involves projecting operating cash flows for a determined period, setting a terminal value at the end of the projected period, and then discounting those values at a set rate to determine the net present value of a company's shares.' "[100] There are three components to the DCF analysis: (i) cash flow projections, (ii) terminal value, and (iii) the discount rate.[101] The precise mathematics of the valuation is as follows:[102]

V = PV cash flows + PV terminal value

where:

Cash flows = Cash flow forecasted during the projection period

Terminal value = Value of the firm at the end of the forecast period

PV = Present value as of the valuation date using the debtor's weighted average cost of capital as the discount rate

V = Value of the enterprise on the date of valuation

The methodology under the DCF approach is as follows: First, future cash flows over a

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[97]*See* Brealey & Myers, *Principles of Corporate Finance* (7th ed. 2002).

[98]Brealey & Myers, *supra* note 97, at 52–54 ("the discounted-cash-flow (DCF) formula for the present value of a stock is just the same as it is for the present value of any other asset. We just discount the cash flows by the return in the capital market on securities of comparable risk."); *Neal v. Alabama By-Products Corp.*, No. 8282, 1990 WL 109243 at *7 (Del. Ch. Aug. 1, 1990), *aff'd*, 588 A.2d 255 (Del. 1991) (noting that DCF analysis is considered by valuation experts to be a "preeminent valuation methodology") (*citing* Pratt, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* (2d ed. 1989)).

[99]*See, e.g., In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485 (Del. Ch. 1991); *Cede & Co. v. Technicolor, Inc.*, C.A. No. 7129, 1990 WL 161084 (Del. Ch. Oct. 19, 1990); *Neal v. Alabama By-Products Corp.*, C.A. No. 8282, 1990 WL 109243 at *7 (Del. Ch. Aug. 1, 1990) (noting that experts consider the discounted cash flow method to be the preeminent method of valuation), *aff'd*, 588 A.2d 255 (Del. 1991); *Cavalier Oil Corp. v. Harnett*, C.A. Nos. 7959, 7960, 7967, & 7968, 1988 WL 15816 (Del. Ch. Feb. 22, 1988), *aff'd*, 564 A.2d 1137 (Del. 1989); *Associated Imports, Inc. v. ASG Indus., Inc.*, C.A. No. 5953, 1984 WL 19833 (Del. Ch. June 20, 1984), *aff'd sub nom. Hubbard v. Associated Imports, Inc.*, 497 A.2d 787 (Del. 1985). *Superior Investment & Development Corp. v. Devine*, 244 Ill. App. 3d 759, 768–769, 185 Ill. Dec. 168, 614 N.E.2d 302 (1993) (approving use of discounted cash flow analysis).

[100]*Dobler v. Montgomery Cellular Holding Co., Inc.*, CA No., 2004 WL 2271592 at *8 (Del. Ch. Sept. 30, 2004) (quoting *Travelocity.com*, 2004 WL 1152338, at *5), *rev'd on other grounds*, 880 A.2d 206 (Del. 2005); *Taylor v. American Specialty Retailing Group, Inc.*, 2003 WL 21753752 at *3 (Del. Ch. July 25, 2003).

[101]*Onti, Inc. v. Integra Bank*, 751 A.2d 904, 917 (Del. Ch. 1999); *Radiology Assocs.*, 611 A.2d 485, 489 (Del. Ch. 1991); *Cede & Co. v. Technicolor, Inc.*, Civ. A. No. 7129, 1990 WL 161084, at *7 (Del. Ch. Oct. 17, 1990).

[102]Peter v. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 Bus. Law. 419, 427 (1996).

specified period are estimated.[103] Second, a terminal value equal to the future value, as of the end of the specified period, of the company's cash flows beyond the projection period is derived.[104] Third, an appropriate discount rate, also called the weighted average cost of capital ("WACC"), is selected and then used to reduce the cash flow and terminal value components to present value.[105]

[a] *Cash Flow Projections*

For the purposes of a DCF analysis, "cash flow" means the difference between cash and noncash inflows and outflows from operating activities reduced by taxes actually paid, net working capital investments, and capital expenditures.[106] Although a five-year period is often used in this analysis,[107] the court will use the period that will provide the most accurate valuation.[108] Further, courts prefer to use cash flow data prepared by management, or with management's input.[109] Thus, Delaware courts have held that[110]

> Contemporary pre-merger management projections are particularly useful in the appraisal context because management projections, by definition, are not tainted by post-merger hindsight and are usually created by an impartial body. In stark contrast, *post hoc*, litigation-driven forecasts have an "untenably high" probability of containing "hindsight bias and other cognitive distortions."
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> When management projections are made in the ordinary course of business, they are generally deemed reliable. Experts who then vary from management forecasts should proffer legitimate reasons for such

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[103] *Travelocity.com*, 2004 WL 1152338, at *5; *Radiology Assocs.*, 611 A.2d at 490–495; *Cede*, 1990 WL 161084, at *7.

[104] *Travelocity.com*, 2004 WL 1152338, at *5; *Cede*, 1990 WL 161084, at *7.

[105] *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30.

[106] *In re Cellular Info. Sys., Inc.*, 171 B.R. 926, 931 n.13 (Bankr. S.D.N.Y. 1994) ("cash flow [for DCF analysis] is Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA"), less capital expenditures, net changes in working capital accounts, and cash taxes").

[107] *See Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963 at n*4 (Del. Ch. Feb. 10, 2004) ("the cash flow is projected for each year into the future for a period of years, typically five"); *Radiology Assocs.*, 611 A.2d at 491 (using five-year cash flow projection); *Cede*, 1990 WL 161084, at *26 (parties used five years of cash flow data).

[108] *Grimes v. Vitalink Communications Corp.*, CA No. 12334, 1997 WL 538676 at *1 n.4 (Del. Ch. Aug. 28, 1997)("[a] five-year period may not, however, always be appropriate. Any time period selected should provide a representative forecast or historical sample of data."), *aff'd* 708 A.2d 630 (Del.).

[109] *See In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485, 490–491 (Del. Ch. 1991) (noting importance of forecasts into which management had input); *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *12–15 (Del. Ch. May 3, 2004). *Cede & Co. v. JRC Acquisition Corp.*, C.A. No. 18648, 2004 WL 286963 at *2 (Del. Ch. Feb. 10, 2004) ("[T]his Court prefers valuations based on management projections available as of the date of the merger and holds a healthy skepticism for post-merger adjustments to management projections or the creation of new projections entirely.").

[110] *Prescott Group Small Cap, L.P. v. Coleman Co., Inc.*, CA No. 17802, 2004 WL 2059515 at *21 (Del. Ch. Sept. 8, 2004).

variance.

[b] *Terminal Value*

Terminal value is intended to represent the future value of the corporation at the end of a fixed projection period once the corporation's future cash flows have stabilized.[111] Although several methods can be used to develop a terminal value, the two most commonly employed are the "multiples methodology" and the "constant growth methodology."[112]

Under the multiples methodology, terminal value is determined as a multiple of a metrics of financial performance (sales, EBIT, and EBITDA are commonly used examples) that were determined for the final year of the cash flow projection.[113] The multiple is then obtained from companies deemed comparable to the company being valued.[114]

Under the constant growth methodology, cash flows in the final year of the projection are presumed to grow at a constant growth rate, and that infinite stream of cash flows is discounted to present value using the WACC.[115] Delaware courts have often favored this methodology.[116]

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[111] *See, e.g., Cavalier Oil Corp. v. Harnett*, C.A. No. 7959, 1988 WL 15816 (Del. Ch. Feb. 22, 1988), *aff'd*, 564 A.2d 1137 (Del. 1989). There are two main methods for calculating terminal value—the multiples methodology and the constant growth methodology. *See Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963 at *4 (Del. Ch. Feb. 10, 2004) ("The terminal value may be determined by using multiples from comparable transactions, referred to as an exit multiple, or may be ascertained by assuming a constant growth rate after the initial five year forecast period, i.e., the growth rate in perpetuity.").

[112] *Cede & Co., Inc. v. MedPointe Healthcare, Inc.*, 2004 WL 2093967 at *19 n.102 (Del. Ch. Aug. 16, 2004) ("while '[s]everal methods can be used to estimate the value of a company during the terminal year, including methods based on price/earnings and other value multiples … the one most often used by valuation consultants, is the capitalization of the terminal year operations [under the Constant Growth Methodology]' ") (quoting 1 Jay E. Fishman, Shannon P. Pratt, *et al., Guide to Business Valuations* 5-57 (12th ed. 2002).

[113] *Gray v. Cytokine Pharmasciences, Inc.* C.A. No. 17451, 2002 WL 853549 at *11 (Del. Ch. Apr.25, 2002) (using a revenue multiple to determine terminal value); *Grimes v. Vitalink Communications Corp.*, CA No. 12334, 1997 WL 538676 at *7 (Del. Ch. Aug. 28, 1997) (using several different multiples in determining terminal value), *aff'd*, 708 A.2d 630 (Del. 1998).

[114] *Gilbert v. MPM Enters., Inc.*, 709 A.2d 663, 669 (Del. Ch. 1997) (determining which comparable companies to use in determining terminal value through a multiples method), *aff'd* 731 A.2d 790 (Del. 1999); *Grimes v. Vitalink Communications Corp.*, CA No. 12334, 1997 WL 538676 at *7 (Del. Ch. Aug. 28, 1997) (same).

[115] *Cede & Co., Inc. v. MedPointe Healthcare, Inc.*, 2004 WL 2093967 at *19 (Del. Ch. Aug. 16, 2004) ("For terminal value, I have used the constant growth methodology as applied to project year eight cash flow of $49.9 million from the end of the pro forma period. When this value is extended into perpetuity using the previously determined long-term growth rate of 3.35% it leads to a value of $756.06 million"); *Lane v. Cancer Treatment Centers of Am., Inc.*, 2004 WL 1752847 at *31 ("To calculate the terminal value for CTCA after projected year 5, a terminal growth rate must be determined. I find Baehr's assumption that no growth would occur beyond the projected five-year period unreasonable; it must be assumed that CTCA would continue to grow at least at the rate of inflation. Thus, I will assume a 5% growth rate for perpetuity.")

[116] *Onti, Inc. v. Integra Bank*, 751 A.2d 904, 923 ("Constant Growth Valuation Model ("CGVM"), which is widely accepted as the best, even if imperfect, method to determine a terminal value for a discounted cash flow analysis.")

Determination of terminal value can be critical, because often 50% to 90% of the total value of a corporation is its terminal value. Significantly, when terminal value exceeds 75% of the total value of the company, Delaware courts have rejected the use of this methodology.[117] In *Gray v. Cytokine Pharmasciences*, the court determined that:

> [The respondent's] DCF is so heavily dependent on the determination of [the company's] terminal value that the entire exercise amounts to little more than a special case of the comparable companies approach to value and, thus, has little or no independent validity. This is easily seen from the fact that [the] discounted terminal value calculations equal or exceed 75% of the total discounted cash flow value of the enterprise in the lowest case and 85% or more in the other three cases presented.… In the circumstances presented, this is an added reason not to rely upon [the respondent's] DCF analysis in valuing [the respondent company].[118]

[c] *WACC*

The weighted average cost of capital ("WACC") is calculated as follows:

WACC = (Weight × Cost of equity) + (Weight × Cost of debt).[119]

It is common to use the capital asset pricing model ("CAPM") to determine the cost of equity.[120] Under CAPM, the goal is to determine cost of equity by determining the return on a riskless investment (risk-free rate) and then increasing the return to account for the overall risk experienced in stocks as a whole (market risk premium), modified by the risk profile of the company at issue (beta). Thus,

Cost of equity = Risk-free rate + (beta × risk premium).[121]

The cost of debt is the company at issue's actual cost of debt.[122] The "weight" is the portion of the company's capital structure that is debt and the portion that is equity.[123] Each of these inputs can be subject to dispute.

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[117] *Gray v. Cytokine Pharmasciences, Inc.* C.A. No. 17451, 2002 WL 853549 (Del. Ch. Apr. 25, 2002); *The Union Illinois 1995 Investment Limited Partnership, et al. v. Union Financial Group, Ltd.*, 847 A.2d 340 (Del. Ch. 2003) (noting unreliability of a DCF model in which 97% of the value was derived from the terminal value).

[118] *Id.*

[119] *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30.

[120] *Medpointe*, 2004 WL 2093967 at *11; *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30.

[121] *Medpointe*, 2004 WL 2093967 at *11 n.53 ("[u]nder CAPM, the goal is to determine the cost of equity by determining the return on a riskless investment (risk-free rate) and then increasing the return to account for the overall risk experienced in stocks as a whole (market risk premium), modified by Beta"); *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30 ("Under CAPM, cost of equity is calculated as follows:
Cost of Equity = Rf + B × (E(Rm) − Rf) + Ssp + A,
where Rf is the risk-free rate of return, B is the beta of the company and measures the risk and volatility of the company's securities relative to the overall market portfolio, E(Rm) is the expected rate of return on an investment in the market portfolio, Ssp is Small Stock Premium, which recognizes the difference between the returns of small companies and the market in general, and A is the specific risk premium, which is applied to account for additional risk not captured by the equity of small stock premiums.").

Risk-free rate. The risk-free rate is the return one would expect to receive on a completely riskless investment.[124] Usually some form of long-term (20- or 30-year) U.S. Treasury rate is used.[125]

Beta. " 'Beta' is the measure of a given company's nondiversifiable risk relative to the market, specifically, the tendency of the returns on a company's security to correlate with swings in the broad market. A beta of 1, for example, means that the security's price will rise and fall with the market; a beta greater than 1 signifies that the security's price will be more volatile than the market; and a beta less than 1 indicates that it will be less volatile than the market."[126] The beta can be calculated through company-specific data, where available, or through the use of market data.[127]

Risk premium. The market risk premium is the premium received by investors who invest in a market basket of equities, as opposed to investors who invest in a risk-free investment.[128] There is substantial recent disagreement among academics over the best means of calculating the risk premium.[129] The most recent academic research on valuation issues concludes that data from 1950 onward is the most relevant because of fundamental economic changes that have occurred since World War II.[130] The risk premium was traditionally determined using data prepared by Ibbotson Associates, which looks at data from 1928 to 2000.[131] Either approach could be found

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[122]*Medpointe*, 2004 WL 2093967 at *11 ("The cost of debt is Carter-Wallace's actual cost of debt"); *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30; *Hintmann v. Fred Weber, Inc.*, C.A. No. 12839, 1998 WL 83052 (Del. Ch. Feb. 17, 1998).

[123]*Medpointe*, 2004 WL 2093967 at *11 ("the weight is the portion of the company's capital structure that is debt and the portion that is equity"); *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30–31; *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *12–15 (Del. Ch. May 3, 2004) ("Under WACC, the discount rate is calculated based upon the subject company's cost of capital. WACC is the sum of: (1) the percentage of the company's capital structure that is financed with equity, multiplied by the company's cost of equity capital, plus (2) the percentage of the company's capital structure that is financed with debt, multiplied by its after-tax cost of debt"); *Radiology Assocs.*, 611 A.2d at 493 ("I will use Radiology's own debt to equity ratio in determining its WACC.").

[124]*Medpointe*, 2004 WL 2093967 at *11.

[125]*Medpointe*, 2004 WL 2093967 at *11 (using 20-year Treasury rate); *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30–31 (same); *Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963 at *4 (Del. Ch. Feb. 10, 2004) (same).

[126]*Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *16 (Del. Ch. May 3, 2004). *See also Medpointe*, 2004 WL 2093967 at *11 n.53 (defining beta as "the measure of total return volatility of common stocks of public companies."); *Lane v. Cancer Treatment Centers*, 2004 WL 1752847 at *30 ("the beta of the company and measures the risk and volatility of the company's securities relative to the overall market portfolio."

[127]*See, e.g., Gilbert v. MPM Enter.*, 1998 WL 229439 at *2 ("Because privately held companies such as MPM have no observable betas, the parties used the median beta of comparable companies as the beta for MPM.")

[128]*Medpointe*, 2004 WL 2093967 at *11 ("The market risk premium is the premium received by investors who invest in a market basket of equities, as opposed to investors who invest in risk-free investments.").

[129]*See id.* at *18.

[130]*See* Eugene F. Fama & Kenneth R. French, *The Equity Premium*, J. Fin., Vol. LVII, No. 2, April 2002. This study was adopted by the court in *Medpointe*, 2004 WL 2093967 at *18.

[131]*Medpointe*, 2004 WL 2093967 at *15.

acceptable, although most courts are much more familiar with the Ibbotson data.[132]

[2] Comparable Companies: Multiples Valuation

"The comparable company approach entails the review of publicly traded competitors in the same industry, then the generation of relevant multiples from public pricing data of the comparable companies and finally the application of those multiples to the subject company to arrive at a value."[133] The methodology involves:

> (1) identifying comparable publicly traded companies; (2) deriving appropriate valuation multiples from the comparable companies; (3) adjusting those multiples to account for the differences from the company being valued and the comparables; and (4) applying those multiples to the revenues, earnings, or other values for the company being valued.[134]

This model has been described as "valuation by analogy,"[135] but is well accepted by courts.[136] The key to the valuation is the selection of the companies deemed to be comparable, for the analysis is only as good as the comparable nature of the companies selected.[137]

[3] Comparable Transactions

A comparable transactions approach is similar to a comparable companies analysis, except that, rather than using multiples derived from on-going businesses, "[t]he comparable transactions approach involves finding similar transactions, quantifying those transactions through financial metrics, and applying those metrics to the company at issue in order to arrive at a value.[138] It has

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[132]*Medpointe*, 2004 WL 2093967 at *18 (using Fama & French, although noting that the Ibbotson Associates data was "older and more widely accepted"); *Radiology Assoc.*, 611 A.2d at 1269 (using Ibbotson data).

[133]*Travelocity.com, Inc.*, 2004 WL 1152338, at *8.

[134]*Agranoff v. Miller*, 791 A.2d 880, 892 (Del. Ch. 2001).

[135]Jay W. Eisenhofer & John L. Reed, *Valuation Litigation*, 22 Del. J. Corp. L. 37, 118 (1997).

[136]*Agranoff v. Miller*, 791 A.2d 880, 892; *Borruso v. Communications Telesystems Int'l*, 753 A.2d 451 (Del. Ch. 1999) (valuing company in appraisal action using comparable companies analysis); *Bomarko, Inc. v. International Telecharge, Inc.*, 794 A.2d 1161, 1189 n.14 (Del. Ch. Nov. 4, 1999 *revised* Nov. 16, 1999) (same), *aff'd*, 766 A.2d 437 (Del. 2000); *Radiology Assoc.*, 611 A.2d at 489 ("[t]his Court has affirmed the general validity of this [comparable companies] approach[]")

[137]*Onti v. Integra Bank*, 751 A.2d 904, 915 ('The comparative analysis approach, also called a comparable companies approach, seeks to value a company based on first finding companies that are similar to the company under appraisal and then "calculat[ing] the value of the company through the use of earnings and other multiples.' "); *Prescott Group Small Cap L.P*, 2004 WL 2059515 at *22 ("A comparable company analysis is only as valid as the "comparable" firms upon which the analysis is based, are truly comparable.")

[138]*Dobler v. Montgomery Cellular Holding Co., Inc.*, 2004 WL 2271592 at *8 (Del. Ch. Sept. 30, 2004) (relying primarily on a comparable transactions approach), *rev'd on other grounds*, 880 A.2d 206 (Del. 2005); *Gentile v. Singlepoint Fin.*, 2003 WL 1240504 (Del. Ch. Mar. 5, 2003) (adopting the comparable transactions approach).

been used in Delaware valuation litigation.[139]

[D] Discounts, Premiums, and Elements of Value to Be Considered

In an appraisal action applying fair value, Delaware courts have universally held that it is impermissible to consider "discounts" or "premia" at the "stockholder level."[140] The basis for this rule has been explained as follows:

> the purpose of a Delaware appraisal is to determine the fair value of 100% of the corporation, and to award to the dissenting stockholder his proportionate share of that fair value. The objective is not to value a specific minority stock interest in the corporation as such. That a stockholder might happen to own a significant block of stock will not, for that reason, entitle him to a premium above the appraised fair value of his shares. Similarly, that a dissenting stockholder may own a minority interest (which is the case in all appraisal proceedings) will not diminish his right to receive fair value by subjecting him to a penalty in the form of a "minority discount."[141]

This rule is not necessarily applicable outside Delaware.[142] The MBCA, however, following Delaware's lead, makes clear that fair value means the value of the corporation's shares "without discounting for lack of marketability or minority status."[143]

The rule against using discounts and premia in appraisal proceedings generally benefits shareholders, because it is often defendants that, in the past, have sought to reduce the value of petitioners' shares through the use of specific discounts. Two specific discounts are often at issue: minority discounts and lack of marketability or liquidity discounts.

The minority discount seeks to address the fact that, where the shares at issue constitute a minority block, the company is subject to the control of others—rendering the minority block less valuable than a controlling position. Such a minority discount is impermissible in the fair value

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[139] *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 556 (Del. 2000) ("[the] corporate level comparative acquisition approach to valuing a company, which include[s] a control premium for a majority interest in a subsidiary, [is] a relevant and reliable methodology to use in an appraisal proceeding to determine the fair market value of shares in a holding company.") (citing *M.G. Bancorporation*, 737 A.2d 513, 525).

[140] *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 557 ("after the entire corporation has been valued as a going concern by applying an appraisal methodology that passes judicial muster, there can be no discounting at the shareholder level").

[141] *Cavalier Oil Corp. v. Harnett*, CA No. 7959, 1988 WL 15816 (Del. Ch. Feb. 22, 1988), *aff'd*, 564 A.2d 1137 (Del. 1989).

[142] *Stanton v. Republic Bank of South Chicago*, 144 Ill. 2d 472, 480, 163 Ill. Dec. 524, 581 N.E.2d 678 (1991) (affirmed the trial court's assessment of minority and illiquidity discounts of 5% each, but in reviewing a dispute over the percentage used, noted that the application of a discount was a matter for the discretion of the trial court, and that the court "was not even required to apply any discounts.").

[143] MBCA §13.01(4)(iii).

context.[144]

The marketability/liquidity discount seeks to address those situations in which the shares of stock in a company are difficult or impossible to sell on the open market. Again, such discounts are not permissible in the fair value context.[145]

Be aware, however, that in an arm's-length merger, an entity purchasing a corporation may well pay what is known as a control premium—an increment over the market value of a company designed to recognize the fact that "[t]he acquisition of majority status and the consequent privilege of exerting powers of majority ownership come at a price. That price is usually a control premium which recognizes not only the value of a control block of shares, but also compensates the minority stockholders for their resulting loss of voting power."[146] Although the purchaser pays such a premium, the concept of fair value does not permit the recognition of any such premium.[147] Thus, the appraised fair value may be less than the merger price because the merger price can include a control premium.[148]

There are two significant exceptions to the rule prohibiting the use of premia/discounts in the appraisal context. First, courts have recognized that, when using the comparable companies approach to valuation, there is a discount inherent in the valuation because it determines various metrics in comparison to the stock price, which has an inherent minority discount. Delaware courts have held that this discount must be reversed in determining fair value:

> The comparable companies analysis generates an equity value that includes an inherent minority trading discount, because the method depends on comparisons to market multiples derived from trading information for minority blocks of the comparable companies. In a §262 appraisal, the court must correct this minority trading discount by adding back a premium designed to correct it.[149]

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[144]*Cavalier Oil Corp. v. Hartnett*, 564 A.2d 1137, 1145; *Tansey v. Trade Show News Networks, Inc.*, CA No. 18796, 2001 WL 1526306 at *8 (Del. Ch. Nov. 27, 2001); *Agranoff*, 791 A.2d 880, 888–889.

