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Entire Fairness: A Call to Preserve Delaware Doctrine

Lisa Bei Li

ENTIRE FAIRNESS: A CALL TO PRESERVE DELAWARE DOCTRINE

LISA BEI LI*

* J.D. Candidate, May 2018, The George Washington University Law School; B.S., Finance & International Business, May 2010, New York University Stern School of Business. Thank you to my Journal Adjunct Brian Castello for his patient feedback and my Notes Editor John Cavanagh for his detailed review. I also thank Professor Theresa Gabaldon for her guidance and Professor Dalia Tsuk Mitchell for her time and expertise, without which I could not have written this Note. Finally, I am grateful to the other academic experts who have written extensively on this topic and who nonetheless entertained my beginner's inquiries. It was an honor to speak with Professor Lawrence A. Hamermesh, whose work and contributions to the field are referenced throughout this Note.

ABSTRACT

Appraisal arbitrage is on the rise. Institutional investors—namely, hedge funds—buy into target companies after their merger announcements and bet on the price. By purposely taking a minority position, these funds proceed to courts to obtain what they otherwise could not in the market: a "fair value."

Where there is no allegation of wrongdoing or injury, these plaintiffs nonetheless successfully divert deal value away from business combinations. Based on a misunderstood statute, appraisal arbitrage has exploded into a multi-billion dollar industry for large fund investors. In June 2016, amid growing concerns, the Delaware General Assembly amended section 262, Delaware's appraisal statute. While the effort is a start, it can by no means be an end.

Although the debate on appraisal arbitrage is largely one of policy, Delaware's greatest predicament is its conflicting jurisprudence. There exists a corporate governance overlay between the state's common law and section 262, which is now being used by arbitrageurs for fiduciary duty issues. While Delaware's judiciary has decisively constructed its fiduciary duty doctrine, section 262 has stayed in limbo—unclarified by the legislature and unadjusted by the court. As a result, the statute's current use conflicts with established fiduciary duty standards.

This Note examines the development of this conflict. It calls for unification of the two competing areas of law, which would naturally fit under an entire fairness test, if implemented. This Note argues that such implementation follows from the principles of Delaware lawmaking and its deference to judicial expertise. As an example, this Note recommends a simple, but meaningful proposal, after which the General Assembly can model future changes. By adopting such a proposal, Delaware can effectively curb unintended developments like the incredible practice of appraisal arbitrage.

I. INTRODUCTION

In the summer of 2016, mainstream news outlets put a spotlight on appraisal arbitrage.[1] Adjudicating a disagreement over deal price, the Delaware Court of Chancery ordered Dell to pay $5.5 billion[2] to its dissenting minority shareholders[3] who sought appraisal under Delaware General Corporation Law (DGCL)

[1] *See, e.g.*, Andrew Ross Sorkin, *Who Decides 'Fair Value?' In Dell's Case, a Judge*, N.Y. TIMES (June 6, 2016), https://www.nytimes.com/2016/06/07/business/dealbook/who-decides-fair-value-in-dells-case-a-judge.html.

[2] 22% × $24.9 billion = $5.5 billion. *See* Tom Hals, *U.S. Court Rules $24.9 Billion Dell Buyout Underpriced by 22 Percent*, REUTERS (June 1, 2016, 4:50 AM), http://www.reuters.com/article/us-dell-buyout-lawsuit-idUSKCN0YM1M0.

[3] *See* In re Appraisal of Dell Inc., 2016 WL 3186538, at *1 (Del. Ch. 2016).

section 262.[4] Although the term "minority shareholders" may invoke comparison to "the helpless minority,"[5] the petitioners were far from that. In *In re Appraisal of Dell Inc.*, the leading dissenter was T. Rowe Price,[6] one of the five largest global funds in the United States.[7] Among the champions for the "minority" was also billionaire Carl Icahn.[8]

The *Dell* case turned heads when the court departed from its previous presumption that an appraisal would rely on the merger price[9] in a fairly negotiated deal.[10] Instead, the *Dell* court appraised the shares at a premium of 29% over the deal price.[11] The New York Times questioned, "who decides 'fair value'" to which the answer was "a judge."[12] Fortune Magazine challenged "how Michael Dell shortchanged shareholders while doing nothing wrong."[13] In fact, neither Mr. Dell nor his buyout team did anything wrong.[14]

These articles shed light on what was previously a questionable cottage industry,[15] which has now burst into the hedge fund investor's dream.[16] However,

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[4] *See* DEL.CODE ANN. tit. 8, § 262 (2016).

[5] Professor Bayles Manning had long criticized importing issues from the "democratic political process" into the corporate field. *See* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE. L. J. 223, 226–27 (1962).

[6] T. Rowe Price sought appraisal for almost 70% of the total shares petitioned. *See* In re Appraisal of Dell Inc., 2016 WL 6069017, at *2 (Del. Ch. Oct. 17, 2016) (stating that T. Rowe Price petitioned 26,732,930 shares out of 38,765,130 total).

[7] *T. Rowe Price Accused of Charging Excessive Mutual Fund Fees*, REUTERS (Apr. 29, 2016, 11:36 AM), http://www.reuters.com/article/us-funds-troweprice-fees-idUSKCN0XQ1UT.

[8] Mr. Icahn is well-known to be a "billionaire investor" and "a close friend and adviser to the president." Wayne Parry, *Sale of ex-Trump Taj Mahal casino to Hard Rock is finalized*, ASSOCIATED PRESS (Mar. 31, 2017), https://apnews.com/ac10467e2d35414ab3b4ca593dfd4fe2/sale-ex-trump-taj-mahal-casino-hard-rock-finalized*; see also* In re Appraisal of Dell Inc., 2016 WL 3186538, at *16–19 (Del. Ch. May 31, 2016); Connie Guglielmo, *Dell Officially Goes Private: Inside the Nastiest Tech Buyout Ever*, FORBES (Oct. 30, 2013, 6:00 AM), https://www.forbes.com/sites/connieguglielmo/2013/10/30/you-wont-have-michael-dell-to-kick-around-anymore/#792c821c2a9b.

[9] The merger price refers to the final deal price offered. In this case, it is the per share price that the buyer corporation offered to buy out the target company's minority shareholders.

[10] *See* Merion Capital LP v. BMC Software, Inc., 2015 WL 6164771 (Del. Ch. 2015); Long Path Capital, LLC v. Ramtron Int'l Corp., 2015 WL 4540443 (Del. Ch. 2015); Merlin Partners LP v. AutoInfo, Inc., 2015 WL 2069417 (Del. Ch. 2015); In re Appraisal of Ancestry.com, Inc., 2015 WL 399726 (Del. Ch. 2015); Huff Fund Inv. P'ship v. CKx, Inc., 2013 WL 5878807 (Del. Ch. 2013).

[11] *See* In re Appraisal of Dell Inc., 2016 WL 3186538, at *1, 31 (Del. Ch. 2016) (stating that the committee accepted the price of $13.65 per share while the court appraised fair value at $17.62 per share).

[12] Sorkin, *supra* note 1.

[13] Roger Parloff, *How Michael Dell Shortchanged Shareholders While Doing Nothing Wrong*, FORTUNE (June 2, 2016), http://fortune.com/2016/06/02/michael-dell-shortchanged-shareholders/.