[145]*Cavalier Oil Corp. v. Hartnett*, 564 A.2d 1137, 1144; *Paskill*, 747 A.2d 549, 557; *Borrusso v. Communications Telesystems Int'l*, 753 A.2d 451, 459–460 (Del. Ch. 1999); *Chang's Holdings, S.A. v. Universal Chemicals & Coatings*, CA No. 10856, 1994 WL 681091 at *2 (Del. Ch. Nov. 22, 1994).

[146]*Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del.1994).

[147]*See, e.g., Onti, Inc. v. Integra Bank*, 751 A.2d 904, 913 (Del. Ch. 1999). ("[i]n prior appraisal actions, this Court has rejected the use of a control premium derived from merger and acquisition data because the control premium incorporates post-merger value.").

[148]*Cooper v. Pabst Brewing Co.*, CA No. 7244, 1993 WL 208763 at *8 (Del. Ch. June 8, 1993) (court awarded a fair value of less than the merger price, holding that "the market price following the announcement of a tender offer is often an unreliable guide to the true market value because it may reflect a control premium and other factors connected with the acquiror's intentions but unrelated to the value of the firm as a going concern.").

[149]*Agranoff v. Miller*, 791 A.2d 880, 892–893 (Del. Ch. 2001) (footnote omitted). *See also Lane v. Cancer Treatment Centers of Am., Inc*, 1994 WL 263558 at *4 ("Comparable company analysis … suffers from an inherent minority discount. To determine "the intrinsic worth of a corporation on a going concern basis," a premium must be added to adjust for the minority discount.… [T]his Court has tended to apply a premium on the order of 30%.… "adjusting a market-based valuation for an inherent minority discount"), *Doft & Co. v. Travelocity.com, Inc.*, 2004 WL 1152338, at *11 (Del. Ch. May 20, 2004) ("Delaware law recognizes that there is an inherent minority trading discount in a comparable company analysis because 'the [valuation]

Second, Delaware Courts have determined that if it is necessary to value a subsidiary of a corporation in an appraisal proceeding, it is proper to apply the control premium or applicable discounts to the value of the subsidiary in determining the overall value of the corporation.[150] In *Rapid American Corp.*, the Delaware Supreme Court found that the use of a control premium in valuing a subsidiary of a company subject to appraisal was required:

> Rapid was a parent company with a 100% ownership interest in three valuable subsidiaries. The trial court's decision to exclude the control premium at the corporate level practically discounted Rapid's entire inherent value. The exclusion of a "control premium" artificially and unrealistically treated Rapid as a minority shareholder. Contrary to Rapid's arguments, Delaware law compels the inclusion of a control premium under the unique facts of this case. Rapid's 100% ownership interest in its subsidiaries was clearly a "relevant" valuation factor and the trial court's rejection of the "control premium" implicitly placed a disproportionate emphasis on pure market value.[151]

Finally, there is an implied discount for "small companies" that is often built into the mechanics of the discounted cash flow model. A number of decisions in Delaware have required an increase in the discount rate used in the DCF for smaller companies based on the concern that "stocks of smaller companies are riskier than securities of large ones and, therefore, command a higher expected rate of return in the market."[152] This small company adjustment increases the discount rate and, as a result, decreases the appraised value of the company.

[E] Interest

In Delaware, Section 262(i) provides that after appraising the shares,

> The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto.[153]

Under Delaware law, an award of interest in an appraisal action serves two purposes:

> First, it is intended to compensate a petitioner for the loss of use of fair value of her shares during the pendency of an appraisal process, and second, to cause the surviving corporation to give up the benefit it obtained from the use of the fair value of petitioner's shares during that same period.[154]

Thus, an award of interest is intended "to put both parties in the position most closely approximating their respective positions had the fair value of the dissenting shareholder's stock

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method depends on comparisons to market multiples derived from trading information for minority blocks of the comparable companies.' ") (quoting *Agranoff*, 791 A.2d 880, 892).

[150] *Rapid American Corp. v. Harris*, 603 A.2d 796, 806–807 (Del. Supr. 1992).

[151] 603 A.2d 796, 806–807 (footnote omitted).

[152] *Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *19. *See also ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 920 (Del. Ch. 1999); *Cede & Co. v. JRC Acquisition*, C.A. No. 18648, 2004 WL 286963, at *8 (Del. Ch. Feb. 10, 2004).

[153] 8 Del. C. §262(i).

[154] *Gonsalves v. Straight Arrow Publishers, Inc.*, No. 8474, 2002 WL 31057465, *9, (Del. Ch. Sept. 10, 2002).

been paid on the date of the merger. Both the rate and form of interest awarded interact to achieve this goal."[155] In *Gonsalves*, the court determined that awarding interest by weighing equally the respondent's actual costs of borrowing and, based on an objective prudent investor standard, the petitioner's opportunity cost would achieve the goal of the statute.[156]

Delaware allows both pre- and post-judgment interest.[157]

In states using the MBCA, because shareholders have been paid the corporation's view of the "fair value" of their shares prior to the inception of litigation, interest accrues only as to the difference between the corporation's view of fair value and the amount ultimately issued by the court.

§11.05 VALUATION TRIAL

Trials in Delaware are relatively common, with dozens of reported opinions within the last 10 to 15 years. Trials appear to be less common in other jurisdictions, possibly because the complexity of the issues results in settlements by attorneys and courts who are less familiar with the issues.

[A] Expert Testimony

A key component of any trial is testimony, often highly conflicting, by the respective parties' experts.[159] Virtually every reported case involves expert testimony. On the basis of the statement that "[p]roof of value can be established by any techniques or methods that are generally acceptable in the financial community and otherwise admissible in court, subject only to [the Court's] interpretation of 8 Del. C. §262(h)," expert testimony clearly is permissible.[160]

In Delaware, the admission of expert witness testimony is provided for in Delaware Rule of Evidence 702. Under that rule, "[i]f scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of an opinion or otherwise."[161] Further, at its discretion, the court can also employ its own expert.[162]

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[155] *Gonsalves v. Straight Arrow Publishers, Inc.*, No. 8474, 2002 WL 31057465, *9, (Del. Ch. Sept. 10, 2002).

[156] *Gonsalves v. Straight Arrow Publishers, Inc.*, No. 8474, 2002 WL 31057465, *9, (Del. Ch. Sept. 10, 2002).

[157] *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 300 (Del. Supr. 1996) ("An award of compound post-judgment interest is the exception rather than the rule. Nevertheless, the Court of Chancery may, in the exercise of its discretion, award compound post-judgment interest in an appraisal proceeding.").

[158] [*Reserved*.]

[159] *Matter of Shell Oil Co.*, 607 A.2d 1213, 1222 (Del. 1992) ("[a]lthough our affirmance of the Court of Chancery's appraisal determination resolves the merits of this appeal, we take the occasion to comment upon a recurring theme in recent appraisal cases—the clash of contrary, and often antagonistic, expert opinions on value. The presentation of widely divergent views reflecting partisan positions in appraisal proceedings adds to the burden of the Court of Chancery's task of fixing value.").

[160] *M.G. Bancorp., Inc. v. Le Beau*, 737 A.2d 513, 521–523 (Del. 1999).

[161] D.R.E. 702. Delaware Rule of Evidence 702 is identical to Federal Rule of Evidence 702.

[162] *Matter of Shell Oil Co.*, 607 A.2d 1213, 1222 ("the Court of Chancery should consider, in a proper case, appointing its own expert witness. Apparently, no Delaware Court has ever

The procedures the court should follow were set forth in *Shell Oil*:[163]

> The selection of the expert is solely within the discretion of the trial judge. The trial judge may appoint an expert of his own choosing or seek a list of nominations from the parties. Once an expert has been retained by the Court of Chancery, the court should communicate with the expert in writing, filing a copy of the correspondence with the clerk or at a conference in which the parties have an opportunity to participate. Appellate review of the trial court's appointment of an expert or lack thereof proceeds under an abuse of discretion standard. The court appointed expert is subject to the same standards which govern other expert witnesses under the Delaware Rules of Evidence. The expert must advise the parties of all findings and submit to depositions. Once trial commences, it is incumbent upon the trial judge to arrange for the court's expert witness to testify if neither party calls him as a witness. The court's expert must be subject to cross-examination by both parties, even if one party chose to call him as its witness. Finally, the court's expert should be reasonably compensated by the parties in such proportion and at such intervals as the trial court determines.

Significantly, however, any expert appointed by the court must act solely as a provider of opinion and must not become the appraiser—a task left solely to the court.[164]

[1] Shareholders' Expert

The shareholders' expert should have a full understanding of the applicable case law prior to beginning his or her expert report. The expert should be fully aware of the definitions of value and should discuss with counsel all valuation options used to ensure that those options are consistent with case law. Further, the expert should be forced to justify to counsel every single assumption and analytical technique used. If he can't justify the technique in a convincing way to his own counsel, a court will never be convinced. Moreover, it is very important to ensure that the expert has not taken a contrary position in a prior report, testimony, or article. The work must be double-checked to ensure there are no errors, even of the simple mathematical variety. An expert who makes mistakes may well have his opinions discounted by the court.

[2] Company's Expert

Attacking the company's expert requires exactly the same analysis that counsel should have conducted of his own expert. Each assumption and methodology must be questioned and

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appointed a neutral expert witness upon its own initiative. However, federal courts have not hesitated to make such appointments …").

[163] 607 A.2d 1213, 1223 (citations and footnote omitted).

[164] *Cede & Co. v. Technicolor, Inc.*, 758 A.2d 485, 496–497 (Del. 2000) ("the role of the Court of Chancery has evolved over time to the present requirement that it independently determine the value of the shares that are the subject of the appraisal action. It is beyond peradventure that the unambiguous mandate of the language in the appraisal statute now requires such proceedings to be conducted by the Court of Chancery's jurists ab initio, i.e., exclusively by the Chancellor and Vice-Chancellors. Accordingly, we hold that the reference of an entire appraisal proceeding and the use of masters to determine the ultimate valuation are not permitted by the present statutory appraisal scheme.") (footnotes omitted).

attacked. Further, the entire discovery process should be undertaken with the idea of attacking key points that counsel believes are likely to be made by the company and its expert.

[B] Problem with Appraisal Proceedings: Expense over Time

[1] Delaware

The single most serious problem with the Delaware appraisal statute is that the shareholder has all the money represented by the shares tied up during the pendency of the proceeding. The proceeding usually takes at least 2 or 3 years, and sometimes can take much longer (*Cede v. Technicolor* took almost two decades of litigation to resolve), and the shareholder loses any ability to make use of his or her funds during that time. Moreover, the shareholder bears the risk of business failure so that if the business should become insolvent during the course of litigation, the shareholder could receive nothing for its appraised shares. Even though interest payments can to some extent compensate for the lost opportunity costs, in an era such as the 1990s when the stock market increased dramatically, interest payments are unlikely to compensate a shareholder for the lost use of funds. In addition, the expense of an appraisal action can be so significant over many years of litigation, it is effectively unavailable for most shareholders unless they have a significant interest in the company. Further, because of the strict requirements for bringing an appraisal action, a class action appraisal proceeding is impossible.[165]

[2] MBCA

Many of the most severe problems that exist in Delaware are obviated by the procedures of the MBCA. Under the MBCA, shareholders receive the "fair value" of their shares as determined by the company in prior to any litigation. Because, however, that assessment of fair value by the company must be made in a notice prior to the approval of the transaction by shareholders, the company has an incentive to ensure that its determination of fair value is very close to the deal price. Thus, in most cases, shareholders will receive the deal price before they begin litigation. This eliminates the credit risk and lost opportunity cost problems created in Delaware.

The MBCA, however, has its own problems in that it does not provide appraisal rights to publicly traded or widely held stocks. Thus, in any case in which shareholders of such a company are cashed-out (except in an insider deal), the shareholders have no remedy, even if the deal price is inadequate. On the other hand, because there is an expectation that management will obtain top dollar in an arm's-length deal, and deals with interested persons will be subject to the appraisal remedy, this issue may not be significant in practice. Overall, from a procedural perspective, the MBCA is much superior to the Delaware appraisal statute.

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[165] A "quasi" exception to this rule is the remedy set forth by the Delaware Supreme Court for minority shareholders who were not provided with material facts in the notice of a short form merger. In *Berger v. Pubco Corp.*, 2009 WL 1976529 (Del. July 9, 2009), the Court held that the minority shareholders had the right to participate in a "quasi –appraisal' class action, for which they were not required to opt-in or to escrow a portion of the merger proceeds, to recover the difference between fair value and the merger price. *Id.* at *11.

§11.06 RESULTS IN DELAWARE APPRAISAL ACTIONS

The published appraisal decisions over the past 20 years show awards in particular cases of over 400% above the deal price and median premiums of over 80%, as well as average interest awards in excess of 9%. Between 2000 and 2007, as set forth in Table 11-1, many premiums have been in the 200% to 300% range, not including interest (although in a few cases the appraisal award was less than the deal price).

TABLE 11-1

Case Name	*Date of Decision*	*Defendants' Offer*	*Court's Determination of Fair Value Share*	*Premium*	*Annual Percentage Rate* (APR)
Global GT, L.P. v. Golden Telecom, Inc., Civ. A. No. 3698-VCS	04/23/10	$105.00	$125.49	19.51%	Legal rate, compounded quarterly
In re Sunbelt Beverage Corp. S'holder Litig., Civ. A. No. 16089-CC	02/15/10	$45.83	$114.04	148.83%	Legal rate, compounded quarterly
In re Appraisal of Metromedia Int'l Group, Inc., Civ. A. No. 3351-CC	04/16/09	$18.07	$38.92	115.38%	Legal rate, compounded quarterly
Crescent/Mach I Partnership, L.P. v. Turner, Civ. A. 17711-VCN	05/02/07	$25.00	$32.31	29.24%	Pre-judgment: 4.8% Post-judgment: Legal rate
In re PNB Holding Co. Shareholders Litigation, No. Civ. A. 28-N	08/18/06	$41.00	$52.34	27.66%	Legal rate, compounded quarterly

Gesoff v. IIC Industries, Inc., C.A. Nos. 19473, 19600	05/18/06	$10.50	$14.30	36.19%	Legal rate, compounded quarterly
Delaware Open MRI Radiology Associates, P.A. v. Kessler, C.A. No. 275-N	04/26/06	$16,228.55	$33,232.26	104.78%	6.9%, compounded monthly
Montgomery Cellular Holding Co., Inc. v. Dobler, No. 496,2004	08/01/05	$8,102.23	$19,621.74		8.25%, compounded quarterly
Gholl v. eMachines, Inc. No. Civ. A. 19444-NC	11/24/04	$1.06/share	$1.64	54.72%	6.21%, compounded monthly
Dobler v. Montgomery Cellular Holding Co. No. Civ. A. 19211	09/30/04	$8,102.23/share	$19,621.74	142.18%	Legal rate; compounded quarterly
Cede & Co. v. Medpointe Healthcare, Inc. No. Civ. A. 19354-NC	09/10/04	$20.44/share	$24.45	19.62%	7.50%, compounded quarterly
Lane v. Cancer Treatment Centers of America, Inc. No. Civ. A. 12207-NC	07/30/04	$260/share	$1,345.00	417.31%	9.14%, compounded monthly
Cede & Co. v. Technicolor No. Civ. A. 7129	07/09/04	$23/share	$21.98		10.32% from 01/24/83 to 08/02/91; 7% from 8/3/91 until date of paid judgment
In re Emerging Communications, Inc. Shareholders Litig. No. Civ. A. 16415	06/04/04	$10.25/share	$38.05	271.22%	6.27%, compounded monthly
Doft & Co. v. Travelocity.com No. Civ. A. 19734	04/01/04	$28/share	$32.76	17.00%	5% over the Federal Reserve discount rate, compounded quarterly
Cede & Co. v. JERC Acquisition Corp. No. Civ. 18648	02/10/04	$13.00/share	$13.58	4.46%	4.73%, compounded monthly

Union Illinois 1995 Investment Limited Partnership v. Union Financial Group, Ltd. C.A. No. 19586	01/05/04	$9.40 per share with possibility of add'l .80/share	$8.74		Legal rate; compounded monthly
Prescott Group Small Cap v. The Coleman Co. No. Civ. A. 17802	09/08/04	$5.83/share on date of merger	$32.35	454.89%	Legal rate; compounded monthly
Taylor v. American Specialty Retailing Group No. Civ. A. 19239	05/16/03	$2,200/share	$9,079.43	312.70%	Legal rate; compounded quarterly
Gentile v. Singlepoint Financial No. Civ. A. 186677-NC	03/05/03	$2.46	$5.51	123.98%	11%, compounded quarterly
Gray v. Cytokine Pharmasciences No. Civ. A. 17451	04/25/02		$1,114.00		8.31%, compounded monthly
Gonsalves v. Straight Arrow Publishers	03/13/02	$100	$262.96	162.96%	SAP's cost of borrowing based on the prime rate of interest less 0.25% and Gonsalves' opportunity cost based on Whitman's prudent investor rate
Agranoff v. Citicorp Venture Cap., Ltd. Civ. A. No. 16795	11/08/01		$51.13		
Paskill Corp. v. Alcoma Corp. No. 321, 1999	01/01/00	$9,480.50/share	$10,049		Unknown

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

MARY SIEGEL*

I

INTRODUCTION

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

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

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

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

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

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

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

Parts II–V of this article will address each of these four fundamental differences between the two appraisal statutes. After delineating the statutory differences, each part will explain the practical effects that flow from the competing statutory mandates and the resulting policy issues that motivated the choices that are ultimately reflected in these statutes. Finally, each part will show how state legislatures, faced with these two opposing models, have reacted to these four provisions. This article demonstrates that the vast majority of jurisdictions[6] have chosen to reject Delaware's approach and, instead, follow the MBCA on the first three issues. On the fourth issue, however, the majority of jurisdictions that have adopted a market-out exception in their appraisal statutes have followed the Delaware model. One wildcard in this last result is that, unlike the other three provisions, which have a long history in the MBCA, limiting the market-out exception to non-conflict transactions is fairly new: in 1999, the Committee on Corporate Laws (Committee), which writes the MBCA, adopted the country's first conflict exception to the market-out. As a result, lawmakers have had substantially less experience with this conflict exception and less time to evaluate its merits compared to the other three issues.

II

APPRAISAL-TRIGGERING TRANSACTIONS

A. The Statutory Language

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

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

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

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

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

B. Practical Effects and Policy Issues

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

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

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

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

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

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

C. Reaction from the State Legislatures

All jurisdictions offer appraisal rights for mergers, as does the MBCA.[14] Moreover, thirty-five jurisdictions allow for private ordering that authorizes corporations to add other appraisal triggers,[15] as do both Delaware and the MBCA. Only two jurisdictions, however, follow the Delaware statute in providing mergers as the sole statutorily-required appraisal trigger.[16] The vast majority of jurisdictions have overwhelmingly supported offering appraisal rights for a variety of additional triggers, as does the MBCA. Specifically, all forty-four jurisdictions that authorize a compulsory share exchange[17] recognize appraisal rights for this transaction.[18] Moreover, forty-seven jurisdictions offer appraisal rights for significant dispositions of assets,[19] thirty-nine jurisdictions grant appraisal rights for certain amendments to the articles of incorporation,[20]

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

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

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

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

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

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

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

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

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

III
PAYMENT OF THE STOCK'S UNDISPUTED FAIR VALUE

A. The Statutory Language

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

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

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

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

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

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

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

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

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

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

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

B. Practical Effects and Policy Issues

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

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

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

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

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

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

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

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

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

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

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

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

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

C. Reaction from the State Legislatures

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

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

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

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

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

IV

ALLOCATION OF COURT COSTS AND EXPENSES OF THE APPRAISAL PROCEEDING

A. The Statutory Language

As was the case with the prepayment of the fair value of stock, the 1999 revision of chapter 13 fine-tuned the language of the 1978 and 1984 versions of chapter 13 relating to allocation of costs and expenses, but it continued to support the substantive decisions that the prior versions had embodied in the statute.[37] Currently, MBCA section 13.31(a) requires the court to determine the court costs of the proceeding, including the compensation and expenses of court-appointed appraisers. Section 13.31(a) then requires the court to assess these costs "against the corporation."[38] Although the statute permits the court to make an exception to such assessment when all or some of the shareholders demanding appraisal "acted arbitrarily, vexatiously, or not in good faith,"[39] the statutory presumption is that the corporation must absorb the court costs of the appraisal proceeding. Whereas section 13.31(a) creates a statutory presumption that the corporation will pay the court costs, section 13.31(b), in contrast, does not create any presumption regarding the parties' expenses.[40] Therefore, the parties are presumed to bear their own expenses unless their conduct trips section 13.31(b), which allows the court to assess the expenses of the respective parties[41] upon the occurrence of certain triggering events. The statute

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

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

39. *Id.*

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

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

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

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

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

43. *Id.* § 13.31(b)(2).

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

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

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

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

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

B. Practical Effects and Policy Issues

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

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

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

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

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

52. *See infra* note 55.

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

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

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

53. *See supra* note 50.

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

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

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

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

C. Reaction from the State Legislatures

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

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

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

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

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

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

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

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

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

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

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

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

V
THE MARKET-OUT EXCEPTION

A. The Statutory Language

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

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

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

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

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

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

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

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

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

B. Practical Effects and Policy Issues

Prior to the MBCA revisions in 1999, no jurisdiction had adopted a market-out exception that was limited to non-conflict transactions.[74] Additionally, as of 1999, state appraisal statutes were fairly evenly divided between those that contained a market-out exception[75] and those that did not:[76] twenty-six states had a market-out exception, whereas twenty-four states, the District of Columbia, and the MBCA did not. Because the premise of appraisal rights is to afford shareholders whose corporations engage in certain transactions the fair value of their stock in cash, supporters of the market-out exception argued that a sufficiently liquid market offers shareholders the fair value of their stock in cash without either the shareholder or the corporation incurring the large costs attendant to an appraisal process.[77] Opponents of the market-out exception,

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

C. Reaction from the State Legislatures

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

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

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

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

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

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

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

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

eleven jurisdictions that limit their market-out exceptions to non-conflict transactions consist of four of the twenty-six jurisdictions that had a market-out in 1999 and later amended their statutes to include a conflict exception,[93] and seven jurisdictions from the ten that added a market-out exception since 1999.[94] Thus, because a significant number of jurisdictions (seventy percent) that added a market-out exception since 1999 embraced the further exception for conflict-of-interest transactions, there was a greater inclination toward the conflict exception among those legislatures that added a market-out rather than among those who already had a market-out. Such a result is not surprising; those legislatures that already had adopted a market-out exception before 1999 had obviously achieved some level of comfort with this exception, and were therefore less receptive to the Committee's argument that an unqualified market-out is flawed.