[14] *Id.*

[15] Wei Jiang, Tao Li, Danqing Mei & Randall Thomas, *Appraisal: Shareholder Remedy or Litigation Arbitrage?*, 59 J.L. & ECON. 697, 697 (2016). From 2000 through 2014, appraisal petitioned increased from 2% to 25% of total appraisal-eligible deals. *Id.*

[16] Over a ten-year period, the stock market typically generates a return of 7%, but the average

the practice is controversial.[17] Appraisal arbitrage is, by definition, the practice of activist investors purchasing shares from minority shareholders and buying into their appraisal rights as "dissenters" against a "forced" public-company merger.[18] These purchases are done *after* a deal announcement and the court awards profits where none are available in the market.[19]

In response to growing concerns, the Delaware State Bar Association's Council of the Corporate Law Section (the Council) appointed a special subcommittee in 2014.[20] The subcommittee was tasked with studying potential amendments to section 262 and "whether [appraisal arbitrage] is consistent with the intended purpose of the appraisal statute."[21] The subcommittee then made a recommendation to the Council.[22] Given Delaware's unique legislative process, the Council proposes amendments directly, and if adopted, the proposals usually pass unchanged.[23] This was the case for the section 262 amendments (the Amendments) that the General Assembly passed on June 16, 2016.[24]

While they sought to limit appraisal claims and to prevent "interest arbitrage," the Amendments still require further work to achieve those twin aims.[25]As evidenced in the lawmakers' only publicly available document,[26] their

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annualized return on appraisal petitions is approximately 33%. *Compare* Tim Plaehn, *What is the Rate of Return on an Index Fund?*, ZACKS (Feb. 21, 2017, 11:11 AM), http://finance.zacks.com/rate-return-index-fund-6679.html, *with* Jiang et. al., *supra* note 15.

[17] *See* Parloff, *supra* note 13 ("Are these suits abusive? They're controversial.").

[18] Eli Richlin & Tony Rospert, *The Rise of Appraisal Litigation: Will the Fire Spread?* WILLIAMETTE INSIGHTS, at 1, 3, (Autumn 2015), http://www.willamette.com/insights_journal/15/autumn_2015_1.pdf ("Appraisal arbitrage refers to hedge funds and other activist investors acquiring target shares after an announcement of a public company merger with the goal of seeking appraisal rights under state statutory schemes.").

[19] The market refers to the public trading market. By definition, appraisal arbitrage does not involve closely-held target companies. *See id.* (defining appraisal arbitrage as targeting public company mergers).

[20] Council of the Delaware State Bar Association Corporate Law Section, Section 262 Appraisal Amendments 1 (Mar. 6, 2015) (the Explanatory Paper).

[21] *Id*. at 1.

[22] *See id.*

[23] *See* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV 1749, 1754–55 (2006) (explaining that amendments to the DGCL are not the product of any legislative staff or lobbyists, but are instead the work of the Council). See *infra* Part III.B., for further details on the Delaware legislative process.

[24] *See* H.B. 371, 148th Gen. Assemb., Reg. Sess. (Del. 2016), http://legis.-delaware.gov/BillDetail?LegislationId=24344. The bill passed with 38/38 votes in the House and 20/20 votes in the Senate, excluding absentees. *Id.*

[25] *See* Explanatory Paper, *supra* note 20. For example, do the Amendments really limit appraisal claims, and, if so, are they the right ones to limit? The Amendments limit "*de minimis* claims," which have a total value of under $1 million or have total shares less than 1% of all shares outstanding. However, this would only hurt the small claimants that already have trouble recovering under the statute. *See infra* Part I.B.

[26] Professor Hamermesh informed the Author of the existence of this "Explanatory Paper," which was sent to members of the Delaware State Bar Association Corporate Law Section. Telephone Interview with Professor Lawrence Hamermesh, Member and Former Chair of the Council (Jan. 19, 2017); *see also* Explanatory Paper, *supra* note 20. The paper has since been shared by a few

"Explanatory Paper,"[27] several aspects of the Council's reasoning warrant deeper review.[28] Principally, how has appraisal arbitrage developed, and why is it permissible? Should we allow it?

This Note examines these questions from a legal, rather than a policy, point of view. The Note argues that, given the principles that Delaware designed the DGCL to serve, section 262 should defer to judicial doctrine in areas of conflict. While overlaps in the law are certainly permitted, where a statute no longer serves its intent and where the statute's application currently conflicts with doctrinal purpose, the statute should be revised. This Note proposes one example of such a revision.

Part I of this Note examines the mechanics of appraisal arbitrage and explains how arbitrageurs use section 262. Part I then introduces the problem presented by such use. Part II explores the historical development of the two competing areas of jurisprudence: appraisal rights and fiduciary duties. The analysis shows how they both fit under the entire fairness test, which would unify the statute and common law, if implemented. Part III investigates the history and development of Delaware lawmaking, which together establish why fiduciary duty standards should be applied in statutory appraisals. To apply the fiduciary duty doctrine, section 262 must incorporate the entire fairness test. Part IV explains how to incorporate this test, and this Note concludes with an example proposal for the Council.

II. THE PRACTICE OF APPRAISAL ARBITRAGE

A. What is Appraisal Arbitrage?

Arbitrage is defined as "the simultaneous purchase and sale of an asset to profit from a difference in price . . . [caused by] market inefficiencies."[29] By its

law firms, presumably via attorneys who are members of the Section.

[27] This document has been referred to as the "Explanatory Paper," and is so referenced in this Note as well. *See, e.g.*, Michael D. Allen, Samuel T. Hirzel, & Patricia O. Vella, Faculty, M&A 2016 Delaware Update: Standard for Deal Review, D&O Fiduciary Duties, Private Company Mergers, Appraisal Rights 56 (Feb. 11, 2016), http://media.straffordpub.com/products/m-and-a-2016-delaware-update-standard-for-deal-review-d-and-o-fiduciary-duties-private-company-mergers-appraisalrights-2016-02-11/presentation.pdf.

[28] For example, the "recent case law" suggesting that "arm's-length deals with adequate market checks do not create appraisal risks for buyers" does not necessarily hold true after the *Dell* decision, which was published after the Explanatory Paper's issuance to the Corporate Law Section in 2015. To the extent that arm's-length deals satisfy fair process, *Dell* has made fair process an irrelevant consideration. This presents a grave problem for section 262's implications on fairly-negotiated deals. *Contra* Explanatory Paper, *supra* note 20.

[29] *Arbitrage*, INVESTOPEDIA, http://www.investopedia.com/terms/a/arbitrage.asp (last visited Apr. 8, 2017).

definition, arbitrage has nothing to do with the fundamental or "real" value of an asset or stock.[30] Rather, arbitrage is simply a form of timing strategy for hedge funds.[31]

A traditional market timing strategy for cash mergers would work as follows: in a public company merger, the target's stock price will usually trade at slightly below its offer price until the deal goes through.[32] That price difference reflects the uncertainty of whether the deal will close.[33] In a cash merger,[34] a fund would buy the target company's stock on the bet that the deal will close and the price will go up.[35] While the stock's fundamental price does not change, i.e. the company itself is worth the same throughout the transaction, the market price difference generates a profit.[36] This type of profit is completely at odds with profit from a difference in the stock's "fair value,"[37] which reflects the underlying "intrinsic value" of the stock.[38] By using this event-driven timing strategy, hedge funds bet on the market, but they have no legal avenue to recover for bad bets.[39]

In the appraisal arbitrage context, the hedge fund would use the same timing strategy as before, but instead of speculating on the market, the fund would gamble with a court proceeding.[40] How does this work?

To perfect their appraisal rights, minority shareholders must decline the buyer's offered consideration, which can take either the form of cash or stock.[41]

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[30] *See Stock-Picking Strategies: Fundamental Analysis*, INVESTOPEDIA, http://www.investopedia.com/university/ stockpicking/stockpicking1.asp (last visited Apr. 8, 2017).

[31] *See Understanding Merger Arbitrage*, BARCLAYHEDGE, https://www.barclayhedge.com/research/educational-articles/hedge-fund-strategy-definition/hedge-fund-strategy-merger-arbtrage.html (last visited Apr. 8, 2017).