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

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

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

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

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

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

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

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

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

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98. These jurisdictions are: Tennessee and Louisiana.

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

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

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

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

VI

CONCLUSION

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

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

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Unlocking Intrinsic Value Through Appraisal Rights

Law360, New York (September 10, 2013, 3:48 PM ET) -- A review of all Delaware appraisal cases in the last 20 years shows that the court has consistently established a "fair value" greater than the amount a buyer offered to pay for a stand-alone business. The only cases in which appraised value was less than the merger price — fewer than 20 percent of the decisions — were those in which the buyer was paying for something more than the value of the stand-alone business, such as synergies of a combination with the buyer's existing operations or a resolution of disputes.

These results reflect the Delaware law's definition of "fair value" as the long-term intrinsic value of a company, considered as a stand-alone "going concern," and the state's Supreme Court has recently made it clear in Golden Telecom Inc. v. Global GT LP, 11 A.3d 214, 217-28 (Del. 2010) that the court must make its appraisal independently of current market pricing or auction bids. In this context, it is reasonable to assume that a stand-alone buyer would not have offered to pay more for a company than what it was worth, and that a judge will reach the same conclusion. This logic is especially compelling when the buyer is a well-informed management insider partnering with professional private equity investors.

Management Buyouts are Likely Priced Below Intrinsic Value

In a management buyout, one or more individuals responsible for a company's management purchase the stand-alone going concern with funding from professional equity and debt investors. With full access to the company's inside information, the manager and partnering investors price the offer to profit from the difference between market pricing and the intrinsic value of the company.

Viewing a management buyout as a pure "stand-alone buyout" — which, for purposes of this article means a buyout in which the purchaser pays only for the value of the company as a going concern (and not for any additional value resulting from the transaction such as synergies of combination with another company, or for the "resolution of disputes") — it is highly unlikely that management (together with the professional investor) could present a credible argument to the court that they knowingly overpaid for a company. Indeed, court opinions from the Delaware Courts show that there has not been a single case during the past 20 years in which a stand-alone buyout's "fair value" was appraised at less than the offer price.

The Only Appraisal Cases Over the Last 20 Years That Have Been Appraised at Less than Merger Price are Not Stand-Alone Buyouts

Over the last 20 years, 45 appraisal actions have gone to trial and resulted in a post-trial opinion (some appraisal actions, including Cede v. Technicolor have resulted in more than one post-trial opinion). Of those 45 cases, only eight (17.8 percent) resulted in an appraisal of fair value by the court that was less than the merger price.

Significantly, none of those eight cases was a stand-alone buyout. Rather, six of them — Gerreald v. JustCare; Highfields Capital v. AXA Financial; Union Illinois 1995 Inv. Ltd. Partnership v. Union Financial Group; In re Grimes v. Vitalink Communications Corporation; Kleinwort Benson v. Silgan Corporation; and Cooper v. Pabst Brewing Company — involved a competitively bid acquisition as part of a strategic business combination. The other two — Andaloro v. PFPC Worldwide Inc. and Finkelstein v.Liberty Digital Inc. — involved the resolution of disputes with affiliates.

It appears that the acquiring company in each of those eight cases paid for value beyond that of the stand-alone going concern, whereas it is well established that the court's analysis must be based exclusively on the company's value as a stand-alone going concern. Because the buyer's valuation in those cases was based on benefits beyond the stand-alone enterprise value, the price they were willing to offer was more than the fair value of the company.

Foundations of Delaware Appraisal of Fair Value

Under Delaware law, stockholders who properly perfect their appraisal rights are entitled to have the Court of Chancery determine the "fair value" of their shares of stock as of the merger date. The basic concept of fair value is simple, as stated in a frequently cited Delaware Supreme Court case from 1950: stockholders are entitled to be paid for their "proportionate interest in a going concern," which means they are entitled to be paid "the true or intrinsic value of [their] stock which has been taken by the merger." Tri-Cont'l Corp. v. Battye, 74A.2d 71, 72 (Del. 1950).

In determining the price that represents fair or intrinsic value, the Court of Chancery is required to perform an independent evaluation. In doing so, the court must take into consideration all relevant factors that "reasonably might enter into the fixing of value," including (i) market value, (ii) asset value, (iii) dividends, (iv) earning prospects, (v) the nature of the enterprise subject to the appraisal proceeding, and (vi) any other facts (such as the value of intellectual property, including patents, trademarks, trade secrets and other proprietary data) that were known or could have been known as of the date of the merger and which shed light on future prospects of the merged corporation.

Factors Not Relevant to the Court's Determination of "Fair Value"

While the court must consider all relevant factors to determine fair value, those factors do not include merger price, or whether the merger price resulted from a fair process. The merger price is not the same thing as a company's "fair value" as a going concern. As noted above, the Delaware Supreme Court made this point unambiguously clear in its 2010 Golden Telecom decision by refusing to "establish a rule requiring the Court of Chancery to defer to the merger price in any appraisal proceeding."

Subsequent to Golden Telecom, Chancellor Leo Strine refused to give any weight to the merger price in valuing a company at $4.67 per share, which was more than double the $2.05 merger price. In re Orchard Enters. Inc. (Del. Ch. July 18, 2012). And Vice Chancellor Parsons found the merger price irrelevant in concluding that the fair value of a company was $10.87 per share, in excess of the $10.50 merger price. Merion Capital LP v. 3M Cogent Inc. (July 8, 2013). Accordingly, not only is it well settled law that the court need not rely on merger price in an appraisal action, the court does not even have to consider merger price.

Moreover, the court need not consider whether the merger price was a product of a "fair process" in an appraisal action. In Orchard, the company attempted to justify the merger price by "mak[ing] some rhetorical hay out of its search for other buyers." But the court appropriately pointed out that it "[w]as an appraisal action, not a fiduciary duty case, and although I have little reason to doubt Orchard's assertion that no buyer was willing to pay Dimensional $25 million for the preferred stock and an attractive price for Orchard's common stock in 2009, an appraisal must be focused on Orchard's going concern value." Id. In other words, the court recognized its statutory obligation to independently analyze Orchard's "fair value" regardless of whether the company conducted an auction or performed a market check.

Similarly, the Court of Chancery recently explained that "the determination that no breach of duty occurred because the Merger price was fair does not necessarily moot the companion appraisal proceeding." In re Trados Incorporated Shareholders Litig. (Del. Ch. Aug. 16, 2013). For example, the court stated that while the merger price may not support a fiduciary liability claim if it fell within a certain range of reasonableness, an appraisal analysis could still yield an award in excess of the merger price. By way of example, the court cited Cinerama v. Technicolor, 663 A.2d at 1156, 1176-77 (Del. 1995) and Cede & Co. v. Technicolor Inc., 884 A.2d 26, 30 (Del. 2005), in which the Delaware Supreme Court affirmed the determination that the merger consideration of $23 per share was "entirely fair" in the context of that company's breach of duty case, but also awarded "fair value" of $28.41 per share in the company's appraisal case.

Conclusion

The Delaware Courts have made clear that fair value in the context of an appraisal of a corporation's going concern is distinct from a market-based merger price for the stock of that corporation. Given that all the factors the courts must consider in determining fair value in an appraisal proceeding are based on long-term business fundamentals rather than the current market fluctuations that determine a merger price, appraisal actions have resulted in court determinations of fair value (often far) in excess of the merger price in more than 80 percent of the cases that went to trial.

Applied to stand-alone buyouts, appraisal offers a practical and very reliable process for unlocking a company's intrinsic value above the merger price, and such an action is even more likely to unlock value when the stand-alone buyer is a corporate insider. Management buyers, after all, can be expected to know their company's intrinsic value best and are not likely to convince the court that they knowingly offered to pay more than the company was worth.

—By Jeremy D. Anderson and José P. Sierra, Fish & Richardson PC

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The Harvard Law School Forum on
Corporate Governance and Financial Regulation

The Growth of Appraisal Litigation in Delaware

Posted by Noam Noked, co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Thursday December 5, 2013 at 9:11 am

Editor's Note: The following post comes to us from David J. Berger, partner focusing on corporate governance at Wilson Sonsini Goodrich & Rosati

Numerous commentators and academics have written about the growth of M&A litigation over the last several years. Less noticed, but perhaps more significant, has been the growing tendency of institutional and other large investors to exercise their appraisal rights under Delaware law. Investors in several recent high-profile mergers have announced their intention to, or sought to, exercise their appraisal rights, including in deals involving Dell, Dole Food Company, and 3M/Cogent.

In many of these situations, an even more novel phenomenon is occurring: hedge funds, arbitrageurs, and other money managers are buying the stock of target companies even after a deal is announced to have the option to exercise appraisal rights. Some funds even have been created expressly for this purpose, perhaps with the view that the risks in an appraisal proceeding may be far greater to the target company than to the shareholder.

One such risk is that historically the definition of "fair value" in an appraisal proceeding under Delaware law provides wide discretion to the court to "take into account all relevant factors" beyond the price paid in the underlying merger, even where that price was the result of an arms-length transaction. The practical impact of this standard is that the court's determination of value may get reduced to a "battle of the experts," while the experts' own analyses may be based on future projections and/or other financial information that is, by definition, uncertain. As a result, there is often little hard data to predict what the value of an entity in an appraisal proceeding could be.

A second significant risk is that under Delaware law, appraisal awards accrue interest at a statutory rate of *5 percent above the Federal Reserve discount rate compounded quarterly*. Further, this extraordinary interest begins accruing at the date of the deal's closing until the date that payment of the judgment is made. The statutory interest rate under Delaware law creates substantial risk to the target corporation (while also incentivizing a stockholder to bring an appraisal claim by potentially limiting the investor's "downside" risk) since even if the stockholder's recovery is limited to a value similar to the price paid in the merger, the investor currently receives compounded interest at a rate significantly above market rates on whatever award is ultimately obtained.

However, a recent decision by the Court of Chancery gives hope that one of the structural risks to companies defending an appraisal case may be slowly starting to change. Specifically, in *Huff Fund Investment Partnership v. CKx, Inc.*, C.A. No. 6844-VCG (Del. Ch. Nov. 1, 2013), the Delaware Court of Chancery held that under certain circumstances, Delaware courts can and should look to the merger price when determining fair value, and that there are even situations where the merger price generated by an arms-length sales process could be the best and most reliable indication of value. But this decision alone is unlikely to stop the increasing popularity of appraisal suits in Delaware.

The Risky Business of Valuation in Delaware Courts

Delaware law traditionally gives the court "significant discretion" to "consider the data and use [any] valuation methodologies" the court deems appropriate to determine "fair value" in an appraisal case. Because the court has such wide latitude to accept any of the parties' valuations "by any techniques or methods which are generally considered acceptable or otherwise admissible in court," appraisal cases often turn upon the credibility and analysis of expert testimony. This can be the case even where the expert's testimony is based upon projections and/or financial analyses that are questionable (a reality that is even more common in companies that have limited operating histories or operate in more volatile industries).

As a practical matter, a case that is determined by expert testimony can be a risky enterprise. Expert testimony often depends upon the skills of the expert as much as the analyses performed, and the underlying data can be highly questionable since it generally assumes how the company would have performed had the merger in question not occurred. Further, the risks again fall largely on the defendants in these proceedings since defendants must bear almost all of the burden of discovery. Management presentations made to the board in the context of the board considering its alternatives often include an "upside" case that is admissible for appraisal purposes even if it was unrealistic as a practical alternative, and even the passage of time benefits the stockholder since the longer the case continues, the longer interest accrues at the statutory rate discussed above.

The *CKx* Decision and the Use of Merger Price as a Factor in the Valuation of a Company in Appraisal

CKx was a publicly traded company that managed and invested in media and entertainment properties, including 19 Entertainment (which owned rights to shows such as "American Idol" and "So You Think You Can Dance"), Elvis Presley Enterprises, and Muhammad Ali Enterprises.

After several years of unsuccessfully seeking a buyer (both publicly and privately), in 2010, CKx made a public announcement that it was no longer considering a sale. Shortly thereafter, two private equity buyers expressed interest in acquiring the company, and the CKx board decided again to pursue a sale. Once more, the board retained a financial advisor, ran an auction process, and ultimately received two bids: one from private equity firm Apollo at $5.50 per share and a second offer from another private equity firm, "Party B," at $5.60 per share. The board accepted Apollo's lower bid because it offered greater deal certainty and other benefits. Following the now-standard class action litigation (which settled for additional disclosures and a slight modification to the termination fee), the deal closed.

After the deal litigation was resolved in principle and the merger closed, a large stockholder of CKx challenged the transaction and opted to seek appraisal rights rather than receive the cash-out price from Apollo. As is typical in appraisal cases, following discovery, the court conducted a three-day, full trial on the merits that included extensive testimony from, among others, expert witnesses retained by each of the parties, as well as post-trial briefing and post-trial arguments.

The Court's Holding That an Arms-Length Sales Process Can Be the Best Indicator of "Fair Value"

The court began its analysis by recognizing that Delaware law provides the Court of Chancery with "significant discretion" in determining the fair value of stock in an appraisal action. Under well-established Delaware law, "fair value" is defined as the company's value as a going concern (i.e., excluding merger-specific value) and, while the court must take into account "all relevant factors" in determining fair value, it has wide latitude to select one of the parties' valuation models or to fashion its own.

In *CKx*, Vice Chancellor Sam Glasscock rejected the traditional analyses used in many appraisal cases. For example, the court found that the comparable companies and comparable transactions analyses were flawed because the evidence was "abundantly clear" that the comparables presented were not truly comparable to CKx and were thus unreliable. The court also found that the respective discounted cash-flow (DCF) analyses presented by the parties were inherently unreliable because they were based upon the company's unreliable revenue projections.

In the absence of comparable companies or transactions, and without reliable projections to discount in the DCF, the court held that "the merger price [w]as the best and most reliable indicator" of CKx's value. The court further recognized that "in at least one" appraisal case, the court placed 100 percent weight on the merger price.

The court concluded its analysis by specifically rejecting the plaintiffs' argument that the merger price is "irrelevant" in the context of appraisal proceedings. As part of this analysis, the court discussed the Delaware Supreme Court's decision in *Golden Telecom*, where the Delaware Supreme Court dismissed the notion that the Court of Chancery must defer to the merger price in appraisal proceedings. As the Vice Chancellor explained in *CKx*, the Delaware Supreme Court's holding in *Golden Telecom* was fully consistent with his analysis: Because the court has a statutory mandate to consider *all* relevant factors in conducting an appraisal proceeding, there should be no per se, bright-line rule that presumptively or conclusively relies upon one factor or excludes any one factor from consideration. Thus, the court concluded its analysis not far from where it began: that a trial court in an appraisal proceeding is afforded wide latitude to determine "fair value," including as appropriate the merger price in an arms-length transaction.

Conclusion: Even After *CKx* Appraisal, Litigation Is Likely to Increase in Delaware

The *CKx* decision makes clear that a court in an appraisal case can, and under certain circumstances should, look to a price obtained in an arms-length merger as a reasonable proxy for "fair value" under Delaware law. Yet this holding alone is unlikely to stop the increase in appraisal litigations for at least two reasons. First, while *CKx* makes clear that a merger price can be used to determine fair value, it does not limit or alter in any way the court's ability to take into account other factors that the court may find appropriate. Thus, as a practical matter, the "battle of experts" in appraisal cases, with the resulting risks and uncertainty, is likely to continue.

Second, nothing in *CKx* addresses the substantial above-market interest rate provided under Delaware law (nor could it, as this rate is based upon Delaware statutory law). Thus, the financial incentives for shareholders to bring appraisal cases remain in place, as a party challenging a merger can obtain a significant premium, even if the price awarded in the litigation is comparable to the merger price based solely on the interest rate awarded under Delaware law.

Icahn Moving To Perfect Appraisal Rights Of Dell Shares; Urges Other Dell Stockholders To Act Now To Do The Same

NEW YORK, July 10, 2013 /PRNewswire/ -- Carl C. Icahn and his affiliates today issued the following open letter to stockholders of Dell Inc.

Dear Fellow Dell Stockholders:

We are in the process of perfecting our right to seek appraisal of our Dell shares and we believe that you should also perfect your appraisal rights. Under Delaware law if a merger occurs and you did not vote for it, you are entitled, through appraisal, to the fair value of your shares as determined by a Delaware court. We have done a great deal of due diligence concerning the value of Dell, and as we have said in the past, we believe the $13.65 merger price substantially undervalues your Dell shares, and we believe if you seek appraisal, you will receive more. BUT WHAT IS MOST IMPORTANT ABOUT SEEKING APPRAISAL IS THAT YOU CAN CHANGE YOUR MIND ABOUT APPRAISAL UP TO 60 DAYS AFTER THE MERGER AND STILL TAKE THE $13.65 PER SHARE. During the "free 60 day period" we believe Dell may wish to negotiate with those that sought appraisal and possibly pay a premium over $13.65 to get them to settle and drop their appraisal claims, as explained below. To add a new twist to an old saying, "you can have your cake and eat it too".

Those Who Seek Appraisal May Get Lucky

In many merger transactions, if over a certain number of stockholders seek appraisal rights, this gives the purchaser the right to opt out of the transaction and thereby avoid the uncertainty created by appraisal. However, Michael Dell and Silver Lake did not obtain this opt out right. This leaves Michael Dell and Silver Lake VERY exposed. Because they neglected to obtain this right, no matter how many stockholders seek appraisal, if the merger is approved, Michael Dell and Silver Lake are obligated to close or pay a $750 million penalty. We would certainly like to be present to hear the discussion between Michael Dell/Silver Lake and their lenders as they consider the impact of a substantial exercise by stockholders of their appraisal rights. Will the lenders use this as an excuse to refuse to close claiming this is a material adverse change, especially in light of the terrible time Dell is having in the PC market as so often stated by Dell themselves? We think that there is a good chance that none of them will want to face the overhang of a large number of stockholders seeking appraisal. I therefore believe there will be significant pressure on Michael Dell and Silver Lake to resolve the appraisal rights, and possibly seek a settlement during the "free 60 day period". Even if you want the Michael Dell/Silver Lake offer to be accepted, unless you believe your shares will tip the balance, why vote for it? Why not seek appraisal and have the benefit of the "free 60 day period"? Dell may well pay a premium over $13.65 to settle with those seeking appraisal.

THE PROCESS TO SEEK APPRAISAL RIGHTS TAKES TIME, SO ACT NOW IF YOU WISH TO PERFECT YOUR APPRAISAL RIGHTS AND IMMEDIATELY CONTACT YOUR BROKER AND OTHER ADVISORS. **If you have any questions concerning appraisal rights or wish to seek help or information regarding appraisal rights, contact D.F. King & Co., Inc. at 1-800-347-4750 or dell@dfking.com. They will take your information and provide it to people at Icahn who will call you back.**

REMEMBER YOU CAN CHANGE YOUR MIND ABOUT APPRAISAL DURING THE "FREE 60 DAY PERIOD" AND STILL TAKE YOUR $13.65 PER SHARE.

For a detailed discussion of the process for perfecting and exercising appraisal rights, see page 180 of the Definitive Proxy Statement on Schedule 14A filed by Dell with the SEC on May 31, 2013.

We continue to urge stockholders to vote AGAINST the Michael Dell/Silver Lake transaction.

Sincerely,

Carl C. Icahn	Keith Schaitkin
Chairman	General Counsel
Icahn Enterprises, L.P.	Icahn Enterprises, L.P.

NOTICE TO INVESTORS

SECURITY HOLDERS ARE ADVISED TO READ THE PROXY STATEMENT, DATED JUNE 26, 2013, AND OTHER DOCUMENTS RELATED TO THE SOLICITATION OF PROXIES BY ICAHN ENTERPRISES, LP, SOUTHEASTERN ASSET MANAGEMENT, INC. AND THEIR RESPECTIVE AFFILIATES FROM THE STOCKHOLDERS OF DELL INC. FOR USE AT DELL INC.'S SPECIAL MEETING OF STOCKHOLDERS SCHEDULED TO BE HELD ON JULY 18, 2013 BECAUSE THEY CONTAIN IMPORTANT INFORMATION, INCLUDING INFORMATION RELATING TO THE PARTICIPANTS IN SUCH PROXY SOLICITATION. A DEFINITIVE PROXY STATEMENT AND A FORM OF PROXY HAVE BEEN MAILED TO STOCKHOLDERS OF DELL INC. AND ARE ALSO AVAILABLE AT NO CHARGE AT THE SECURITIES AND EXCHANGE COMMISSION'S WEBSITE AT HTTP://WWW.SEC.GOV. INFORMATION RELATING TO THE PARTICIPANTS IN SUCH PROXY SOLICITATION IS CONTAINED IN THE DEFINITIVE PROXY STATEMENT, DATED JUNE 26, 2013. EXCEPT AS OTHERWISE DISCLOSED IN THE DEFINITIVE PROXY STATEMENT, THE PARTICIPANTS HAVE NO INTEREST IN DELL INC. OTHER THAN THROUGH THE BENEFICIAL OWNERSHIP OF SHARES OF COMMON STOCK OF DELL INC. AS DISCLOSED IN THE DEFINITIVE PROXY STATEMENT. WE HAVE NOT SOUGHT, NOR HAVE WE RECEIVED, PERMISSION FROM ANY THIRD PARTY TO INCLUDE THEIR INFORMATION IN THIS LETTER.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this letter, and the documents referred to in this letter, are forward-looking statements including, but not limited to, statements that are predications of or indicate future events, trends, plans or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties. Forward-looking statements are not guarantees of future performance or activities and are subject to many risks and uncertainties. Due to such risks and uncertainties, actual events or results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Forward-looking statements can be identified by the use of the future tense or other forward-looking words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," "should," "may," "will," "objective," "projection," "forecast," "management believes," "continue," "strategy," "position" or the negative of those terms or other variations of them or by comparable terminology.

Important factors that could cause actual results to differ materially from the expectations set forth in this letter include, among other things, the factors identified under the section entitled "Risk Factors" in Dell's Annual Report on Form 10-K for the year ended February 1, 2013 and under the section entitled "Cautionary Statement Concerning Forward-Looking Information" in Dell's Definitive Proxy Statement filed with the SEC on May 31, 2013. Such forward-looking statements should therefore be construed in light of such factors, and Icahn and Southeastern are under no obligation, and expressly disclaim any intention or obligation, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

SOURCE Carl C. Icahn

The New York Times
DealBook
Edited by Andrew Ross Sorkin
JULY 10, 2013, 10:33 AM

Icahn's Latest Gamble at Dell: Appraisal Rights

By MICHAEL J. DE LA MERCED

With the vote on a proposed $24.4 billion sale of Dell Inc. just over a week away, the deal's primary opponent is trying a new tactic.

The activist investor Carl C. Icahn urged fellow Dell shareholders on Wednesday to start preparing appraisal rights for their shares. It's a somewhat uncommon move that could yield a higher payout than the $13.65-a-share that Michael S. Dell and the investment firm Silver Lake are offering.

That is, if the gambit is successful.

The call for shareholders to exercise their appraisal rights is in some ways a surprising shift for Mr. Icahn, who has pushed them to reject the takeover bid. He and another big investor, Southeastern Asset Management, have called for replacing Dell's board with their own slate of directors, who would then push the company into buying back 1.1 billion shares at $14 each.

Despite winning the support of influential proxy advisers like Institutional Shareholder Services, advisers to the buyers and to a special committee of Dell's board are still concerned that they may lose the July 18 vote on the deal. While Mr. Icahn may have lost some negotiating leverage with the I.S.S. report, those people believe that the activist may still succeed in stirring up enough opposition with the promise of his buyback proposal.

Wednesday's announcement appears to signal that Mr. Icahn may be backing away from that plan.

Essentially, shareholders would need to vote against the leveraged buyout and then ask Delaware's court of chancery to "appraise" the true value of their shares. (The New York Times's Gretchen Morgenson previously wrote about appraisal rights in the Dell matter, and how some shareholders have been preparing to use them.)

Mr. Icahn cleverly points out that there is a 60-day period in which shareholders can demand appraisal rights, and then withdraw the request and accept the $13.65-a-share offer. "To add a new twist to an old saying, 'you can have your cake and eat it too,'" he said in a statement.

Mr. Icahn is still urging shareholders to vote against the deal. But he is also betting that even if they win, Mr. Dell and Silver Lake will move to settle with dissident shareholders, paying them off to avoid years of potentially contentious court battles. In short, he's looking for a price bump.

He notes that the buyers are on the hook for a $750 million breakup fee if they can't close the deal under certain conditions, and questions whether the duo's lenders will seek to back away if shareholders seek appraisal rights en masse.

There is obviously an element of chance here, since the Delaware court may award just the $13.65 a share, or even less. Mr. Icahn clearly states in his news release that "those who seek appraisal may get lucky."

And if Mr. Dell's bid fails, appraisal rights don't come into play at all.

But for an investor who has thrown nearly every possible hurdle he can to halt the deal — or at least to force a higher payout — appraisal rights may pay off after all.

Bloomberg

Dell Value Dispute Spotlights Rise in Appraisal Arbitrage

By Miles Weiss - Oct 3, 2013

Carl Icahn's plan to seek a higher price for his stake in Dell Inc. (DELL) put the spotlight on a section of Delaware law that is being used by a growing group of money managers to squeeze more cash from corporate buyouts.

Icahn, 77, has vowed to petition the Delaware Chancery Court for an independent valuation of his 8.9 percent stake in Dell, the computer maker that won shareholder approval last month for a $24.9 billion buyout led by founder Michael Dell. Should he proceed, Dell would have to pay him whatever the court decides his stake, valued at $2.2 billion under the buyout terms, is worth. Icahn would get accrued interest of almost 6 percent on the award, regardless of whether it is more or less than he would have received through the original deal.

With returns from traditional merger arbitrage waning, the battle at Dell is drawing attention to appraisals as a way to systematically profit from buyouts. Money managers such as Nicholas Maounis and Andrew Barroway, boosted by a court ruling Icahn attained years ago, have developed a strategy known as appraisal arbitrage in which they buy stock in takeover targets after a deal is announced and then seek a higher valuation from the chancery court.

"Dell has kind of awoken a sleeping giant," said Matthew Giffuni, the manager of Quadre Investments LP, a New York-based firm using the Delaware court to contest the price paid in July for NetSpend Holdings Inc. "Now there are new firms who are crawling into the space."

Under Delaware law, stockholders of companies incorporated in the state are entitled to a judicial determination of fair value in a takeover. More than half of U.S. publicly traded companies are incorporated in Delaware, the smallest state by area after Rhode Island.

Transkaryotic Therapies

For years, the petitions were mostly filed by disgruntled investors as the only alternative to accepting bids they deemed too low. A court ruling on an appraisal play made by Icahn in 2005 opened the door for money managers to pursue appraisals more systematically, by analyzing stocks to find takeovers that appear to pay less than intrinsic value, then buying shares to gain appraisal rights. The strategy is a twist on traditional merger arbitrage, in which investors buy shares in a takeover target whose stock trades at a discount to the buyout offer because of uncertainty over whether the deal will be completed.

Icahn, SAC Capital Advisors LP and Millennium Management LLC had challenged the price in Shire Pharmaceuticals Group Plc's acquisition of biotechnology company Transkaryotic Therapies Inc. The investors sought appraisal on 11 million shares, most bought after the record date for determining eligibility to vote on the deal.

'Taking Advantage'

The court said the petitioners were entitled to fair value on all shares, upending the notion that stock purchased after the record date couldn't be included in a claim. The case was eventually settled for $37 a share, the same price paid in the merger, plus interest.

The ruling allowed arbitragers to buy stock just before shareholders voted on a transaction, minimizing the danger of a deal falling apart, and giving investors more time to study financial performance as well as valuation methods and fairness opinions in takeover documents, which often are published after the record date is set.

"People are taking advantage of the flexibility on Transkaryotic," said Daniel Wolf, a partner in the mergers practice of Chicago-based law firm Kirkland & Ellis LLP. "You can just sit there and wait and watch and just decide if the business environment is improved."

Merion Investment

One example is Barroway's Merion Investment Management LP, which disclosed a 5.4 percent stake in Houston-based BMC Software Inc. on July 22, two days before Bain Capital LLC and Golden Gate Capital won approval for their $6.7 billion acquisition of the company. Merion sought appraisal last month, forgoing the $46.25 a share that the private-equity firms had agreed to pay.

Barroway, co-founder of one of the nation's largest securities class-action firms, is seeking to raise $1 billion for a group of funds specializing in appraisal arbitrage. His Merion will target management-led buyouts, the type of acquisitions in which top executives, often including the founder, seek to take a company private.

"The fund believes that 'insider acquirers' often have a greater incentive to offer and pay minority shareholders substantially less than fair value," Merion says in a marketing document. It will target a return rate of 20 percent by enforcing appraisal rights through the judicial process.

Maounis's Petitions

Barroway, the managing partner at Radnor, Pennsylvania-based Merion, declined to comment on the strategy.

Maounis, the hedge-fund manager whose Amaranth Advisors LLC collapsed in 2006 after losing $6.6 billion on natural-gas trades, petitioned this year for appraisals of shares that his new firm, Verition Group LLC, held in three takeovers, according to the Delaware Register in Chancery.

Verition sought appraisal after investment bank Duff & Phelps Corp. was bought April 23 by Carlyle Group LP, Swiss bank Pictet & Cie and others. The firm also filed petitions after the Dec. 31 purchase of Ancestry.com Inc. by Permira Holdings Ltd. and the July 2 takeover of NetSpend by Total System Services Inc.

Maounis, whose firm is based in Greenwich, Connecticut, didn't respond to requests for comment.

Of the 18 deals spurring petitions in Delaware through September of this year, at least 12 drew filings by one or more arbitragers. Merlin Partners and its affiliates targeted eight transactions, according to the Chancery docket.

‘Paying Enough’

Merlin is run by Beachwood, Ohio-based Ancora Advisors LLC, a money-management firm founded by Richard Barone. Barone, an activist investor who started his first money-management firm in 1973, said in an interview that Ancora has done the bulk of its appraisal arbitrage for about a year, though it had some experience with the strategy previously.

“We look at these deals and try to judge how fair the deal is,” said Barone, a 71-year-old native of Cleveland who is no longer involved in Ancora’s day-to-day operations. “Where we believe the acquiring company is not paying enough, we will go for appraisal rights.”

Appraisal judgments are paid only to those who file the petition, and can be more or less than what they would have gotten in the original deal. To qualify, an investor needs to file an appraisal demand with the target before the shareholder vote, then oppose the deal or refrain from casting a ballot. The investor must petition the court within 120 days after the deal becomes final.

Settling Cases

Legal fees can reach millions of dollars, and it typically takes one to three years for a judgment, though a petition filed in 1983 over Ronald Perelman’s bid for Technicolor Inc. required 22 years to resolve.

Most appraisal claims are settled before the court rules. Quick accords eliminate the expense of pressing a case, said attorney Jeremy Anderson at Fish & Richardson PC.

Awards accrue interest at the rate the U.S. Federal Reserve charges banks to borrow from its discount window, currently 0.75 percent, plus five percentage points, retroactively to the deal’s completion.

Eight of the 45 appraisal actions that went through trial in the past 20 years resulted in an appraisal of fair value that was less than the merger price, according to Fish & Richardson. In a 2004 ruling on Sunbeam Corp.’s purchase of Coleman Co. for $5.83 a share, the court said the fair value was $32.35.

‘Purest’ Value

“This is value investing in its purest and most professionalized form,” said Gary Lutin, a former investment banker who runs the Shareholder Forum, a New York-based group that created the Dell Valuation Trust to foster the creation of securities backed by appraisal rights. “Except you are depending on a very sophisticated judge rather than Mr. Market.”

In a 2007 case the court went the other way, ruling in response to a petition by Highfields Capital Ltd. that Mony Group Inc. was worth $24.97 a share when acquired by AXA Financial Inc., after $31 was paid in the takeover.

Dell’s founder and Silver Lake Management LLC won the vote on their buyout of the Round Rock, Texas-based company on Sept. 12, after months of opposition, including a competing bid from New York-based Icahn Capital LP. The buyout group ultimately agreed to pay $13.75 a share plus a 13 cent dividend.

Dell Estimates

Icahn built his stake to 156.5 million shares after the transaction was announced in February as he fought for control, then asked fellow investors in July to join him in preparing to seek appraisal rights. Conceding defeat as the buyout gained momentum, on Sept. 9 he reiterated his appraisal plan.

Most professional investors view Dell's intrinsic value in the $15 to $18 range, according to Lutin.

If the court were to take two years to rule and award Icahn $18 a share, the company would owe him $3.17 billion in principal and interest, about $1 billion more than he'd get via the buyout. Outcome aside, it would be one of the court's biggest petitions ever, said Lawrence Hamermesh, the Rudy R. Vale Professor of Corporate and Business Law at the Widener Institute of Delaware Corporate Law in Wilmington.

Dell is a bad bet for appraisal arbitrage, according to Quadre's Giffuni. With others preparing to join Icahn in filing, Dell is unlikely to settle claims because of the prohibitive cost, he said.

Holders "should be happy with what they are getting," said Giffuni, a former merger and acquisitions attorney who formed Quadre in 2009.

Icahn declined to comment on a possible claim. Like any petitioner, he'd have 60 days after the deal is done to change his mind and accept the terms, said Charles Nathan, the former co-head of the mergers practice at law firm Latham & Watkins LLP.

"There is nothing to say that Carl couldn't turn around and settle for the deal price when no one is paying attention," said Nathan, a partner at RLM Finsbury, a strategic-communications firm headquartered in New York and London.

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Bloomberg

Dell Appraisals Demanded by T. Rowe to Magnetar Capital

By Miles Weiss - Nov 28, 2013

T. Rowe Price Group Inc. (TROW) and more than 100 other Dell Inc. shareholders who control a combined 47.5 million shares spurned the company's buyout offer to seek a potentially higher payout through the Delaware court system.

T. Rowe has demanded appraisal on about 30 million shares held in mutual funds and client accounts overseen by the Baltimore-based firm, according to a Nov. 25 legal filing by Dell. Other shareholders who said they may request an independent valuation by the Delaware Chancery Court include Magnetar Capital LLC, an Evanston, Illinois-based hedge-fund firm run by Alec Litowitz; the New York State Common Retirement Fund; and New York-based Loeb King Capital Management. The 47.5 million shares in about 200 shareholder accounts represented 2.7 percent of Dell's outstanding stock at the time of the buyout.

Founder Michael Dell and private-equity firm Silver Lake Management LLC completed their $24.9 billion buyout of the Round Rock, Texas-based computer company on Oct. 30 after facing months of opposition from investors led by billionaire Carl Icahn and Southeastern Asset Management Inc. Icahn initially said he would demand appraisal rights on about $2 billion of shares he held, only to reverse course last month and accept the offer of $13.75 a share.

Under Delaware law, shareholders who deem a takeover offer too low can petition the chancery court to value their holdings. To exercise this right, shareholders must notify the company that they are demanding appraisal rights prior to a vote on the buyout, and they must refrain from casting their ballot in favor of the transaction.

Changing Course

Shareholders who give notice that they are demanding appraisal rights have 60 days from the completion of the buyout to change their mind and accept the bid. Brian Lewbart, a T. Rowe spokesman, declined to comment on whether the money-management firm would follow through with the appraisal process, which can take several years and cost millions of dollars.

"We are aware of the list of those who plan to exercise appraisal rights and will work within the process" followed by the Delaware courts, David Frink, a Dell spokesman, said in a telephone interview.

In an appraisal, the Delaware court can award an amount higher or lower than the takeover price. Claims are often settled before a ruling.

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LAW360

Dell Shareholders Like Their Appraisal Odds In $25B Buyout

By **Liz Hoffman**

Law360, New York (September 10, 2013, 1:08 PM ET) -- Carl Icahn on Monday gave up his fight against Dell Inc.'s $25 billion buyout, but vowed to let a judge decide how much his shares are worth. And a new report out Tuesday from a group of equally disgruntled investors suggests the odds of a price bump are good.

The report finds that in the vast majority of Delaware appraisal actions, a judge has set a "fair value" of the shares higher than the buyout price. In only eight cases in the past 20 years has a judge awarded less — and none quite like Dell's buyout by its founder and CEO.

The analysis was done by lawyers at Fish & Richardson PC on behalf of the Dell Valuation Trust, a **novel effort** to help organize Dell investors who want to seek appraisal rights. The trust is run by the Shareholder Forum, a loose affiliation of institutional investors headed up by Gary Lutin, a former investment banker turned governance hound.

The trust provides a platform for shareholders who think Dell is worth more than the $13.88 per share that Michael Dell and private equity firm Silver Lake Partners are paying. That's an argument that Icahn, who owns about 8.2 percent of the technology company, **has been making** for nine months.

In appraisal actions, judges consider a company's intrinsic fair value, ignoring questions of price and board process that tend to dominate merger litigation. In fact, in the 2010 Golden Telecom decision, the Delaware Supreme Court explicitly said judges needn't defer to the offer price, even as a benchmark. Trial courts essentially have a blank slate, relying heavily on financial metrics and expert testimony.

Forty-five appraisal cases have been decided in Delaware since the early 1990s, and in only eight cases did a judge set a “fair value” below the transaction price. And in those cases, the Fish & Richardson analysis finds, the buyer was paying for some extra value, like cost savings or the chance to settle disputes with affiliates.

“Because the buyer’s valuation in those cases was based on benefits beyond the standalone enterprise value, the price they were willing to offer was more than the fair value of the company by itself,” the memo said.

Management buyouts like Dell's don't fit the bill, the group claims. Inside acquirers aren't chasing synergies or an end to corporate squabbling, but instead are guided by a belief — and access to privileged information — that the company is worth more than its current market value.

“Management buyers, after all, can be expected to know their company’s intrinsic value best and are not likely to convince the court that they knowingly offered to pay more than the company was worth," the report said.

Still, plenty of people have made the opposite argument. CEOs like Michael Dell may very well be overpaying for their companies, blinded by loyalty, a desire to protect their legacy and a belief that they can turn it around. A close read of Dell's story suggests this might be true. When Silver Lake, which has its own investors to think about and no emotional connection to Dell, balked at raising the offer, Michael Dell **dug into his own pocket** for an extra $190 million.

The question will soon be before a Delaware judge, likely Chancellor Leo E. Strine Jr., who is also hearing Dell's shareholder class action.

The following appraisal actions resulted in shareholders getting less than the offer price:

- **Gerreald v. Just Care (2012):** Just Care Inc., a privately held operator of halfway houses, was acquired in 2009 by a company founded by Just Care's former CEO, as part of a long-running management spat. The offer price was $40 million. In an appraisal action, Just Care's shareholders claimed the fair value was $55.2 million, while the defendants said it was $33.6 million. The court landed on $34.2 million.

- **Highfields Capital v. AXA Financial (2007):** Hedge fund Highfields Capital turned down a $31-per-share offer for its stock in insurance broker MONY Group Inc. by AXA Financial, only to have a judge decide the shares were only worth $24.97. Even with accrued interest — shareholders are entitled to 5 percent plus the federal funds rate — Highfields lost money.

- **Finkelstein v. Liberty Digital Inc. (2005):** John Malone's Liberty Media Corp. acquired its digital affiliate in 2002 for cash valued at $3.31 per share. Notably, the parties agreed that the fair value of all but one of Liberty Digital's asset was $2.15 per share, but disputed the value of a contract with AT&T Inc. Then-Vice Chancellor Strine slapped a $135 million price tag on the contract to come up with a $632 million valuation for all of Liberty Digital — $133 million less than the purchase price.

- **Andaloro v. PFPC Worldwide (2005):** PFPC Worldwide was acquired by its parent, which already owned 98 percent, for $34.26 per share. A few shareholders wanted more, pegging the fair value at $60.76. The buyer said it was more like $19.86. Using discounted cash flow projections and comparisons to peer companies, the court landed on $32.81.

- **Union Illinois 1995 Inv. Ltd. Partnership v. Union Financial Group (2004):** The founding family of Union Financial owned 38 percent of the bank when it was acquired by First Banks Inc. in 2001. They sought an award of more than $16 per share, well above the merger price of up to $11. Then-Vice Chancellor Strine settled on $8.74 per share, the merger price minus synergies.

- **Grimes v. Vitalink Communications Corp. (1997).** Vitalink, a maker of network routers, was bought by a larger rival in 1991 for $146 million. Owners of about 200,000 shares dissented and demanded appraisal. The two sides sparred over Vitalink's sales projections, future tax rate and peer valuations, with shareholders demanding $13.32 per share and the company saying they were worth only $8.50. Then-Vice Chancellor Chandler agreed with the company.

- **Kleinworth Benson v. Silgan Corp. (1995):** Silgan, a can and jar maker, was bought out by its holding company in 1989 for $6.50 per share. Stockholders disputed William Blair & Co.'s fairness opinion and claimed their shares were worth $12.65 apiece, while Silgan said fair value was just $4.88. Then-Vice Chancellor William Chandler III used discounted cash flow to arrive at $5.94 per share, about 10 percent below the buyout price.

- **Cooper v. Pabst Brewing Company (1993):** Pabst was trading at around $14 per share when it was acquired by Heileman for $29.50 per share. Setting aside the hefty control premium, the court said the stock was actually worth $27 per share.

The Dell Valuation Trust is represented by Jeremy D. Anderson and José P. Sierra of Fish & Richardson PC on appraisal matters and by Bingham McCutchen LLP on securities regulatory matters.

--Editing by John Quinn.

THE WALL STREET JOURNAL.
WSJ.com

October 31, 2013, 3:55 PM ET

Dole Food Deal Passes By Slim Margin as Hedge Funds Seek Appraisal

By Liz Hoffman

Dole Food Co.’s $1.2 billion sale to its chief executive and founder squeaked past a shareholder vote on Thursday, but several large holders plan to seek a second opinion on the deal price from a judge, according to people familiar with the matter.

The buyout passed with the support of 50.9% of the shares not held by CEO David Murdock, who owns 39.5% of Dole and is trying to take it private for the second time in a decade. To pass, it needed a majority of shares not controlled by Mr. Murdock to vote yes.

But hedge funds holding at least 10 million shares — or more than 12% of Dole’s stock — have said they will seek appraisal for their shares, a legal proceeding in which a judge set a fair price, the people said. Judges in appraisal cases have often awarded more than the offer price, especially in buyouts by large shareholders like Mr. Murdock. But an appraisal can come in lower than the deal price, too, and either way resolution can take years.

The bulk of those shares are held by Merion Investment Management LP, which on Tuesday disclosed an 8.3% stake in Dole. Prior to then it hadn’t disclosed a position, meaning it owned less than 5%.

Two other hedge funds holding as many as seven million shares between them have also reserved their right to seek appraisal, according to one person. Another person put the number lower, closer to 2.5 million. A representative for Dole declined to comment, but confirmed that the company had received such notices from several shareholders.

In all, at least 10 million and possibly as many as 14 million shares have foregone the $13.50-per-share buyout offer in the hopes of getting more from a judge. Albert Fried & Co. analyst Sachin Shah said Thursday that the company could be worth more than $17 per share, including valuable land it owns in Hawaii.

This isn’t the first appraisal case for Merion, whose strategy includes buying shares of companies on the brink of a buyout and pushing for more in court.

Merion teamed with three other funds in 2011 to seek appraisal for 5.84 million shares of Cogent Inc., which had just been sold to 3M Co. This summer, a judge awarded the funds 3.5 percent more than the sale price. In 2012, the Radnor, Pa.-based fund sued for appraisal of its stake in Deltek Inc., which had been bought by private-equity firm Thoma Bravo LLC. That suit was later dismissed.

Merion is currently seeking appraisal for its 5.4 percent stake in BMC Software Inc., which it acquired weeks before the company's shareholders voted to approve a $6.9 billion buyout by private-equity firms Bain Capital and Golden Gate Capital this summer.

Between BMC and Dole, Merion now has more than $450 million tied up in appraisals, based on the merger prices of the two deals.

Merion is run by Andrew Barroway, a former lawyer at Kessler Topaz Meltzer & Check LLP, which represents plaintiffs in big merger and securities cases. Barroway did not respond to a request for comment.

Dole's stock price spiked briefly on news that the deal had passed and closed at $13.55.

It's too late for investors to benefit from an appraisal, which requires shareholders to notify the company before the vote.

But a person familiar with the trading strategy said the newcomers are likely betting on a the outcome of a separate lawsuit over the deal that is moving ahead in Delaware.

In that case, shareholders accuse Mr. Murdock, who also chairs Dole's board, of manipulating the stock price in the run up to his bid. The company canceled a planned stock buyback in May, sending shares plunging to their lowest levels in nearly a year. Dole also announced it would spend $165 million on new ships, a big upfront cost the plaintiffs say was designed to further depress the shares. Mr. Murdock announced his bid two weeks later.

And as it was telling stockholders the shares were worth $13.50, Dole was telling its banks that the company had net assets worth more than $23 per share, according to the complaint, which cites nonpublic materials shown to lenders. The company denies the allegations.

Few merger lawsuits result in more money for shareholders. Most settle, with companies agreeing to disclose more information about the deal process and to pay the plaintiffs' attorney fees.