[32] *See id.*

[33] *See id.*

[34] A cash merger is a merger where the buyer offers cash, as opposed to stock, in exchange for the seller's shares. *See All-Cash Deal*, INVESTOPEDIA, http://www.ivestopedia.com/terms/a/all-cash-deal.asp (last visited Oct. 12, 2017).

[35] *See* BARCLAYHEDGE, *supra* note 31.

[36] *See id*; *see also Stock-Picking Strategies: Fundamental Analysis*, *supra* note 30.

[37] *Compare* BARCLAYHEDGE, *supra* note 31, *with Stock-Picking Strategies: Fundamental Analysis*, *supra* note 30.

[38] *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, J. OF CORP. L. 119, 124 (2005) (describing fair value).

[39] The Author is unaware of any statute or claim that could be made for such recovery.

[40] Granted, the actual execution of this bet involves making a fair value determination, but the strategy itself is much more a timing play than the type of long-term investment inherent in fundamental value investing, which is actually based on determinations of "fair value." Latham & Watkins, LLP, *Appraisal Arbitrage: When Will it Become a New Hedge Fund Strategy?*, M&A Deal Commentary, 1–2 (May 2007), http://www.lw.com/upload/pubcontent/_pdf/pub1883_1.pdf; Christian Carroll & T.J. Hope, STOUT, *"Appraisal Arbitrage" Has Been on the Rise, as Shown in Recent Cases in the Delaware Court* (Sept. 1, 2016), https://www.stoutadvisory.com/insights/article/-appraisals-gone-wild-spotlight-fair-value-appraisal-cases-delaware.

[41] Richlin & Rospert, *supra* note 18. The offer from the buyer company can either be cash or its own stock, in exchange for the target company's stock. *See id.* Although the target company is public, the later combined company may either stay public or go private, depending on the deal. *See id.*

Appraisal arbitrage investors target public-company cash deals since stock transactions are generally excluded from appraisal through section 262(b)(1)'s market-out exception.[42] The market-out exception prohibits appraisal of highly liquid stocks based on the theory that their fair value is easily determinable in the market.[43] Section 262(b)(2) exempts cash deals from the market-out exception,[44] although courts have indicated that it makes little difference to fair value what form the consideration takes, whether it be cash or stock, as long as the purchased stock is highly liquid.[45] Notwithstanding judicial reactions, almost all appraisal claims are made on publicly-traded cash deals as a result of the cash exception to market-out.[46] After a deal goes through, the fund must then file an appraisal petition within 120 days of the merger's effective date.[47] If the deal is cancelled, appraisal rights do not accrue.[48] As long as the claimant is a stockholder "of record" who has not voted in favor of the merger,[49] the claimant can obtain section 262 appraisal rights, subject to the statutory exceptions.[50]

Appraisal arbitrageurs follow the statute's requirements, but, unlike traditional claimants, arbitrageurs buy in after a merger is announced.[51] They are not bona fide dissenters, nor are they usually ever the "record holders" of their stock.[52] In this way, hedge funds arguably lack standing under the statute. How-

(referring to appraisal arbitrage as buying into public company deals, with no restriction on how the deal will be structured).

[42] DEL. CODE ANN. tit. 8, § 262 (2016). Section 262(b)(1) is the market-out exception, which provides "no appraisal rights . . . for the shares of any class or series of stock, which stock, or depository receipts in respect thereof, at the record date . . . were either: (i) listed on a national securities exchange or (ii) held of record by more than 2,000 holders." *Id.*

[43] *See* JEFFREY HAAS, CORPORATE FINANCE 90 (2014) ("The market-out exception recognizes that the market is superior to a judge when it comes to fairly valuing the shares of dissenting public stockholders."); Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE. L. J. 223, 226–27 (1962) ("The courts have virtually refused to go beyond an inquiry as to the market price on the date determined to be relevant."). *Cf.* Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 598, 602–05 (1989) (describing that offer prices are typically well above the market price, resulting in even higher buyout prices for shareholders).