But the law firm for the Dole plaintiffs, Grant & Eisenhofer PA, has a string of big damages cases to its name. The firm secured multimillion-dollar payouts in litigation over the sale of Del Monte Foods Co. to KKR & Co. LP in 2011, of El Paso Corp.'s pipeline business to Kinder Morgan Corp. in 2012, and of Delphi Financial Group Inc. to Tokio Marine Holdings Inc. in 2012.

Dole's trading after Thursday's vote suggests investors are optimistic Dole will be the next in that line.

UPDATE: Sachin Shah is an analyst at Albert Fried & Co., an earlier version of this post said he was at Goldman Sachs.

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Article

FREEZE-OUT TRANSACTIONS IN GERMANY AND THE U.S.: A COMPARATIVE ANALYSIS

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A. Introduction

A freeze-out is a transaction in which a controlling shareholder forces out the minority shareholders and compensates them in cash or stock.[1] A successful freeze-out transaction marks the end of the exchange-traded life of a corporation--it is a "going private" transaction. A freeze-out is therefore the counterpart to an initial public offering. Whereas the latter leads to the public listing of a corporation and thus a multiplication of shareholders, the freeze-out transaction aims at reducing the number of shareholders of a corporation to one.

Freeze-out transactions are subject to a wealth of case law and scholarly discussion, both in the US legal system, and in Germany. This does not come as a surprise. The rules on freeze-outs need to resolve the diametrically opposed interests of the controlling shareholder[2] and minority shareholders. The controlling shareholder, often after a tender offer, seeks to consummate her acquisition of the target corporation and to establish efficiency gains. The minority shareholders are excluded from their share of the future earnings of the company and are concerned that they may not receive full compensation for their shares. After all, if the compensation is ultimately set or at least influenced by the ***942** controlling shareholder, it is evident that a strong element of self-dealing is involved. So the regulation of freeze-outs is caught in a zone of tension between the legitimate interest of the controlling shareholder to maximize the efficiency of her corporation, and the fears of minority shareholders of self-dealing by the controlling shareholder.

It is striking that the rules on freeze-outs differ significantly between the U.S.[3] and Germany. The regulation of freeze-out transactions in Germany is fairly new and quite restrictive by comparison with U.S. standards. This is remarkable, as the corporate and capital market laws of European and U.S. jurisdictions are generally converging as a result of the ongoing development of European capital markets.[4] In many instances, Delaware law has inspired the formulation of corporate laws in Germany and on the EU-level. The German squeeze-out rules, however, are remarkably different from those developed in Delaware. Although the general framework for squeeze-outs has meanwhile been firmly established in Germany, the courts and legal scholars are still engaging in lively discussions of certain aspects of the procedure. So while some aspects of the squeeze-out procedure are still crystallizing in Germany, the discussion is more mature in Delaware, where the last notable development dates back to 2002.[5] The current vitality of the German discussion invites a comparative analysis of the freeze-out procedures in Germany and the U.S., with a focus on Germany. The rest of the article is structured as follows: Part B of the article briefly discusses the economic rationale of freeze-outs. Part C describes the history and development of the rules on freeze-out transactions in Delaware through case law, up to the current state of the discussion. Part D illustrates the introduction of squeeze-out rules into German law in 2002 and the subsequent legal development in Germany. Part E sets out the general squeeze-out procedure in Germany, discusses the most relevant issues with this procedure, illustrates some empirical data on the use of squeeze-outs in Germany, and draws comparisons with the U.S. where appropriate. Part F explains the takeover squeeze-out procedure in Germany and explains, based on empirical data, why this procedure has not yet become popular in practice. Finally, Part G compares the U.S. and German approaches, analyzes some specific issues, and argues that the different systems are a result of path dependency, and that therefore the potential for further convergence between the German and U.S. freeze-out rules is limited.

*943 B. Rationales for Freeze-Out Transactions

There are several economic reasons for a controlling shareholder to execute a freeze-out procedure. For listed companies, the freeze-out is a way to delist the company from a stock exchange.[6] A freeze-out, then, is the inverse of going public.

Such a “going private” transaction can be desirable if the cost-benefit analysis that motivated the earlier decision to go public is no longer viable.[7]

A common reason for going private is the perception that the market price of the exchange-traded securities does not reflect the real value of the issuing corporation. In that case, going private can be desirable for the controller who thinks she is able to extract a hidden value from the corporation, and the minority shareholders who could expect to be paid a premium over the current market price for their shares.[8] The reduction of the cost of compliance with securities laws and regulations may be another reason for a delisting, which appears, however, to be more prevalent in the U.S. than in Germany.[9]

While the aforementioned considerations are mostly limited to listed corporations, there is also a more general reason that justifies freeze-outs, which is also valid for unlisted companies. The protection rights of minority shareholders are quite costly to the corporation. Shareholders have the right to participate at the general meetings of the corporation and they have certain rights of information and of access to the books of the company. These costs remain essentially the same, even if the proportion of minority shareholders diminishes greatly.[10] Also, the board of directors has a variety of fiduciary duties towards minority shareholders, particularly in cases of self-dealing transactions involving the controlling shareholder. These costs can be avoided by freezing out the minority shareholders.

***944** Another concern for the controller that may lead her to consider a freeze-out is the permanent risk of disruptive legal disputes with minority shareholders. These claims often need to be settled, sometimes even regardless of their merits. The risk of illegitimate shareholder suits is very high both in the U.S. and in Germany.[11] However, the “nuisance value” of such claims is even higher in Germany, as pending shareholder lawsuits can effectively block the execution of structural changes of the corporation, such as mergers or capital increases.[12]

Finally, in Germany, the freeze-out rules are seen as the necessary counterpart to the mandatory tender offer under Sec. 35 of the German Securities Acquisition and Takeover Act (Wertpapiererwerbs-und Übernahmegesetz--“WpÜG”), pursuant to which an acquirer must offer to buy all shares that are tendered if she acquires more than 30% of the outstanding share capital and voting rights.[13] As compensation for this potentially onerous duty, the acquirer shall be enabled to effectively become the sole owner of the acquisition target.[14]

This very brief discussion of the reasons for freeze-out transactions shows that the institution as such can increase social welfare, and is therefore an important and legitimate component of the toolkit of corporate structural measures. Every freeze-out, however, occurs in the zone of tension between the controlling shareholder’s interest to maximize the efficiency of her investment, and the minority shareholder’s interest to receive full compensation for the loss of their shares, which embody the right to a share in all future earnings of the issuer.

The problem is that every freeze-out is by its nature a highly conflicted transaction, as the controller determines the conditions of the freeze-out, and most importantly, the timing of the freeze-out and the price per share. Capital markets are highly volatile. Among other factors, there is hence the risk that the controller may use market timing to cash out the minority at a time when the market irrationally undervalues the target shares. Therefore, the bone of contention is almost invariably the question of whether the controller has offered a fair price for the minority shares.

*945 C. History and Development of Freeze-Outs in Delaware

I. Early Developments

Until the first half of the 20th century, the minority shareholder’s property interest allowed them to thwart the efforts of controlling shareholders to freeze the minority out; they had the right to continue as shareholders of the acquiring entity.[15] In the 1950s, Delaware adopted a cash-out merger statute[16] after Florida had pioneered this type of statute in the mid-1920s. In a statutory merger freeze-out, the controller establishes a wholly-owned subsidiary of the controlled corporation. The target board, usually dominated by the controller, approves the merger and the shareholders of the target--*i.e*. the board of the controlling entity--approve the transaction. The target shareholders receive either cash or the controller’s stock in exchange for their shares in the target.

As of *Singer v. Magnavox,*[17] Delaware courts established that self-dealing transactions of a controlling shareholder, such as cash-out mergers, would be subject to a judicial “entire fairness” review. During the stock market depression of the early 1970s, the level of freeze-out activity increased, which sparked concerns that the controlling shareholders were taking advantage of the low market prices to the detriment of the minority shareholders.[18] The SEC responded to these concerns with the enactment of Rule 13e-3 in 1979, which requires the controller to make various disclosures in relation to the freeze-out transaction to enable minority shareholders to make an informed decision about how to respond to the freeze-out.[19]

II. The Introduction of Procedural Safeguards in Statutory Freeze-Outs

Beginning in the 1980s with *Weinberger v. UOP*,[20] the Delaware courts started to shape procedural safeguards for the decision-making process regarding the freeze-out consideration, which, if observed, would relieve the transaction from entire fairness review. In *Weinberger*, the minority shareholders of UOP were frozen out by its 50.5% shareholder Signal Companies. The decisive fact in the case was that two directors served on the boards of both UOP and Signal and withheld an important feasibility study on the merger ***946** from their fellow directors and the shareholders of UOP. Furthermore, "the entire transaction was presented to and approved by UOP's board within four business days."[21] The Delaware Supreme Court concluded that the freeze-out process was deficient in many ways which amounted to a breach of fiduciary duty by the defendant directors, and subjected the case to the court's entire fairness review.

The *Weinberger* court clarified that entire fairness consists of both fair dealing and a fair price and, in a now famous footnote, introduced the idea that the entire fair dealing element could be met by showing that the contending parties had bargained the terms of the freeze-out at arm's length.[22] This led legal practitioners to set up a Special Committee comprised of independent directors in freeze-out transactions, which would negotiate the terms of the freeze-out on behalf of the minority shareholders. These Special Committees get independent advice from investment bankers and outside legal counsel to enable them to negotiate with the acquirer at eye level. This new practice was viewed skeptically by many academics,[23] as it is questionable whether independent directors can ever be truly independent of a controlling shareholder. Even where no legal ties between director and controlling shareholder exist, there is always the possibility of informal influence by the controller[24] or social pressure by the inside directors.[25] These concerns culminated in the question of what deference courts should afford a freeze-out that was approved by a Special Committee of independent directors, or, put differently, how strict should the standard of judicial review of such a transaction be? The two competing views in the judiciary were either a restriction to business judgment review,[26] or a shifting of the burden of proof that the transaction was not entirely fair from the defendant to the plaintiff.[27]

In *Kahn v. Lynch*,[28] the minority shareholders of Lynch Communications were frozen out by Alcatel. The Lynch board of directors had established a Special Committee of independent directors to negotiate the deal. Alcatel initially offered $14 per share and the Special ***947** Committee requested $17 per share. Finally, the Special Committee recommended, and the board endorsed, a price of $15.50 per share after Alcatel had threatened to initiate a hostile tender offer for a lower price. The court held that the Special Committee was not truly independent because it did not have the power to say "no" in the face of Alcatel's threat and remanded the case for entire fairness review with the burden on the defendant. The *Kahn* court also implicitly decided that the establishment of a Special Committee only reverses the burden of proof for the entire fairness review and does not reduce the standard of judicial review to business judgment.[29]

A second way to remedy the conflictedness of the share price negotiation is to get approval by a majority of the minority shareholders (*MOM approval*). The underlying logic of this approach is that the minority shareholders are acting on their own behalf (there is no principal-agent conflict), and therefore the approval of a majority of the affected shareholders should serve as an indication of an arm's length negotiation. After *Weinberger*, it was unclear if Special Committee negotiation and MOM approval would both need to be fulfilled to establish fair dealing, but the *Kahn* court clarified that either requirement would suffice. In *Rosenblatt v. Getty O il Company*,[30] the deal was approved by a 58% majority of the 89% of minority shares that were voted. As in *Kahn*, the court decided that MOM approval would reverse the burden of showing the (lack of) entire fairness to the plaintiffs, but it did not defer to business judgment review.

As Guhan Subramanian notes, there is no incentive for the controlling shareholders to establish a Special Committee and subject the freeze-out to a MOM approval,[31] as the combination of both measures does not yield any additional benefit to them.[32]

III. The Tender Offer Freeze-Outs

In response to the high standard of review exemplified by *Weinberger*, beginning in the 1990s the statutory merger was complemented by a novel freeze-out technique: The two- ***948** step freeze-out tender offer. Using this route, the controlling shareholder would first make a tender offer for all of the minority shares, usually conditioned on a tender that gets at least 90% of the total amount of voting shares. Next, the controller would effect a short-form merger pursuant to DGCL Sec. 253, which does not require a shareholder vote, in order to eliminate the remaining (non-tendering) shareholders.[33]

This technique became attractive after the Delaware Supreme Court held in *Solomon*[34] that a tender offer by a controlling shareholder to the minority (without freeze-out) was not subject to entire fairness control. This was contrary to the then common understanding that such a tender offer is an interested transaction. This view emphasizes the fact the board of directors of the target company negotiates the terms of the offer with the controlling shareholder.[35] The court, however, saw no conflict of interest, reasoning that the parties to the tender offer are the controller and the minority shareholders.[36] In other words, the minority shareholders cannot be forced to agree to the deal.

In *Siliconix*,[37] the Court rejected the application of the entire fairness review on the front-end tender offer of the two-step freeze-out in the absence of disclosure violations or a coercive offer. Shortly thereafter, the Court rendered judgment on the back-end short-form merger in a freeze-out transaction in *Glassman*,[38] where it also declined to apply an entire fairness review, noting that **appraisal** is the appropriate remedy for minority shareholders objecting to short-form mergers. The overarching policy argument for this lax standard of review was the *ratio legis* of DGCL Sec. 253: To provide a streamlined process for accomplishing a merger, which would be undermined if too many procedural safeguards were required.[39]

In the final case of interest for this analysis, *In re Pure Resources, Shareholders Litigation,*[40] Unocal, the controlling shareholder of Pure, launched a share-for-share tender offer on the common stock of its subsidiary, conditioned on reaching the 90% threshold necessary for the short-form merger. Unocal stated that it would proceed to the merger as soon as possible after completion of the tender offer, at the same exchange ratio as the front-end ***949** offer. The Special Committee instituted by Pure briefly considered the implementation of a *poison pill* to increase its bargaining power but ultimately only recommended the minority shareholders not to tender their shares. The plaintiffs filed a class action lawsuit and sought to enjoin the transaction based on entire fairness review.

The court declined to apply the entire fairness review but apparently attempted to close the gap between statutory merger and tender offer freeze-outs with the introduction of an additional requirement for the entire fairness review to be rejected. The tender offer shall not be coercive to the minority shareholders. Specifically, V ice Chancellor Leo Strine established three procedural conditions that must be met in order to defer to business judgment review: (1) the offer must be subject to a non-waivable condition of MOM approval; (2) the bidder must guarantee to promptly consummate a short-form merger at the same conditions as the tender offer regarding exchange ratio and/or share price; (3) and the bidder must make no “retributive threats” in dealing with the Special Committee.[41]

Strine’s efforts to introduce additional procedural requirements for tender offer freeze-outs have been aimed to remedy the fact that, in the tender offer situation, the minority shareholders lack a genuine bargaining agent. Whereas in the *Weinberger* line of cases, the Special Committee has the power to say “no,” the Special Committee in a tender offer situation only has the duty to make a recommendation to the shareholders. *Pure* therefore aims to increase the Special Committee’s bargaining power by setting out the framework for a fair bargaining procedure, and requiring robust engagement of the Special Committee instead of passivity. This leveling of the playing field shall serve to prevent the controller from making low-ball offers to the minority.[42]

IV. Practical Consequences

It was noted, however, that these conditions were already met in most tender offer freeze-outs even before *Pure* was decided, and that they would thus have little practical impact.[43] The unequal treatment of statutory merger freeze-outs and tender offer freeze-outs has been widely debated, and many proposals on how to reconcile these apparently conflicting approaches to freeze-outs have been discussed. According to Subramanian,[44] one line of authors champions an equal treatment of both situations (“convergence up”) through ***950** (re)introduction of entire fairness review for tender offer freeze-outs.[45] Another group of commentators defends the status quo,[46] while a third one suggests mixed approaches.[47] This article is not the place to delve into this debate. For the purposes of this analysis it shall be sufficient to note a few points.

The Special Committee has significantly less bargaining power in a tender offer freeze-out than in a merger freeze-out. In the latter, the Special Committee can effectively veto the transaction, whereas in the former, the Special Committee serves only to make a recommendation to the minority shareholders within ten days of the initiation of the tender offer and in accordance with Schedule 14D-9. Subramanian has found in an empirical study that, as a consequence, the share premiums in merger freeze-outs have been higher than in tender offer freeze-outs.[48] The study also found that in the period between 19 June 2001 (announcement of *Siliconix*) and 31 December 2003, there had been 96 freeze-outs of listed Delaware corporations. The percentage of tender offer freeze-outs increased from 6% pre-*Siliconix* to 28% post-*Siliconix*.[49] The answer to the obvious question of why controlling shareholders did not (yet?) prefer the two-step freeze-out after Siliconix remains somewhat unclear, but may be explained by path dependency and lesser experience of legal practitioners with the two-step procedure.[50] There is, however, contrasting empirical evidence offered by Bates et al. which renders Subramanian's findings inconclusive on the hypothesis that minority shareholders get lower payments in tender offer freeze-outs.[51]

951** ***V. Brief Summary of Case Law and Conclusion

Freeze-out transactions in Delaware can be achieved by either statutory merger or front-end tender offer with subsequent back-end short-form merger. In contrast to the German system (discussed *infra*), there are no specific shareholding thresholds which the controlling shareholder must meet before a freeze-out can be executed. For a statutory freeze-out, a shareholder needs only as many voting shares to win the requisite shareholder vote by simple majority pursuant to DGCL Sec. 251 (which is the very definition of a controlling shareholder);[52] the controlling shareholding can thus be as little as 35%.[53] In case of a tender offer freeze-out, the controlling shareholder does not need to have any shares before the launch of the tender offer. Here, the relevant threshold is that the controller needs to own 90% of all outstanding shares after consummation of the tender offer in order to meet the threshold for application of the short-form merger statute.

Delaware law does not provide for any specific procedural safeguards to protect the interests of minority shareholders during the freeze-out.[54] The protective framework has been developed by the judiciary on the premise that freeze-outs are self-dealing transactions because the controlling shareholder has the power to influence the board of directors, which negotiates the purchase price of the shares on behalf of the minority shareholders (in case of a statutory merger freeze-out). Shareholders can therefore bring claims against directors based on breach of a fiduciary duty when they think the negotiating process or the negotiated share price was not fair. The Delaware courts will scrutinize the entire fairness of the transaction with the burden on the defendant, unless (1) a Special Committee comprised of truly independent directors with the power to say "no" had been established which negotiated the deal on behalf of the board; or (2) if the deal was sanctioned by a majority of the minority shareholders, in which cases the burden will be on the plaintiffs to show that the transaction was not entirely fair. The rationale for these two exceptions is that they approximate the conflicted transaction to an arm's length transaction, either because an (at least formally) independent actor negotiated the deal, or because the conflicted transaction was put to a market test by way of the minority shareholder approval.

The rendering of the *Siliconix/Glassman* judgments marked the advent of the two-step tender offer freeze-outs. The Delaware courts did away with entire fairness review in ***952** tender offers, applying the deferential business judgment review and decided that the ratio of the short-form merger--providing a streamlined process for parent-subsidiary mergers--excluded entire fairness review of its terms. *Pure* confirmed this new doctrine and marginally increased the minority protection in two-step freeze-outs by requiring that the transaction may not be coercive.

The Delaware freeze-out regime therefore relies on an *ex post* court review that is regularly initiated by a class action of minority shareholders, based on breach of fiduciary duty by either the board of directors, or the Special Committee which negotiated the deal with the controlling shareholder. These procedural safeguards to protect the minority shareholders in Delaware were entirely evolved in the courtroom. It has been suggested that this fact may facilitate the development of management-friendly rules, because "case-law precedents are relatively free from interest group influence," and management is in a good position to control which litigation will be decided by the courts.[55]

VI. The Appraisal Remedy

In cases where entire fairness review is not available (such as in tender offer freeze-outs) the minority's only remedy is **appraisal** pursuant to DGCL Sec. 262. *Prima facie*, one might think that the **appraisal** remedy is actually more beneficial to the plaintiff than a breach of fiduciary duty claim, as the former does not require the showing of such a breach.[56] The **appraisal** remedy, however, is a less capable remedy for several reasons. First, "**appraisal** is not available to minority shareholders in the approximately 20% of tender-offer freeze-outs that involve stock consideration"[57] because of the "market-out" exception.[58] Second, unlike an **appraisal**, a fiduciary duty action can be brought before the effectuation of the merger and may result in a preliminary injunction, which potentially increases the plaintiff's bargaining power in settlement negotiations.[59] Third, fiduciary claims can be and mostly are brought as class actions, in which the legal fees are mostly paid from the settlement or the target company.[60] Lastly and most importantly, whereas the class in a fiduciary claim can consist of all public shareholders of the corporation,[61] the **appraisal** can only be ***953** pursued by shareholders who contested the cash-out.[62] The **appraisal** remedy, therefore, is considered to be "notoriously weak"[63] among scholars and practitioners. Consequently, minority shareholders seldom initiate **appraisal** proceedings.[64]

From a more doctrinal perspective, it should be noted that **appraisal** **rights** were originally introduced by the state legislatures between 1900 and the 1950s in response to the fact that mergers which initially required unanimous consent by all shareholders were now possible with approval of a simple or qualified majority of shareholders.[65] The purpose, therefore, was to give dissenting shareholders in arms-length mergers a possibility to leave the company at a fair price when the capital markets were not yet as well developed as today ("liquidity purpose").[66] The **appraisal** statute was never designed for self-dealing situations like a cash-out by a controlling shareholder, and as such, it is not a very effective remedy in this respect.

D. History and Development of the Legal Framework for Squeeze-Outs in Germany

The squeeze-out rules in Germany are fairly young. They came into force at the beginning of 2002 through an amendment of Sec. 327a-327f of the German Stock Corporation Act (Aktiengesetz--"AktG").[67] Before that, there was no direct way for controlling shareholders to freeze out the minority. The German Transformation Act (Umwandlungsgesetz) of 1934, however, had introduced a so-called "transferring conversion," through which the controlling shareholder, if she owned at least 90% (later reduced to 75%) of the share capital of the subsidiary, could transfer all assets of the subsidiary company into another entity and thereby freeze out minority shareholders against their will.[68] But this measure had been abolished in 1994[69] because the exclusion of minority shareholders against their will was considered to be contrary to the ***954** government's aims of minority protection.[70] Since then, business lobbyists pointed out that a squeeze-out procedure is necessary.[71] Between 1994 and the implementation of the squeeze-out rules in 2002, the controlling shareholder could initiate one of several structural transactions which could indirectly lead to the exclusion of minority shareholders, such as a reverse stock split or a sale of all assets, but these transactions were onerous, might have had unwanted implications, and because of the lack of clear rules, there was generally some uncertainty about the level of minority protection in these transactions.[72]

Until the introduction of the squeeze-out rules, the most relevant of these measures was the "transferring conversion" (übertragende Auflösung),[73] by which a company sells and transfers all of its assets to the controlling shareholder or a subsidiary of the controlling shareholder and is subsequently dissolved and liquidated. This procedure requires shareholder resolutions with a 75% majority of the share capital of the company[74] and has been confirmed as a valid way to exclude minority shareholders, provided that a "full economic compensation" of the excluded minority is ensured and legally enforceable.[75] The transferring conversion, however, entails several disadvantages which render it undesirable in many cases. First, it can lead to the disclosure of hidden reserves with detrimental tax effects. Second, the asset transfer is a complex and laborious exercise and the following liquidation may take up to several years. Finally, the shareholder resolution to sell and transfer all assets of the company can be enjoined on the grounds that the consideration is not adequate (fair market value).[76]

***955** Hence, the introduction of the squeeze-out rules in 2002 was welcomed by many practitioners and academics. The enactment of the European Takeover Directive[77] required Germany to allow for a specific squeeze-out procedure following a tender offer.[78] Instead of adjusting the general squeeze-out procedure to the requirements of this directive, the German legislature decided to leave the general squeeze-out rules untouched and to introduce a second squeeze-out regime which applies following a tender offer ("Takeover Squeeze-Out") pursuant to Sec. 39a and 39b WPüG. The Takeover Squeeze-Out aims to allow for a more expedient and cheaper way to exclude the residual shareholders.

E. The General Squeeze-Out Mechanism in Germany

I. General Procedure

In the following, I will set out the particular requirements and steps that need to be fulfilled to achieve a squeeze-out pursuant to Sec. 327a-f AktG.

1. Supermajority of Share Capital

The squeeze out procedure is available to all shareholders holding 95% or more of the share capital and can be initiated by the controlling shareholder through a shareholder resolution at a general meeting (Sec. 327a(1) AktG). The shareholdings of controlled subsidiaries in the target are attributed to the controlling shareholder in calculation of the 95% threshold (Sec. 327a(2), 16(2) and (4) AktG), so the top company of a group of companies does not need to hold all shares itself in order to reach the threshold.

Recently, the German Federal Court in Civil Matters (Bundesgerichtshof-- "BGH") has also heard and condoned a case in which the controlling shareholder originally only owned 63% of the outstanding shares and later acquired an additional 33% of shares through a securities loan.[79] According to German law, a securities "loan" entails a transfer of title, but the lessor has the right to the transfer of title in stock of the same kind after termination of the loan agreement. In the case at hand, the loan was not to be terminated before the passage of three years, and the lessor kept her dividend rights. The decision was surprising and contrary to the views of many scholars, which had argued until then ***956** that a squeeze-out was abusive and therefore impermissible if the controller acquired stock above the 95% level only in the short term with a view to the squeeze-out.[80] This judgment has significantly eased the burden of the 95% shareholding threshold and appears to allow a controlling shareholder to combine his shareholdings with other block shareholders in order to meet the threshold.

2. Shareholder Resolution

The controlling shareholder has to ask the management board of the corporation to convene a shareholder meeting and propose the squeeze-out.[81] The requirement of a shareholder resolution can be seen as a peculiarity[82] of the German system. After all, what is the purpose of such a resolution if the controller must own a minimum of 95% of the share capital? Consequently, the requirement of a shareholder resolution was criticized heavily from the beginning.[83] The resolution seems to be an empty formality that gives the minority shareholders one last chance to obstruct the controlling shareholder through an action to enjoin the resolution.[84] Consequently, other European jurisdictions like the U.K., France, Italy, or the Netherlands do not require a shareholder resolution.[85]

The requirement of a shareholder resolution, however, is mainly a means to ensure that the minority shareholders get full disclosure about all relevant details of the squeeze-out and therefore serves the same purpose as SEC Rule 13e3. In preparation of the general meeting, the management board of the corporation must provide the shareholders with various information about the squeeze-out. The convocation to the general meeting must include the agenda to the meeting and must be received by the shareholders no later than ***957** 21 days before the meeting (Sec. 120 AktG). The agenda must already include the amount of cash compensation as determined by the controller (Sec. 327c(1) AktG).

The controller must make numerous documents pertaining to the squeeze-out available to the minority shareholders for inspection, among them the annual financial statements for the three previous financial years, a written report by the controller, and an audit report[86] (Sec. 327c(4) AktG). All these requirements aim to ensure that the minority shareholders can make an informed decision and that the squeeze-out can be subject to a comprehensive discussion at the general meeting.[87]

Informing the shareholders, however, could also be achieved without shareholder resolution. It appears that the requirement of a shareholder resolution is in the tradition of the procedure for other structural measures, but in cases involving squeeze-outs, it is just a superfluous formality.

3. Written Report and Auditor's Report

The adequacy of the cash compensation shall be ensured *ex ante* (before the squeeze-out takes legal effect) by two means: A written report of the controlling shareholder and a report of an independent auditor regarding the adequacy of the cash compensation (Sec. 327c(2) AktG), which in practice will often be one of the Big Four auditing firms.

Particularly the auditor's report appears to be another peculiarity of the German system.[88] The auditor is appointed by a court, although the controlling shareholder can make suggestions which will often be heeded by the court in practice.[89] The auditor has the duty to execute an impartial audit of the cash compensation offered by the controlling shareholder and to render a written report.

The rationale of the independent audit is threefold: It aims to (1) protect the interests of the minority shareholders; (2) increase their willingness to accept the cash compensation and thus reduce the number of claims against the valuation; and (3) facilitate subsequent lawsuits.[90] Considering the empirical evidence on the number of lawsuits regarding the valuation it is questionable whether the latter two aims have been achieved, though.[91]

958** ***4. Legal Effect Through Registration in the Commercial Register

The transfer of the minority shares to the controlling shareholder takes legal effect with the registration of the squeeze-out in the commercial register (Sec. 327e(2) AktG). This is not just a mere formality, as the competent register judge has to scrutinize the squeeze-out procedure before registration. This is a formal inspection, so the register judge may not contest the adequacy of the cash compensation.[92]

The registration, however, requires that no lawsuits to enjoin the squeeze-out resolution have been filed (Sec. 327e(2), 319(5) AktG). In principle, the registration is blocked as long as any lawsuits concerning the validity of the squeeze-out procedure are pending. This rule potentially gives minority shareholders the power to block the consummation of the squeeze-out procedure for months or possibly years.[93]

II. Empirical Data on the Practical Application of the General Squeeze-Out

The general squeeze-out procedure has very quickly become popular in Germany. In 2002 alone there already had been more than 100 squeeze outs executed; and this number increased to 289 by May 2007[94] and to 317 by the end of 2007.[95] About 70% of these companies were listed on a stock exchange.[96] The initial surge in squeeze-outs right after its introduction into the German legal system can be attributed mainly to cases in which a shareholder with an overwhelming majority (above 98%) wanted to streamline its holding structure, but did not have the legal means to do so before the enactment of the squeeze-out rules.[97] This process now seems to be mostly completed, shifting the focus of squeeze-outs to those following a control transaction.

However, there are also 27 listed companies which could have been subjected to a squeeze-out for several years--because a controlling shareholder owns more than 95% of their stock--but in which nothing has happened. This may be a sign that controllers have analyzed the costs and benefits of a squeeze-out and concluded that the future efficiency gain does not offset the squeeze-out costs.

***959** 141 of 260 (54%) of the general squeeze-out transactions have become legally effective through registration with the commercial register within three months, while the average time for registration was five months. However, a significant number of squeeze-outs (57 of 317 (18%) squeeze-outs in Stange’s analysis) have not been registered yet (presumably because of actions to enjoin the squeeze-out).

137 of the 317 (43%) companies were not listed on any stock exchange. This shows that a demand for squeeze-outs also exists for non-listed companies. Out of the 180 listed companies that were subject to a squeeze-out, 62 (34%) had been involved in a tender offer beforehand.[98] The average time between the tender offer and the squeeze-out was 17.3 months.

III. Constitutionality Issue: Property Right Infringement?

The introduction of the squeeze-out regime was accompanied by many comments which voiced concerns about its constitutionality in light of the protection of property pursuant to Art. 14 of the German Basic Law (Grundgesetz--“GG”). Almost all lawsuits to enjoin specific squeeze-outs in the first years claimed the unconstitutionality of the measure.[99] According to the German Constitutional Court (Bundesverfassungsgericht--“BVerfG”), Art. 14 GG protects the economic rights and corporate membership rights of the shareholders.[100] That means that the BVerfG considers share ownership to be real property and not just a capitalized stream of income. Nevertheless, the BVerfG has ruled as early as 1962 that the limitation of the property right of minority shareholders (through the squeeze-out regime, for example) is justified by a legitimate interest to provide entrepreneurial freedom to investors, provided that the minority shareholders are adequately compensated. The court emphasized that the adequate compensation must be effectively protected. The squeeze-out regime provides several safeguards to ensure an adequate compensation of the minority:[101] (1) the cash consideration is scrutinized by a court-appointed auditor; (2) the controlling shareholder has to procure a bank guarantee to secure the claims of the shareholders to be excluded (Sec. 327b(3) AktG); and (3) the minority shareholders can file a claim to enjoin the squeeze-out or initiate an **appraisal** procedure. Drawing on its reasoning in earlier cases, the BVerfG explicitly declared the ***960** squeeze-out regime to be constitutional in 2007.[102] The court emphasized that the three essential prerequisites for constitutionality were fulfilled, namely an adequate compensation of the minority shareholders, effective legal remedies, and a legitimate interest in the exclusion of the minority shareholders. Regarding this latter point, the court pointed out that controlling shareholders generally can have an interest in a squeeze-out to avoid the administrative costs a minority creates. This is because, in particular, since the 1980s, the number of lawsuits from predatory shareholders[103] with minimal share amounts which try to block structural corporate decisions to create a hold-out situation--which thereby increases their settlement value--has increased. The court finally also argued the required quorum of 95% ensures that only shareholders who have no realistic possibility of influencing the firm management get excluded, or in other words, only shareholders with a purely financial interest and not a strategic interest.

According to this reasoning it is unclear whether the BVerfG would still consider a squeeze-out to be constitutional if the required quorum were reduced to a number below 90%.[104]

IV. The "Adequate Compensation": How to Evaluate the Minority Shares

The squeezed-out shareholders have a right to "adequate compensation" (Sec. 327a(1)(1) AktG). That means that the controlling shareholder has to evaluate the company and explain the evaluation in the required written report to the shareholders. In practice, the evaluation is done through advice similar to a "fairness opinion,"[105] which is rendered by an ***961** external advisor (investment banks or audit companies), although in theory the controller could also do the valuation herself. In contrast to a fairness opinion, the written report is issued by the controlling shareholder, signaling that it is she who is ultimately responsible. An independent expert then audits the compensation offered by the controller in the written report.[106]

Four essential questions remain unanswered by academics: (1) Which valuation methodology is required?; (2) How should the reference period for the pre-squeeze-out stock price be calculated?; (3) Should the valuation be based on the company value or on the value of the specific minority shares?; and (4) Should the minority shareholders be benefitting from the synergies of an expected merger? I will address each of these questions in turn.

1. Valuation Methodology

The law does not provide guidance on the question of how a company is to be valued. Such guidelines, however, have been developed by case law in similar situations where minority shareholders are deprived of their "membership rights."[107] The commonly recognized[108] valuation method is the "Discounted Earnings Method" (Ertragswertmethode),[109] but the Discounted Cash Flow Method ("DCF") is getting ever more prevalent in practice.[110]

In pre-*Weinberger* Delaware, the courts used the *Delaware block* (or *weighted average*) method to determine the fair value of a company for **appraisal** purposes. This technique entailed a mix of factors including earnings, price/earnings multiples in the industry, asset ***962** values and shares' market prices. The DCF method was considered to be too speculative.[111] In *Weinberger*, the court conceded that the "mechanistic procedure" of the block method had been outdated and thus permitted any methods generally accepted in the financial community, so that DCF soon became the standard valuation technique in **appraisal** cases.

So the German situation appears to arrive at the situation that was already achieved in Delaware in the 1980s: DCF valuation as the prevalent valuation technique. Whether this is the desired result from the perspective of legal certainty remains unclear. As Allen, Kraakman, and Subramanian pointed out, DCF valuations create "exceptionally wide differences in value,"[112] so the Delaware courts have begun to appoint their own expert witnesses--in addition to the parties' expert witnesses--in **appraisal** proceedings and actions for entire fairness review.

2. Calculation of the Reference Period

The BVerfG has held in *DAT/Altana*[113] that for listed companies, the stock price provides the floor for the calculation of the adequate compensation, so that the compensation may never be lower than the stock price of the target company during a reference period of three months before the squeeze-out, even if the fairness opinion determined a lower value. The court reasoned that the exiting shareholders must be compensated at least as highly as if they had autonomously decided to divest on the stock market.[114]

The BGH, implementing the parameters outlined by the BVerfG in *DAT/Altana*, ruled that the three-month period had to be casted backward from the day of the general meeting of shareholders which would approve the squeeze-out, since Sec. 327b(1)(1) AktG requires that the compensation shall take into account the condition of the company at the time of the shareholder resolution.[115]

This decision, however, quickly became the target of strong criticism. A general meeting must be announced at least 30 days before the meeting (Sec. 123(1)(1) AktG) and from this date the proposed cash compensation amount must be published (Sec. 327c(3) AktG). As a consequence of the efficiency of capital markets, the stock market will quickly incorporate the information about the proposed compensation payment into the share price.

***963** Therefore from the date of the announcement the share price does not solely reflect the inherent value of the company anymore, but rather the expected discounted value of the compensation payment. In order to avoid this result it is necessary to cast the reference period backward from the date of the announcement of the squeeze-out. After extensive criticism from academics and many OLGs,[116] the BGH recently reversed its old judgment and decided to calculate the reference period from the date of the announcement of the transaction.[117] Most recently the OLG Frankfurt has further specified that the reference period starts at the time the management speaks publicly about the squeeze-out so that a reasonable person would expect it to happen in the near future.[118] That means the reference period can already start before an official announcement to the shareholders (convocation of general meeting). For example, if the CEO of the controlling shareholder speaks publicly about her intention to acquire 95% of the shares of the subsidiary and conduct a squeeze-out, at that time the capital markets will begin to impound the expectations about the squeeze-out into the market price. Such announcements, however, must be reasonably credible and the execution of the announced measure must be palpable, in order to distinguish relevant announcements from mere market rumors. For listed companies, the relevant announcement will often be the ad hoc disclosure pursuant to sec. 15(1) WpHG.[119]

The recent judgment of the BGH certainly was an important clarification for the **appraisal** of minority shares. This decision, however, introduced an additional rule for cases in which there is a considerable time-gap[120] between the public announcement of a squeeze-out transaction and the date of the shareholder resolution, during which the stock price ***964** develops further. In such cases, the court requires the calculated average stock price to be adjusted in accordance with the current market trends up to the date of the shareholder resolution. So if the market goes up between the end of the reference period and the date of the shareholder resolution, the calculated average price would need to be increased in proportion with the general market trend.[121] Unfortunately, the court did not give more specific guidelines on how to calculate such an adjustment, so this question seems to invite future **appraisal** claims.

3. Value of the Company or Value of the Minority Shares?

A rather theoretical issue that shall only be briefly discussed is whether the valuation should look at the total company value and give each leaving shareholder a fraction of that value, or if the specific value of the minority shares should be determined. The minority shares can in theory have a value different from the company value because each share is tradable on a stock market. Looking at the value of the minority shares could lead to a situation where the fewer minority shares there are, the more valuable they get, as their holdup value would increase. This would not make sense and would infringe the rule of equal treatment of all shareholders. The value of the whole company, therefore, has to be evaluated, and a respective fractional value has to be attributed to each share.

4. Pre-Squeeze-Out or Post-Squeeze-Out Valuation?

The exit of the minority shareholders leads to efficiency gains in the administration of the company which will positively influence the firm value. It is questionable whether the minority shareholders should benefit from such “squeeze-out gains” which are difficult to determine and quantify.[122] The main argument for factoring in the “squeeze-out gains” is the following: The minority shareholders cannot influence whether they leave the company in case of a squeeze-out. The unilateral determination of the compensation by the controlling shareholder serves as a substitute for an arms-length negotiation between the controller and minority.[123] If the minority had the chance to negotiate the sale of their shares, then they would take the squeeze-out gains into account. Arguably, the minority should not fare worse than in a negotiation which they were deprived of by the legislature by reason of making the squeeze-out procedure more effective.[124] However, the German ***965** courts rejected this reasoning in recent convincing judgments.[125] They argued that the squeeze-out gains are not part of the company at the time of the shareholders’ resolution (the relevant valuation date) and that the squeeze-out gains are a result of the squeeze-out and therefore could never have been realized by the minority shareholders had they continued to stay in the company. Further, the courts stressed that the recognition of squeeze-out gains would reduce the incentives of the controller to affect a squeeze-out. This could prevent controllers in some cases from initiating squeeze-outs that would be socially efficient. This may be true, for example, because the controller will, *inter alia*, consider the court costs of a subsequent **appraisal** proceeding (which are in most cases entirely borne by her) in her cost-benefit analysis of an envisaged squeeze-out. Squeeze-out gains are thus to be disregarded in the valuation of the minority shares.[126]

In the U.S. context a similar yet different problem exists. The German squeeze-out procedure can be implemented irrespective of a following merger, so that the question of whether the minority would also participate in the merger synergies does not arise. In Delaware, a cash-out of the shareholders is only possible in the context of a merger. The question therefore arises of whether the minority should participate in the merger synergies.

DGCL Sec. 262(h) clearly states that the valuation of these shares should not include such a premium: "[T]he fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger." In *Weinberger*, the court clarified that the fair value "is to include all elements of future value that were present at the time of the merger, excluding only speculative elements of value,"[127] thereby narrowing down the exception of DGCL Sec. 262(h) significantly.

The *Weinberger* approach seems to be consistent with the German regime. In both jurisdictions, the courts prescribe the valuation of the minority shares including future elements susceptible to determination at the date of the merger, but excluding the gains to be expected from the very measure they are compensated for (the exclusion of the shareholders).

966** ***V. Shareholder Remedies

Shareholders can bring two different kinds of lawsuits against a squeeze-out procedure: They can try to enjoin the whole transaction by claiming that certain aspects of the procedure were not in accordance with the law; or they can contest the adequacy of the cash compensation, which will be reviewed in a specific **appraisal** procedure. Both courses of action will be analyzed in turn.

1. Action to Enjoin Squeeze-Out

Every shareholder who contested a shareholder resolution during the general meeting of shareholders has the right to file a lawsuit to enjoin the execution of the resolution. German law distinguishes between the so-called action to void the resolution (Anfechtungsklage) pursuant to Sec. 243 AktG, and the so-called action for nullification (Nichtigkeitsklage) pursuant to Sec. 241, 249 AktG. The former action can be brought for every infringement of stock corporation law with respect to the content of the resolution or the procedure in the run-up to the resolution. This can occur within one month from the date of the resolution and as far as the shareholder has contested this resolution during the general meeting. The latter action is reserved for the most severe breaches of stock corporation law principles and can be brought without time limitation. A squeeze-out cannot be enjoined because of an alleged inadequate compensation of the minority.

The initiation of an action to enjoin creates significant hold-out leverage for minority shareholders, even if their suit would not ultimately succeed on the merits. As long as an action to enjoin is pending, the squeeze-out cannot be registered with the commercial register, and therefore the transaction cannot become legally effective.[128]

Recognizing this flaw and trying to improve the balance between minority and controlling shareholders, the legislature provided a "fast-track" procedure (Freigabeverfahren) to protect the controlling shareholder from (some of) the effects of frivolous claims or claims that the court otherwise considers to be of less relevance than the interest of the controlling shareholder in consummating the squeeze-out. The target company can apply for a court order to rule that the squeeze-out can be registered in spite of such actions to enjoin in certain cases,[129] such as: (1) when it is evident that the action is without merits; (2) the grounds for the action are de minimis compared to the interest of the company (and the controller) to finalize the transaction; or (3) when the plaintiff has owned less than ***967** EUR1000 in the share capital[130] of the company at the time of the announcement of the squeeze-out.[131] The fast-track procedure is not supposed to take longer than three months.[132]

In practice, however, the fast-track procedure is not always as efficient and quick as intended, and there remains a certain pressure on the controlling shareholder to settle all actions to enjoin. Therefore minority shareholders still have considerable hold-out bargaining power.

2. Appraisal Procedure

The **appraisal** procedure is governed by the **Appraisal** Procedure Act (Spruchverfahrensgesetz--"SpruchG") that was introduced in 2003 in order to increase the efficiency of **appraisal** proceedings.[133] Minority shareholders can initiate an

appraisal proceeding against the controlling shareholder within three months from registration of the squeeze-out resolution with the commercial register.[134] In contrast to the action to enjoin and the Delaware **appraisal** procedure, shareholders do not need to have opposed the merger during the general meeting at which the resolution was passed. The **appraisal** has a class character insofar as the judicial determination of the adequate compensation is binding on all minority shareholders (*erga omnes* effect), including those who accepted the original compensation offer.[135] The court appoints a shareholder representative in order to duly represent the interests of the class of minority shareholders who are not direct claimants in the proceeding.[136] In practice this will be a representative of an investor protection organization. The presence of the representative shall prevent the controlling shareholder from buying out the plaintiffs with a high settlement to the detriment of the minority shareholders not participating in the **appraisal**. Should that situation occur, the representative would have the right to continue the **appraisal** proceeding.

***968** The downside of the **appraisal** procedure is that the dire prophecies regarding the expected wave of **appraisal** proceedings[137] came true. 214 of the 317 (68%) squeeze-outs from 2002 until the end of 2007 resulted in the initiation of an **appraisal** proceeding.[138] Another concern is the length of the proceedings. One of the goals of the SpruchG was to reduce the length of time **appraisal** proceedings take. Yet there has only been an insignificant improvement in the length of proceedings. Before promulgation of the SpruchG the average proceeding lasted for over five years, but today the average time for proceedings not terminated by settlement is still over three years.[139] A likely important factor regarding the length of the proceedings was that until recently, the cheap interest rate on the possible liability of the controller was only 2% (uncompounded) above the “base rate” (Basiszinssatz)[140] of the German Federal Bank[141]--a price well below the cost of capital of any corporation, which gave the controller an incentive to stall the proceeding for as long as possible. The legislature, meanwhile, has recognized this deficiency and has increased the interest rate to 5% above the base rate of the German Federal Bank.[142]

3. Empirical Data Regarding Shareholder Remedies[143]

Shareholders initiated lawsuits to enjoin the transaction in 107 out of 317 cases (34%). Since 2005, the number of such lawsuits has risen to 60-70% of all squeeze-outs; whereas almost all squeeze-outs of listed companies are being challenged.

In cases in which the squeeze-out was not contested, the registration of the squeeze-out resolution in the commercial register took an average of 68 days (median 54 days). However, the contested squeeze-out resolutions took an average of 286 days (median 240 days) for registration. This clearly shows the hold-out leverage which contesting shareholders can acquire. That the difference is not even more severe is owed to the fact that the overwhelming majority of lawsuits are settled--and thereby the contesting shareholders’ compensation is increased. Even after settlement of the suit to enjoin, in many cases the minority shareholders go on to initiate an **appraisal** proceeding.