[44] Section 262(b)(2) is known as the exception to the exception, reinstating appraisal rights in certain situations where they were removed under § 262(b)(1), but § 262(b)(2) exempts cash from reinstatement. DEL. CODE ANN. tit. 8, § 262 (2016).

[45] *See, e.g.*, Klotz v. Warner Commc'ns, Inc., 674 A.2d 878, 882 n.5 (Del. 1995).

[46] *See generally* Gaurav Jetley & Xinyu Ji, *Appraisal Arbitrage—Is There a Delaware Advantage?*, 71 BUS. LAW. 427, 430 (2016) (focusing on large company cash deals).

[47] DEL. CODE ANN. tit. 8, § 262 (2016).

[48] *See id.* (providing appraisal rights for only shareholders who hold shares through the effective date of the merger).

[49] *Id.*

[50] In addition to the market-out exception and that exception's exclusion of cash, the Council's Amendments implemented a *de minimis* exception to reduce "nuisance" litigation. *See* Explanatory Paper, *supra* note 20.

[51] Richlin & Rospert, *supra* note 18.

[52] *Compare Beneficial Owner*, INVESTOPEDIA,

ever, they are able to obtain standing under section 262 by way of unintended consequences from technological developments.[53]

Although buyers and sellers historically conducted trades with one another through paper delivery of stock certificates, almost all certificates are now held at central depositary institutions.[54] These depositaries warehouse the certificates and process trades without physical delivery.[55] As long as both the buyers and the sellers trade through the same depositary, the depositary remains the "record holder" throughout.[56] However, the buyers are still the beneficial holders of the stock and have rights to its dividends and proceeds.[57] Ultimately, this system allows arbitrageurs to purchase their shares after a merger vote and to reap the economic benefits in court.[58] In doing so, appraisal arbitrageurs target conflict-of-interest transactions, which more likely result in higher fair values.[59]

B. The Problem with Section 262

At the same time, as hedge funds enter deals after their announcements, section 262 provides a remedy to these "dissenting" shareholders.[60] These funds take the position of traditional minority claimants who assert the loss of power to vote against a merger.[61] But, of course, the funds do not oppose the merger and, therefore, lack any real injury under the statute.[62]

This perplexity understandably led to controversy.[63] In addition to the legal

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http://www.investopedia.com/terms/b/beneficialowner.asp (last visited Apr. 10, 2017, 9:15 AM), *with Registered Holder*, INVESTOPEDIA, http://www.investopedia.com/terms/r/registered-holder.asp (last visited Apr. 10, 2017, 9:15 AM) (showing these owners are, in fact, beneficial owners). Beneficial ownership entitles the holder to the stock's economic benefits (i.e. its sale price and dividends) while record ownership maintains the stock's legal ownership, in name. Record holders are generally equivalent to registered holders, like banks and depositary institutions, who are bound to the beneficial holders through a fiduciary relationship.

[53] *See* George S. Geis, *An Appraisal Puzzle*, 105 NW. U.L. REV. 1635, 1650–51 (discussing the technological developments of stock trade processing).

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *See id.* at 1651–55 (discussing the plaintiff's beneficial ownership despite lack of record ownership and the history that led to this result).

[58] *See id.*

[59] *See* Jiang et. al., *supra* note 15, at 727 (Appraisal petitions, particularly in the post-2007 era, appear focused on mergers with potential conflicts of "interest, such as going-private deals, minority squeeze outs" as well as targeting transactions with low deal premiums.). *Id.*

[60] *See* Richlin & Rospert, *supra* note 18; *see also* DEL. CODE ANN. tit. 8, § 262 (2016).

[61] The court still attributes § 262 to this loss of veto power, although many no longer recognize that as the goal of § 262. *See In re Transkaryotic Therapies, Inc.*, 2007 WL 1378345, at *5 (Del. Ch. May 2, 2007); *but see* ROBERT B. THOMPSON & F. HODGE O'NEAL, O'NEAL AND THOMPSON'S OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS §§ 5-3, 5-10, 5-15 (Thomson Reuters, rev. 2d ed. 2011).