***969** **Appraisal** proceedings were brought against 214 of the 317 squeeze-outs (68%). The **appraisal** proceedings ended by court decision lasted an average of 37.9 months (median 39 months). Including the cases that were settled, the disputes lasted an average of 31.4 months (median 30 months). 50-75% of the **appraisal** proceedings were settled.

F. Takeover Squeeze-Out

I. General Remarks

The new Sec. 39a-39c WpÜG regarding the Takeover Squeeze-Out have been in force since July 2006. Germany was required to transpose the EU Takeover Directive into national law, but German scholars were also of the opinion that the legal practice was awaiting a streamlined squeeze-out process for takeover situations.[144] The German legislature decided to introduce a new instrument separate from the general squeeze-out pursuant to Sec. 327a et seq. AktG instead of integrating the takeover situation in the framework of the general squeeze-out. Both forms of squeeze-out are non-exclusive, meaning that in a takeover situation the controller can choose freely between both procedures.

II. Scope of Regulation

The Takeover Squeeze-Out is only available when the relevant shareholding threshold of 95% is reached through a mandatory tender offer or a voluntary offer launched by a non-controlling shareholder to obtain 100%[145] of the target stock.[146] That means that, for example, a controller who owns 51% of the target stock and wants to acquire additional shares (stock-up) cannot take advantage of the Takeover Squeeze-Out.[147] The reason is that the Takeover Squeeze-Out was introduced to compensate the acquirer of a control stake for the cost and effort she incurs through the takeover regulation, and this rationale is not present in stock-ups.[148]

970** ***III. Determination of Adequate Compensation

As is the case in the General Squeeze-Out, the controller has to adequately compensate the minority shareholders. The compensation shall have the same form as the consideration in the preceding tender offer; in case of a share for share tender offer the acquirer shall also offer cash compensation.[149] The acquirer will regularly ascertain the amount of compensation by way of fairness opinion.[150] In order to facilitate the Takeover Squeeze-Out, Sec. 39a(3)(4) WpÜG presumes that the compensation is adequate if the bidder has acquired more than 90% of the share capital included in the triggering tender offer. That means that the presumption applies if at least 90% of the outstanding shares are tendered. Such a market test indicates that the offer was fair.

It is hotly disputed whether this presumption is rebuttable or unrebuttable by contesting minority shareholders. The legislature initially wanted to create an unrebuttable presumption for the sake of an efficient procedure.[151] However many legal commentators raised concerns that such a rule, which deprives contesting minority shareholders of the possibility of legal recourse, would infringe the protection of property by the German Constitution (Art. 14 GG),[152] the European Convention of Human Rights, and the European Takeover Directive.[153] It was argued that legal redress must be possible at least in exceptional cases, such as insider dealing or securities fraud by publication of misleading information.[154] However the prevailing opinion prioritizes the public interest in an efficient procedure that cannot be stalled after it has passed the market test.[155] Proponents of this view emphasize that market manipulations in these cases are all punishable by law and that empirical evidence from the UK suggests that such cases would be extremely rare, and should not be the reason to prevent an efficient squeeze-out regime.[156] This issue has not yet been decided by the BGH, though.

***971** From a doctrinal perspective it is very remarkable that the public interest in an efficient procedure is given priority here, as German courts and scholars generally attribute superior importance to the human right to an effective judicial review (Art. 19(4) GG), which is construed very broadly. However I support the view that the presumption should be unrebuttable with the arguments set out above--a majority of the minority of 90% is a very high burden. This market test substitutes the procedural protections that otherwise prevail in German law. From a comparative perspective, it must be conceded that this situation is similar to the one decided in *Rosenblatt*,[157] where the Delaware court considered MOM approval to be sufficient to shift the burden of showing the fairness of the transaction, but insufficient to defer to business judgment review. However, the Delaware MOM approval requirement is already fulfilled at the level of a simple majority (>50%), whereas Sec. 39a(3)(4) WpÜG requires at least a 90% majority. This yardstick is sufficiently high to justify a complete deference to the market test.

If less than 90% of minority shareholders tender their shares, then the adequacy of the share price will be determined by the court. Yet the law does not set out specific procedures about how to determine the value. Legal practitioners fear the imponderability of this procedure, which has not yet been applied in practice, and so they avoid the Takeover Squeeze-Out in the vast majority of cases where a 90% MOM approval of the minority is uncertain from an *ex ante* perspective.[158]

IV. Legal Effect by Court Decree

In the interest of an efficient procedure the Takeover Squeeze-Out--in contrast to the general squeeze-out--does not require a shareholder resolution approving the transaction. Instead, if the shareholder owns at least 95% of the voting share capital of the target company, she can file a motion with the court to apply for the transfer of the remaining outstanding voting shares.[159] The substitution of the shareholder resolution with a court procedure is sensible. The shareholder resolution would be a pure formality and almost all squeeze-outs are contested in court anyway.[160] The minority shareholders may file a motion and have the right to be heard, although the court may decide to do so in a written procedure without oral arguments.[161]

***972** The squeeze-out becomes legally effective once there is no further legal recourse against the court decree ordering the transfer of the minority shares to the controller. This is the case when the time for appeal has elapsed or when OLG Frankfurt denies the appeal.[162]

V. Empirical Data on the Practical Application of the Takeover Squeeze-Out

Although the Takeover Squeeze-Out option has been available for six years, there are only four known cases in which the procedure has been invoked.[163] One reason could be the uncertainty regarding the procedure which is inherent in untested laws. Most importantly, the law does not specify how the adequacy of the compensation shall be evaluated if the 90% threshold is not reached.[164] Because the legal effect of the Takeover Squeeze-Out is pending until the final determination of the adequacy of the offer price by the court, the legal practice is wary of a possible never-ending procedure, and therefore favors the general squeeze-out procedure, which becomes legally effective at an earlier stage, namely with registration of the transaction in the commercial register.[165]

G. Analysis

I. Convergence or Path Dependence?

US law and German law on freeze-outs have the same goal: To protect the minority shareholder from the risk of an unfair treatment by the controlling shareholder when they are cashed out. Despite this common goal and a global tendency of convergence of corporate laws,[166] I submit that this is not an area of the law where the prophecy of "the end of history for corporate law" will hold completely true. While the general lines and ideas of how to protect minority shareholders will continue to converge--for example, the idea of MOM approval or the idea of a facilitated cash-out for controllers owning at least 90% of a company--many of the formal aspects of the freeze-out procedure will remain different in the two analyzed countries. More specifically: The rules governing freeze-outs in Germany and the U.S. were developed on the basis of different roots and traditions in the respective legal systems and, more specifically, their corporate laws. American law has ***973** a tradition for preferring to defer the resolution of issues to market forces instead of regulatory intervention. Germany (and Continental Europe, more generally) has the tendency to regulate possible issues between market participants by laws and regulations. This dichotomy is also recognizable in the different approaches of U.S. and German law towards the regulation of freeze-outs. The American system uses a system of *ex post* protection: The controlling shareholder can cash out the minority, but at the risk that they can (and will) bring fiduciary duty claims to force an entire fairness review of the transaction. The specter of class action litigation is supposed to induce the controller and the board of directors of the target company to negotiate a fair cash-out price. The requirement of having a truly independent Special Committee to negotiate the deal with the controller in order to release him from the burden of showing the entire fairness of the transaction shows that US law aims to remedy the conflict of interest with the simulation of an arms-length transaction.

The German system, in contrast, relies on *ex ante* procedural safeguards on the squeeze-out procedure through the introduction of third parties, which impose checks and balances on the controller. The most notable of these checks and balances are the requirements that the cash-out price be audited by an independent expert, and that the transaction must be registered in the commercial register, which checks that all formal requirements of the procedure have been complied with (a *gatekeeper strategy*).[167] The high threshold of 95% shareholding to cash out the minority is also based on the European tradition of seeing share ownership as essentially equivalent to real property, instead of just as a financial security to invest in capital markets. Although German courts have meanwhile recognized that shareholders owning 5% or fewer shares in a corporation are purely financial investors,[168] the German jurisprudence still does not seem to have arrived at quite the liberal capital market definition of share ownership that prevails in the U.S.

The different approaches of US and German law towards freeze-outs therefore seem to be a result of path dependency,[169] which limits the extent to which future convergence of these systems can be expected.

***974** *II. The Uselessness of Fairness Opinions and "Independent" Audits, or Why the Fair Cash-Out Price Is Ultimately Determined by the Court*

Both approaches to ensure a fair cash-out price work well, but also have deficiencies. What is striking is, for example, that in both jurisdictions, practically every freeze-out gets challenged in court, either by fiduciary duty action in Delaware or by **appraisal** action in Germany, so that the final arbiter in practice is always the court, which regularly will appoint yet another auditor to evaluate the fair cash-out price. This result seems to be inevitable. There is bound to be at least one shareholder who is willing to take on the risk of losing in court in exchange for the chance that the court determines a higher cash-out price. This situation is reinforced by the fact that the Delaware class action lawsuit automatically spreads legal fees among many investors, while in the German **appraisal** procedure the court fees are generally borne by the controller; the remaining legal fees are borne by the plaintiffs, but can be imposed on the controller for reasons of equity.[170]

Empirical evidence also suggests that the independent auditor in the German general squeeze-out procedure may not be truly independent after all. That is at least one way to explain Stange's findings that in many[171] cases the court ultimately determined a higher compensation than the independent auditor did. This result is not very surprising considering that the auditor's fees are paid by the controller. Of course, every auditor is bound by professional duties to act objectively, but although the auditor is ultimately appointed by the court, the court generally follows the suggestion of the controller.[172] Hence, the auditor may have an incentive to ingratiate herself with the management of the controller to improve their business relationship. Interestingly, this conclusion seems to be in line with New York's experience with independent court-appointed **appraisers** that they serve "no useful purpose but add considerably to the expense and time involved."[173]

Consequently, it seems sensible to abolish the requirements of shareholder approval and independent audit report in the general squeeze-out procedure and substitute it with a ***975** court procedure to determine the adequate compensation, as it is in the Takeover Squeeze-Out.

III. The German 95% Threshold

The threshold of 95% of the share capital that a controlling shareholder must meet in order to squeeze-out the minority exemplifies the fundamentally different approach that Germany takes towards cash-outs as opposed to Delaware, where every controlling shareholder can cash out the others. As already set out, I believe that this difference has its roots in the different perceptions of share ownership. The German view seems to be closer to the Delaware view of 1920 than it is to today's prevailing views in Delaware.[174] Whereas in Delaware a share is primarily a financial investment that should be secured, in Germany the share ownership is still viewed as being closer to real ownership.

However, Germany is not alone with its threshold requirement. Indeed, a recent study of EU squeeze-out procedures has shown that many European countries[175]--including the U.K.--have similar thresholds for squeeze-outs, ranging from 90%[176] to 95%.[177] This shows that the 95% threshold is an expression of a European legal tradition. Still, the threshold seems to be overly restrictive. German law provides for other measures that effectively cash out the shareholders and only require a shareholder resolution with a 75% majority. Management can sell all assets of the company and then dissolve the company.[178] However this procedure is rarely used in practice, *inter alia*, because shareholder actions challenging the price for the transfer of assets can delay the transaction significantly.[179] Another way of economically cashing out the minority is a peculiarity of German group law (*Konzernrecht*). The controller can implement a so-called domination and profit and loss transfer agreement (*Beherrschungs-und Gewinnabführungsvertrag*) with the subsidiary. The most salient effects of such an agreement are that (1) shareholders lose their right to dividend payments, which is substituted with a perpetual compensation payment;[180] (2) the subsidiary has to follow all instructions of the controller;[181] and (3) the balance-sheet ***976** profit or loss of the subsidiary is automatically attributed to the parent company, which allows for a tax consolidation at the parent level.[182] That means, *inter alia*, for the minority, that they economically cease to participate in the business risks and opportunities of the company, and that they instead receive a perpetual fixed rent payment as compensation. The implementation of a domination and profit and loss transfer agreement also only requires a shareholder resolution with 75% majority.

Consequently the German legislature should consider reducing the threshold for general squeeze-outs to 75%, as well. This demand seems particularly reasonable in light of the recent decision of the BGH, which allows crossing the 95% shareholding threshold by way of securities loans.[183] This judgment has already initiated the retreat from a strict application of the 95% rule. Yet for reasons of legal tradition, path dependency, and because of the question at which threshold the squeeze-out would run the risk of being qualified as unconstitutional by the BVerfG it is unlikely that the threshold will in fact be lowered below a 90% threshold in the near future.[184]

IV. The 90% Threshold in Merger Situations

In mid-July 2011, the German legislature enacted a law to streamline the squeeze-out procedure in connection with upstream mergers in group constellations.[185] If a controller intends to merge a subsidiary into itself, then a squeeze-out in connection with this parent-subsidiary merger shall only require a 90% ownership in the subsidiary (instead of the usual 95%).[186] Additionally, the merger shall not require a shareholder resolution of the target company. The German legislature felt compelled to adjust the applicable threshold in this specific case in order to conform with EU directive 2009/109/EC,[187] but decided against a ***977** general lowering of the threshold.[188] It should be expected that the limitation of these new rules to merger situations will not hamper their popularity. In cases where the controller does not want the subsidiary to be merged into herself, she can easily transfer her shares to an intermediary holding company and have the subsidiary merge into this holding company.[189]

The new German legislation bears a striking resemblance to the Delaware short-form merger pursuant to DGCL Sec. 253. Both instruments aim to provide to controlling shareholders who hold at least 90% of the shares of a company, a simplified procedure to merge with their subsidiary without needing to let the minority shareholders of the subsidiary participate in the equity of the controller. In this respect, the German squeeze-out system seems to converge towards the Delaware position.

It is noteworthy that the 90% threshold also emerges in many EU jurisdictions, as well as in Art. 15 of the European Takeover Directive. Across many jurisdictions, therefore, there seems to be a mutual understanding that a 90%-controller has legitimate interests to undertake a business combination, such as a merger, without participation of the minority in the new legal entity.

H. Conclusion

The analysis of German and U.S. freeze-out rules has shown profound differences, but also striking similarities. The similarities concern the 90% short-form merger and the tender offer freeze-out rules. The Delaware jurisprudence in *Pure* has been subjected to substantial critique,[190] as empirical evidence has shown that shareholders in statutory cash-out mergers get higher compensation on average than shareholders in tender offer freeze-outs. The German system also favors tender offer freeze-outs by requiring fewer procedural protections. As Ventoruzzo eloquently notes: “[T]he very fact that very different systems, moving from distinct perspectives and characterized by dissimilar law-making processes have converged toward a common framework is not only an interesting theoretical observation, but offers some support to the soundness of Delaware jurisprudence in *Pure* and its progeny.”[191] However, German rules require a 90% MOM ***978** approval, whereas *Pure* only requires a simple MOM approval, i.e. over 50%. It makes intuitive sense to believe that the increase of the MOM threshold would increase the value of the cash-out payment the controller will offer in order to get the required approval rate. Delaware should therefore not fall back to entire fairness review in tender offer freeze-outs, but rather increase the MOM approval requirement to a supermajority of e.g. 66%, if the legislature wants to increase payoffs of minority shareholders.[192]

For Germany, in contrast, it would be desirable to reduce the general shareholding threshold from 95% to 75% in order to make the squeeze-out rules more attractive and bring them into line with other corporate measures which achieve a similar economic effect to a squeeze-out. This would improve the consistency of the German legal system in this area and would eliminate the incentive to use other (more complex) measures to circumvent the high 95% threshold. It is submitted, however, that for the reasons set out above in Part G.III, this is unlikely to be realized in the near future.

Germany should also abolish the requirements for shareholder approval and an audit report by an independent expert in the general squeeze-out procedure in favor of a court procedure which will determine the fair cash-out compensation. The court is the place where this question will end up eventually, anyway.

In conclusion, we can see a tendency toward convergence regarding several specific elements of the freeze-out procedures, but also continued differences in the system which are owed to path dependency.

Footnotes

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[1] *Cf*. Guhan Subramanian, *Fixing Freezeouts*, (Harvard Law Sch. John M. Olin Ctr. for Law, Econ. and Bus., Discussion Paper No. 501, 2004); Marco Ventoruzzo, *Freeze-Outs: Transcontinental Analysis and Reform Proposals* 2 (European Corporate Governance Inst., Working Paper No. 137, 2009). In the U.S. legal system, the term *squeeze-out* is used to refer to measures--whether legal or not--which confer benefits from the corporation on the controlling shareholder to the detriment of the minority shareholder, thereby creating a *de facto* incentive for the minority shareholders to leave the corporation. *See id.*; HOLGER FLEISCHER, GROßKOMMENTAR AKTIENGESETZ Vor §§327a-f mn.4 (4th.ed. 2007). In Europe and in Germany, however, the term *squeeze-out* has been established as the equivalent of the term *freeze-out*. *Cf*. Council Directive 2004/25/EC, art. 15, 2004 O.J. (L 142) (EU); FLEISCHER at §327a. In the following, the term *freeze-out* will be used to describe general principles and in relation to U.S. law. The term *squeeze-out* will be used in relation to European and German law and never in relation to its ambiguous meaning in the U.S. legal system

[2] The terms *controlling shareholder* and *controller* are used interchangeably in this text

[3] As the state corporation law of the U.S. today is dominated by Delaware law, which is widely recognized as the most developed corporate law in the U.S. and which governs over 50% of U.S. corporations, Delaware will serve as a proxy for the U.S. for the purposes of this analysis. A reference to the U.S. in this article can therefore be understood as a reference to Delaware

[4] *See* Reinier H. Kraakman & Henry Hansmann, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001)

[5] *See In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002)

[6] A delisting is generally also possible without a freeze-out, but freeze-outs are a convenient way to achieve a delisting. The reduction of the number of shareholders to one means that no regular exchange trade is possible anymore, so that the admission to the securities exchange is void or will be revoked, depending on the regulations of the respective stock exchange. In Germany, such a measure which leads to the loss of the stock exchange admission is called "cold" delisting. FLEISCHER, *supra* note 1, at mn. 33

[7] *See* Ventoruzzo, *supra* note 1, at 6 (giving a more detailed overview and additional reasons like reducing agency costs and reducing the corporation's tax burden by increasing the debt-to-equity ratio because of the tax deductibility of interest payments)

[8] *Id*

[9] A reason for that may be the onerous obligations introduced with the Sarbanes-Oxley Act of 2002 in the U.S

[10] KOMMENTAR ZUM AKTIENGESETZ: AKTG §327(a) mn. 2 (Gerald Spindler & Eberhard Stilz eds., 2d ed. 2010); FLEISCHER, *supra* note 1, at mn. 8

[11] While in U.S. law *derivative* lawsuits are prone to be abused to extract exorbitant legal fees, in Germany *direct* shareholder claims tend to be used illegitimately

[12] *See infra* Part E.V.1

[13] The mandatory bid rule is required by Art. 5(1) of the European Takeover Directive and therefore exists in all EU jurisdictions. However, the applicable threshold was left to be determined by the Member States

[14] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begr RegE WpÜG, 14/7034, S. 32 (Ger.)

[15] This paragraph draws heavily on Subramanian, *supra* note 1, at 3

[16] DEL. CODE ANN. tit. 8, § 251 (2012)

[17] Singer v. Magnavox, 380 A.2d 969 (Del. 1977)

[18] Subramanian, *supra* note 1, at 3

[19] *Id*. at 4

[20] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)

[21] *Id*. at 711. [22] *Id*. at 709 n. 7. [23] Subramanian, *supra* note 1, at 7

[24] *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002)

[25] *See* Kahn v. Tremont, 694 A.2d 422, 428 (Del. 1997); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. L.J. 1287, 1308 (2001)

[26] *Cf. In re* Trans World Airlines, Inc. S'holders Litig., CIV. A. No. 9844, 1988 WL 111271 (Del.Ch. 1988) (unpublished decision)

[27] Citron v. E. I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990); Rabkin v. Olin Corp., 1990 WL 47648 (Del. Ch. 1990) (unpublished decision)

[28] Kahn v. Lynch, 638 A.2d 1110 (Del. 1994)

[29] Although the standard of review formally remains the same, it is noted by Rock, Davies, Kanda, and Kraakman that the standard as applied seems to be more lenient. *See Edward Rock, Paul Davies, Hideki Kanda & Reinier Kraakman, Fundamental Changes, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 183, 204 (Reinier Kraakman et al. eds., 2d ed. 2009)

[30] Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985)

[31] Subramanian does not mention that there is the benefit of marginally stronger transactional security: in case a court would find either one of the procedural safeguards deficient to reverse the burden of the fairness review, there would still be the other safeguard

[32] In *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604 (Del Ch. 2005), Chancellor Leo Strine apparently reacted to Subramanian's concern with the proposal (*obiter dictum*) to defer to business judgment review if both an independent Special Committee and MOM approval were established, as was already proposed in Subramanian's paper. *See* Subramanian, *supra* note 1, at

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[33] Subramanian, *supra* note 1, at 11

[34] Solomon v. Pathe Commc'ns, 672 A.2d 35 (Del. 1996)

[35] Ventoruzzo, *supra* note 1, at 26

[36] Subramanian, *supra* note 1, at 12

[37] *In re* Siliconix Inc. S'holders Litig., No. CIV. A. 18700, 2001 WL 716787 (Del. Ch. 2001) (unpublished decision)

[38] Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2001)

[39] *Id*. at 247. [40] *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421 (Del. Ch. 2002)

[41] *Id*. at 445. [42] Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. PA. L. REV. 785, 799 n.47 (2003)

[43] Christopher A. Iacono, Comment, *Tender Offers and Short-Form Mergers by Controlling Shareholders Under Delaware Law: The "800-Pound Gorilla" Continues Unimpeded--In re* Pure Resources, Inc., Shareholders Litigation, 28 DEL. J. CORP. L. 645, 668 (2003); Subramanian, *supra* note 1, at 51

[44] Subramanian, *supra* note 2, at 16-23

[45] Kimble Charles Cannon, *Augmenting the Duties of Directors to Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obligating Directors to Express a Valuation Opinion in Unilateral Tender Offers After Siliconix, Aquila, and Pure Resources*, 2003 COLUM. BUS. L. REV. 191 (2003); Ely R. Levy, *Freeze-Out Transactions the Pure Way: Reconciling Judicial Asymmetry Between Tender Offers and Negotiated Mergers*, 106 W. VA. L. REV. 305 (2004); Brian M. Resnick, Note, *Recent Delaware Decisions May Prove to Be "Entirely Unfair" to Minority Shareholders in Parent Merger with Partially Owned Subsidiary*, 2003 COLUM. BUS. L. REV. 253 (2003)

[46] Jon E. Abramczyk et al., *Going-Private Dilemma? Not in Delaware*, 58 BUS. L.J. 1351 (2003); Thomas M. McElroy, II, Note, In re Pure Resources*: Providing Certainty to Attorney Structuring Going-Private Transactions, or Not?,* 39 WAKE FOREST L. REV. 539 (2004)

[47] Gilson & Gordon, *supra* note 42; Subramanian, *supra* note 1

[48] Subramanian, *supra* note 1

[49] Subramanian, *supra* note 1, at 15

[50] Subramanian, *supra* note 1, at 10

[51] Thomas W. Bates et al., *Shareholder Wealth Effects and Bid Negotiation in Freeze-Out Deals: Are Minority Shareholders Left Out in the Cold?* 81 J. FIN. ECON. 707 (2006). Bates et al. observe that "on average, minority claimants in freeze-out bids actually receive approximately 11% more than their pro-rata share of deal surplus generated at the bid announcement, an excess distribution of roughly $6.1 million. These results are inconsistent with the notion that controlling shareholders systematically undertake freeze-out transactions at the expense of the minority claimants of the target firm." [52] At least in the absence of other control measures like influence on board members, shareholder agreements or special charter rights

[53] *See, e.g.*, *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531 (Del. Ch. 2003) (finding a 35% stockholder to be a controller)

[54] *See* Subramanian, *supra* note 1, at 48 n.226 (noting that the so-called "freeze-out statute," Del. Code Ann. tit. 8, § 203 (2007), is "generally not applicable to most 'real' freeze-outs")

[55] Paul Davies and Klaus Hopt, *Control Transactions*, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 232 (Reiner Kraakman et al. eds., 2d ed. 2009)

[56] WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 496 (3d ed. 2009)

[57] *See* Subramanian, *supra* note 1, at 24 n.133

[58] DEL. CODE ANN. tit. 8, § 262(b)(2) (2010)

[59] ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 56

[60] *Id.;* Subramanian, *supra* note 1, at 24 n.135

[61] ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 56; SUBRAMANIAN, *supra* note 1, at 24 n.136

[62] DEL. CODE ANN. tit. 8, § 262(d)(1) (2010)

[63] SUBRAMANIAN, *supra* note 1, at 24 n.137

[64] *Id*

[65] Ventoruzzo, *supra* note 1, at 11-13 nn.29-30, 34-35

[66] *See id*. at 13 (noting that this term was coined by Robert B. Thompson)

[67] Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und Unternehmensübernahmen [The amendment was introduced by the Act on the Regulation of Company Acquisitions and Public Offers to Purchase Securities], Dec. 20, 2001, BGBL. I at 3822 (Ger.)

[68] KRISTIAN STANGE, ZWANGSAUSSCHLUSS VON MINDERHEITSAKTIONÄREN (SQUEEZE-OUT)) 30 (2010)

[69] Gesetz zur Bereinigung des Umwandlungsrechts [UmwBerG] [Law to Clean up the Transformation Law], Nov. 11, 1994, BGBL. I at 3210, as amended by Gesetz [G], Jan. 1, 1995, BGBL. I at 428 (Ger.)

[70] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begründung zum Regierungsentwurf [Legislator's Explanatory Notes], 12/6699, 114 at 144 (Ger.)

[71] Eberhard Vetter, *Squeeze-Out in Deutschland*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1817, 1818 (2000)

[72] *Cf*. FLEISCHER, *supra* note 1, § 327(a)-(f) n.34, n. 39 (providing a detailed account of the direct and indirect possibilities to exclude shareholders)

[73] Also known as "sale of assets squeeze-out" or "Moto Meter method." [74] *See* Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at §§ 179(a), 262(1) no. 2 (Ger.)

[75] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case Nos. 1 BvR 68/95, 1 BvR 147/97, Aug. 23, 2000, 2001 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 279 (2001) (Ger.)

[76] Bayerisches Oberstes Landesgericht [BayObLGZ - Bavarian Higher Regional Court] Case No. 3Z BR 37/98, Sept. 17, 1998, 1998 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 2002 (1998) (Ger.); Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 8 W 43/93, Dec. 4, 1996, 1997 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 362 (1997) (Ger.). The arguably more suitable **appraisal** procedure is not applied by the courts

[77] *See* Council Directive, *supra* note 1 and accompanying text; Council Directive 04/25, art. 21, 2004 O.J. (L 142) 12, 23 (EC) (providing that, per Art. 21, the Directive was to be transposed into national law no later than 20 May 2006)

[78] The complementary sell-out right pursuant to Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at 3832 (Ger.); Council Directive 04/25, art. 16, 2004 O.J. (L 142) 12, 23 (EC) and § 39(c) respectively, are beyond the scope of this analysis

[79] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZR 302/06, Mar. 16, 2009, 180 BGHZ 154, 2009 (Ger.)

[80] *See, e.g.*, HOLGER FLEISCHER, *Das Neue Recht des Squeeze Out,* ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT (ZGR) 757, 758 (2002)

[81] *See* Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Aug. 24, 2004, BGBL. I at 2198, § 78 (Ger.) (noting that the management board is generally the competent corporate body to summon a shareholder meeting and set the agenda); *cf*. FLEISCHER, *supra* note 1, at § 327(a) n.57

[82] Christoph Van der Elst & Lientje Van den Steen, *Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-Out and Sell-Out Rights*, 6 EUR. CO. & FIN. L. REV. 391, 398 (2009)

[83] *Cf*. HARALD KALLMEYER, *Ausschluß von Minderheitsaktionären*, DIE AKTIENGESELLSCHAFT 59 (2000); Matthias Habersack, *Der Finanzplatz Deutschland und die Rechte der Aktionäre*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1230, 1237 (2001); Vetter, *supra* note 71, at 1819; Eberhard Vetter, *Squeeze-Out nur durch Hauptversammlungsbeschluss?*, DER BETRIEB 743 (2001); Maximilian Schiessel, *Ist das deutsche Aktienrecht kapitalmarkttauglich?*, DIE AKTIENGESELLSCHAFT 442, 452 (1999)

[84] These are the actions used by predatory shareholders as illustrated below. See *infra* text accompanying note 102

[85] *Cf*. Christoph Van der Elst & Lientje Van den Steen, *supra* note 82; FLEISCHER, *supra* note 1, § 327(a) n.64

[86] *See infra* Part E.I.3

[87] *Cf*. FLEISCHER, *supra* note 1, § 327(a) n.65

[88] Van der Elst & Van den Steen, *supra* note 82, at 430

[89] The controlling shareholder has a right of appeal if the court does not follow his suggestions pursuant to Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL I at §§ 327(c) ¶ 2, 293(c) ¶ 2 (Ger.)

[90] FLEISCHER, *supra* note 1, § 327(c) n.17

91 *See infra* Part E.IV.1-4

92 SINGHOF ET AL., *supra* note 10, § 327(e) n.4

93 *See infra* Part E.V.1

94 SINGHOF ET AL., *supra* note 10, § 327(a) n.4

95 STANGE, *supra* note 68, at 279. The following empirical data is taken from Stange unless otherwise indicated

96 SINGHOF ET AL., *supra* note 10, § 327(a) n.4

97 *Id*

98 *Id*. This number rises to 50% for the squeeze-outs conducted in the years 2004-2007. This rise can be explained by the fact that 2002 and 2003 a lot of companies with an over 95% shareholder took the opportunity to simplify their shareholder structure

99 MARTIN WEBER, *Die Entwicklung des Kapitalmarktrechts im Jahre 2006*, NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 3685, 3693 (2006)

100 Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvL 16/60, Sept. 7, 2011, 14 BVERFGE 263 (Ger.)

101 STANGE, *supra* note 68, at 84

102 Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvR 390/04, May. 30, 2007, 11 BVERFGK 253(Ger.)

103 "Predatory" or "professional" shareholders are those who own only a minimal amount of shares (often as little as one share) and then use lawsuits to enjoin important corporate structural changes to induce the company to "buy out" their claims at a settlement value that reflects their "hold-out" or "nuisance" potential and not any actual damages to the shareholder

104 A 90% quorum is sanctioned by the Takeover Directive and therefore unlikely to be held unconstitutional. See *supra* notes 77-78 and accompanying text

105 Fairness opinions and audit reports by an independent expert need to be distinguished in Germany. Fairness opinions are neither required nor regulated by law. They have been introduced into German practice through international M&A transactions with the U.S. (where the practice to use fairness opinions for reasons of legal prudence has been established since the seminal judgment in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)). Their aim is to help the management of a company to ascertain and prove the fairness of a determined price in an M&A transaction or other corporate transaction which requires the determination of a company's value. Managers therefore use fairness opinions "voluntarily" to reduce transaction and liability risks. Audit reports by independent experts, in contrast, are an element of many corporate structural measures (like squeeze-outs, mergers, capital increases by contribution in kind and similar measures) which are required by German law to ascertain a certain adequacy of the price or share exchange ratio offered (a "gatekeeper strategy"). The goals of fairness opinion and independent audit report are therefore not completely congruent. Moreover, the independent auditor must be a professional auditor (bound by professional rules) and is appointed by the court for the specific task. In contrast, the drafters of fairness opinions are not necessarily bound by professional rules and are directly chosen by the company. In practice, fairness opinions are done by investment banks, M&A advisors or audit companies. On the use of fairness opinions in Germany, see Klaus Cannivé and Andreas Suerbaum, *Die Fairness Opinion bei Sachkapitalerhöhungen von Aktiengesellschaften: Rechtliche Anforderungen und Ausgestaltung nach IDW S 8*, DIE AKTIENGESELLSCHAFT 317 (2011); Holger Fleischer, *Zur Rechtlichen Bedeutung der Fairness Opinion im Aktien-und Übernahmerecht*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 201 (2011)

106 *See supra* Part E.IV.1-4

107 Such cases are: Controlling entity executes a domination agreement, a profit transfer agreement, or both, with the target company (Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at §§ 291, 305) or so-called "integration" (this rare measure is different from a merger pursuant to German law) of the target company into the controlling entity (Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 320(b))

108 *Cf*. Oberlandesgericht Düsseldorf [OLG - Higher Regional Court], Case No. I-26 W 7/06, Apr. 10, 2006, 2219 WM 2222 (2006) (Ger.)

109 This appears to be a typically German valuation method. It is quite old and still commonly used pursuant to the audit standard IDW S1 set by the German Institute of Accountants (Institut der Wirtschaftsprüfer in Deutschland e.V.). "The standard calculates the net present value of the net profits accrued to the shareholders." Christoph Van der Elst & Lientje Van den Steen, *supra* note 82, at 430 n.101

110 *Cf*. FLEISCHER, *supra* note 1, § 327(b) n.13

111 ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 56, at 479

112 *Id*. (providing an example where one DCF valuation valued stock at $13 a share and the opposing valuation valued it above $60 a

share)

[113] Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvR 1613/94, Apr. 27, 1999, 100 BVERFGE 289, 307 (Ger.)

[114] ARNE KIEßLING, DER ÜBERNAHMERECHTLICHE SQUEEZE-OUT GEMÄß §§ 39A, 39B WPÜG 144 (2008)

[115] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZB 15/00, Mar. 12, 2001, 147 BGHZ 108 (Ger.)

[116] Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 6/06, Feb. 16, 2007, 2007 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 682 (2007) (Ger.); Oberlandesgericht Düsseldorf [OLG - Higher Regional Court], Case No. I-26 W 13/06, Sept. 09, 2009, 2009 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1427 (2009) (Ger.); Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 2/08, Dec. 18, 2009, 2009 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 274 (2010) (Ger.)

[117] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZB 18/09, July 19, 2010, 186 BGHZ 229 (Ger.); *cf*. Olaf Müller-Michaels, *BGH Schafft ein Neues Feld für Diskussionen und Streitigkeiten*, *in* BETRIEBS-BERATERR 1944 (2010)

[118] Oberlandesgericht Frankfurt [OLG - Higher Regional Court], Case No. 5 W 15/10, Dec. 21, 2010, 2011 ZEITSCHRIFT FÜR DAS GESAMTE FAMILIENRECHT (FAMRZ) 832 (2011) (Ger.)

[119] Hartwin Bungert & Carsten Wettich, *Neues zur Ermittlung des Börsenwerts bei Strukturmaßnahmen*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 449, 450 (2012)

[120] Even though the court did not define the time-gap further, the case law to date suggests that a time frame of up to six months does not qualify as considerable. *See* cases cited *supra* note 116 (7.5 months considerable); Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZB 2/10, June 28, 2011, 2011 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1708 (2011) (Ger.) (3.5 months not considerable); Oberlandesgericht Stuttgart [OLG - Higher Regional Court Case No. 20 W 3/09, Jan. 19, 2011, 2011 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 382 (2011) (Ger.) (up to 6 months not considerable); Oberlandesgericht Frankfurt a.M. [OLG - Higher Regional Court], Case No. 21 W 13/11, Apr. 29, 2011, 2011 AG 832 (Ger.) (4.5 months not considerable)

[121] It is currently unclear if an adjustment below the calculated average price would also be permissible. *Cf*. Bungert & Wettich, *supra* note 119

[122] *Cf*. HANS MORITZ, "SQUEEZE-OUT": DER AUSSCHLUSS VON MINDERHEITSAKTIONÄEREN NACH §§ 327 A FF AKTG 125 (2004)

[123] *Id*. at 126

[124] *Id*.; STANGE, *supra* note 68 at 152

[125] Oberlandesgericht Frankfurt a.M. [OLG - Higher Regional Court], Case No. 5 W 39/09 (June 17, 2010), http://openjur.de/u/305834.html (Ger.); Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 9/08, Mar. 17 2010, 2010 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1498 (2010) (Ger.); Oberlandesgericht Munich [OLG - Higher Regional Court], Case No. 31 Wx 12/06, Oct. 26, 2006, 2007 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 375 (2007) (Ger.)

[126] Equally Patrick Hohl, BETRIEBSBERATER 596 (2011), in a commentary on Oberlandesgericht Frankfurt a.M. [OLG - Higher Regional Court], Case No. 5 W 39/09 (June 17, 2010), http://openjur.de/u/305834.html (Ger.)

[127] ALLEN, KRAAKMAN, & SUBRAMANIAN, *supra* note 55, at 479

[128] This problem exists in all structural corporate measures which require a registration with the commercial register to take legal effect

[129] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 327e(2), 319(6) (Ger.)

[130] German stock corporations almost always have shares with a nominal value of EUR 1., so that usually means that the plaintiff or group of plaintiffs needs to have held at least 1000 shares

[131] This latter case was introduced recently with the Act on the Implementation of the Shareholders' Rights Directive, Gesetz zur Umsetzung der Aktionärsrechterichtlinie [ARUG], May 28, 2009, BGBL I at § 2479 (Ger.), in an attempt to further reduce the impact of predatory shareholders

[132] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at §§ 327e(2), 319(6) (Ger.)

[133] STANGE, *supra* note 68, at 256

[134] **Appraisal** Procedure Act [SpruchG] [Spruchverfahrensgesetz], June 12, 2003, BGBL I at §§4(1)no.3, 5(1) no.3 (Ger.)

[135] **Appraisal** Procedure Act [SpruchG] [Spruchverfahrensgesetz], June 12, 2003, BGBL I at § 13 (Ger.)

[136] *Id*. § 6

[137] *Cf.* Maximilian Schiessl, *Fairness Opinions im übernahme- und Gesellschaftsrecht Zugleich ein Beitrag zur Organverantwortung in der AG*, ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT (ZGR) 814, 837 (2003)

[138] At the time the data was gathered in twenty-four cases, an initiation of the **appraisal** was not yet possible because of a pending action to enjoin, so the actual percentage of cases may well have been higher

[139] STANGE, *supra* note 68, at 279

[140] Currently 0.12%

[141] *See e.g.*, THOMAS HEIDEL ET AL., FESTSCHRIFT FÜR WIENAND MEILICKE 2268 (2003); STANGE *supra* note 68, at 259

[142] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 327b(2) (Ger.)

[143] This section draws on data from STANGE, *supra* note 68, at 279

[144] Philipp Rühland, *Der übernahmerichteliche Squeeze-out im Regierungsentwurf des Übernahmerichtlinie-Umsetzungsgesetzes (Regierungsentwurf)*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 401, 402 (2006)

[145] It is a general requirement of German Takeover law that partial tender offers which are limited to an acquisition of less than 100% of the target stock are not allowed. Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at § 29 (Ger.)

[146] *Cf. id*. §§ 39a, 29

[147] *Cf.* Ventoruzzi, *supra* note 1, at 50

[148] Walter Paefgen, Z*um Zwangsausschluss im neuen Übernahmerecht*, WERTPAPIERMITTEILUNGEN (WM) 765 (2007)

[149] Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at § 39a(1)

[150] Ulrich Noack & Dirk Zetzsche, *Vor §§ 39a bis 39c WpÜG, in* KAPITALMARKTRECHTSKOMMENTAR 19 (Eberhard Schwark & Daniel Zimmer eds., 4th ed. 2010)

[151] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begründung zum Regierungsentwurf [Legislator's Explanatory Notes], 16/2003 at 22 (Ger.); STANGE, *supra* note 68, at 271

[152] Rühland *supra* note 144, at 405; Noack & Zetzsche, *supra* note 150, at Sec. 39a mn. 28

[153] *See e.g.*, Silja Maul, *Die EU-Übernahmerichtlinie - ausgewählte Fragen*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 151 (2005) at 157; Noack & Zetzsche *supra* note 150, Sec. 39a mn. 28

[154] Noack & Zetzsche, *supra* note 150, Sec.39a mn. 28

[155] Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 13/08, May 5, 2009, 2009 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1059 (2009) (Ger.); Noack & Zetsche *supra* note 150, Sec. 39a mn. 28

[156] *Id*

[157] *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985)

[158] *See infra* Part F.IV

[159] Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at § 39a(1)(1) (Ger.). The Regional Court (*Landgericht - "LG"*) Frankfurt has exclusive jurisdiction for Takeover Squeeze-Out applications. *See id*. § 39a(5)

[160] STANGE, *supra* note 68, at 274

[161] Noack & Zetsche, *supra* note 150, at Sec.39b mn. 11

[162] *Id*. at Sec.39b mn. 21

[163] *Cf. Noack & Zetzsche, supra note* 150, at *mn. 3* (accounting for data until May 2010 and found two cases). Two additional cases occurred in 2011: After successful takeovers, Nordfrost GmbH & Co. KG squeezed out the minority shareholders in Kuehlhaus Zentrum AG, and Engine Holding GmbH squeezed out the minority shareholders in Tognum AG

[164] *See supra* Part F.III

[165] Kai Hasselbach, *Verfahrensfragen des übernahmerechtlichen Squeeze out*, BETRIEBSBERATER 2842 (2010); Noack & Zetzsche, *supra* note 150, at mn. *3*

[166] *Cf*. Reinier Kraakman & Henry Hansmann, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001)

[167] Rock et al., *supra* note 29, at 202

[168] *See* Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvR 1613/94, Apr. 27, 1999, 100 BVERFGE 289, 302 (Ger.); *see also* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case Nos. 1 BvR 68/95, 1 BvR 147/97, Aug. 23, 2000, 2001 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 279 (2001) (Ger.)

[169] *Cf*. Mark J. Roe & Lucian A. Bebchuk, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999)

[170] **Appraisal** Procedure Act [SpruchG] [Spruchverfahrensgesetz], June 12, 2003, BGBL I at § 15

[171] Stange found that in over 40% of cases the ultimate compensation was higher than the one initially offered by the controller. However, this result includes cases where the ultimate compensation was determined by the court or (in the majority of cases) by settlement. The valuation agreed upon in a settlement is not an accurate indicator for the intrinsic value of the shares, however, as the controlling shareholder will also consider the "nuisance value" of the claim and the legal fees she will save (for example, for an additional expert testimony by a court-appointed auditor), considering that she has to bear all legal court fees pursuant to Section 15 of the **Appraisal** Procedure Act

[172] See *infra* Part E.I.3

[173] Michael R. Schwenk, *Valuation Problems in the **Appraisal** Remedy*, 16 CARDOZO L. REV. 649, 679 (1994) (citing Senator Jess J. Present, in his Memorandum in Support of Chapter 202, reprinted in 1982 New York State Legislative Annual, 96, 97)

[174] *Cf*. Allen, Kraakman & Subramanian, *supra* note 54, at 485

[175] The study focused on Belgium, France, Germany, the Netherlands and the U.K

[176] This threshold is predetermined by Article 15 of the European Takeover Directive. However, the scope of this provision is so small that member states could have created or maintained a separate squeeze-out procedure with differing thresholds without infringing on the Directive

[177] Van der Elst & Van den Steen, *supra* note 82, at 404

[178] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 179a (Ger.)

[179] Rock, Davies, Kanda, & Kraakman, *supra* note 29, at 207 n. 117

[180] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 304 (Ger.)

[181] *Id*. § 308

[182] KÖRPERSCHAFTSSTEUERGESETZ [KStG] [Corporation Tax Act], Oct. 15, 2002, BGBL. I at 1444, § 14 (Ger.)

[183] See infra Part E.I.1

[184] Compare, on the one hand, the somewhat reserved comments of several members of Parliament in the *Bundestag* regarding the 90% threshold in Bundestag Plenarprotokoll 17/111, 12754, and on the other hand the judgment of Oberlandesgericht München *infra*, note 186

[185] DRITTES GESETZ ZUR ÄNDERUNG DES UMWANDLUNGSGESETZES [3. UmwGÄndG], BGBL. I 2011, 1138 [Third Act Amending the Transformation Act], July 11, 2011, BGBL. I at 1138 (Ger.)

[186] As a precursor during the financial crisis a squeeze out procedure for holders of 90% of the share capital of a company was established by Finanzmarktstabilisierungsbeschleunigung [FMStBG] [The Financial Market Stabilization Acceleration Act], Oct. 17, 2008, BGBl. I at 1982, §§ 12(3) no.1, 12(4) (Ger.), in order to allow for the measures necessary to rescue or "stabilize" financial institutions. The - apparently - only time this procedure was used to date was in the case of the distressed Hypo Real Estate Holding AG. The squeeze-out was held valid and constitutional by the Oberlandesgericht München [OLG - Higher Regional Court], Sept. 28, 2011, 2011 NZG 1227 (2011) (Ger.)

[187] Directive 2009/109/EC of the European Parliament and of the Council of Sept. 16, 2009, amending Council Directives 77/91/EEC, 78/855/EEC and 82/891/EEC, and Directive 2005/56/EC in regards to reporting and documentation requirements in the case of mergers and divisions

[188] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begründung zum Regierungsentwurf [Legislator's Explanatory Notes], 17/3122 at 12 (Ger.). Reducing the threshold to 90% was necessary because the legislator was reluctant to introduce a sell-out right for minority shareholders, which would have been an alternative way to implement the directive

[189] This procedure is considered not to be an abuse of a legal position by most German scholars. *Cf*. Stephan R. Göthel, *Der verschmelzungsrechtliche Squeeze Out*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1541, 1549 (2011) (Ger.), *available at* http://zip-online.de/b8c99a914d25a8e135632f4037ee771c (last visited 10 Aug. 2012)

[190] *See e.g.*, Subramanian, *supra* note 1

[191] Ventoruzzo, *supra* note 1, at 61

[192] *Id*. at 62

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