[62] *See* Richlin & Rospert, *supra* note 18.

[63] White & Case LLP, *Increasing Hostility Towards Appraisal Arbitrage*, LEXOLOGY (Apr. 17,

issues of standing and injury, appraisal arbitrage has controversial economic consequences. The practice extracts company payouts at the expense of previously existing shareholders.[64] In addition, arbitrage activity increases the risks and costs of mergers,[65] which in turn hinders the market for control that acts as a check on bad management.[66] Finally, returns are awarded even if the deal price was set by a fair process.[67] This interesting role of Delaware courts as market regulators is juxtaposed against the state's foundations of market liberalism.[68]

Proponents of appraisal arbitrage cite, as a policy justification, arbitrage appraisals' "market check" on managerial misconduct.[69] In these cases, such misconduct equates to a breach of fiduciary duty by the board[70] because the only check shareholders have against management itself is through the board.[71] Even if a check were assumed to have been created,[72] section 262 is not meant to, nor is it effective at, addressing fiduciary duty issues.[73]

2015), http://www.lexology.com/library/detail.aspx?g=d4ca52ee-ed65-4647-9c87-eec93bb5154c.

[64] *See* STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 32–33 (3d ed. 2011). Under the Efficient Capital Markets Hypothesis, on which our entire federal securities law regime is based, the loss of money from the combined business is reflected in lower share prices for the other and previously existing shareholders' stock after the payout. *See id.*

[65] Steven Epstein, Philip Richter, Robert C. Schwenkel & Gail Weinstein, *Keeping Current: Delaware Appraisal: Practical Considerations*, BUS. LAW TODAY 1 (Oct. 2014), http://www.shareholderforum.com/ appraisal/Library/20141000_FriedFrank.pdf (discussing increased risk and uncertainty in transactions as a result of appraisal arbitrage).

[66] RICHARD A. POSNER & KENNETH E. SCOTT, ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION 195 (1980) ("mergers may be a method for protecting shareholders from dishonest or incompetent management . . . .") (citations omitted).

[67] The court has indicated that "fair process" is the predominant factor in determining whether the "entire fairness" standard is met. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) (holding that "the dual procedural protection merger structure optimally protects the minority stockholders in controller buyouts."); *cf.* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (holding that "[t]he concept of fairness has two basic aspects: fair dealing and fair price.").

[68] *See* Joel Seligman, *A Brief History of Delaware's General Corporate Law of 1899*, 1 DEL. J. CORP. L. 249, 257, 271 (1976) (describing Delaware's ascendance to the "state of incorporation for more large business corporations than any other state" by imitating New Jersey's "liberal" statute and by implementing reactionary Jacksonian corporate "liberalism.").

[69] *See, e.g.*, Charles R. Korsmo & Minor Meyers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1598–99 (2015) ("The substantial transaction costs involved in a takeover often render it a governance mechanism of last resort, but the possibility nonetheless serves as an important market check on managerial abuse and neglect.").

[70] *See* ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 131 (3d ed. 2009) (describing fiduciary duties of the board of directors).

[71] The board of directors elect management. *See id.*

[72] However, there is much evidence to the contrary. *See, e.g.*, Charles Korsmo & Minor Meyers, *Reforming Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 285 (2017) (quoting Abigail Pickering Bomba, Steven Epstein, et al., *New Activist Weapon: The Rise of Delaware Appraisal Arbitrage: A Survey of Cases and Some Practical Implications*, FRIED FRANK 4 (2014), http://tinyurl.com/FF-6947.).

[73] *See* Steven M. Hecht & Richard Bodnar, *Does the Appraisal Remedy Discipline Corporate*

Practitioners have advised that the appraisal statute "is available as a remedy only in certain transactions (e.g., the market-out exception), and even among those transactions that qualify for appraisal, initiating appraisal litigation may often not be cost effective, especially for small shareholders."[74] The limit against small shareholders is caused by the "lack of a class action procedure that would allow joinder of all dissenting shareholders."[75]

Academic studies have also found that section 262 primarily benefits large fund investors.[76] Without a class action mechanism, these big institutions do not end up funding small, minority investors in a suit.[77] While plaintiffs can automatically join a fiduciary duty action,[78] they must use their own resources and affirmatively assert a statutory appraisal claim.[79] Section 262 does not provide weak plaintiffs an adequate avenue to pursue remedies for corporate misconduct, and the statute was not designed to do so.[80]

Accordingly, courts have referred to appraisal "market checks" as checks on price, not on corporate conduct.[81] Nonetheless, courts have necessarily also reviewed deal conduct to analyze fair price[82] (e.g. if the deal was competitively shopped, the price and value is likely fair).[83] This essential determination of fair conduct—which is termed "fair process" or "fair dealing" under fiduciary duties—creates the statute's underlying problem.[84] Although the determination may be the same, it is treated differently under a statutory appraisal claim versus one brought under common law fiduciary duties.

Even though an analysis of fair process is fundamental to deciding fair price, the court disregards process in its final judgment under section 262.[85] For example, the court in *Dell* reviewed the board's actions, weighed their effects on price, and then proceeded to determine fair value.[86] If the same claim had been brought under fiduciary duties,[87] the steps of analysis would have been the same,

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Management?, LOWENSTEIN SANDLER APPRAISAL RIGHTS LITIGATION BLOG (July 11, 2016), http://www.appraisalrightslitigation.com/2016/07/11/does-the-appraisal-remedy-discipline-corprate-management/.

[74] *Id.*

[75] *Id.*

[76] Jiang et. al., *supra* note 15, at 715 (showing that hedge funds are by far the dominant force among the appraisal petitioners).

[77] *Id*.

[78] Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 32 (1990).

[79] *See* Hecht & Bodnar*, supra* note 73; *see also* DEL. CODE ANN. tit. 8, § 262 (2016).

[80] *See* DEL. CODE ANN. tit. 8, § 262 (2016) (requiring plaintiffs to follow the steps of the statute).

[81] *See, e.g.*, Global GT LP v. Golden Telecom, Inc., 993 A.2d 497, 497 (Del. Ch. 2010).

[82] Although there are arguably technical differences, fair price refers to fair value, and vice versa. *See* Rutherford B. Campbell Jr., *Fair Value and Fair Price in Corporate Acquisitions*, 78 N.C. L. REV. 101, 102–04 (1999).

[83] *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644–45 (Del. 2014).

[84] *See id.*

[85] *See* DEL. CODE ANN. tit. 8, § 262 (2016).

[86] *See* Dell, 2016 WL 3186538, at *29 (describing the court's analysis of the sale process).

[87] *See infra* Part II.A. (discussing the increase in allegations of unfair price in cash-out mergers

but the results would likely have differed.[88] If the suit were brought under a fiduciary duty claim, the court would have assessed fair process using the entire fairness test.[89] Under section 262, however, the *Dell* court did not consider entire fairness, but instead assessed fair process only to the extent it affected price, not as a separate test of ultimate fairness.[90] Therefore, the two approaches would likely have resulted in different judgments on the same issue, fair price, and the same underlying cause of action, an allegedly unfair deal.[91] Since fair process is reviewed in both section 262 and fiduciary duty claims, why is it treated differently?

The difference between the two types of claims is that fiduciary duties are based on a shareholder's right to be protected by his or her fiduciary, i.e. the board, whereas section 262 is currently interpreted as the "right to fair price."[92] However, price itself has never been recognized as a right that accrues with share ownership.[93] It is highly unlikely that the statute was meant to grant fair price on its face.[94] Instead, fair value and price is the result of *other* rights and remedies inherent in share ownership.[95] Although section 262 and common law fiduciary duties addressed different rights, the two areas of law converged over the past decades.[96] This convergence indicates strongly that the specific purpose section 262 previously served[97] and its current use have caused section 262's conflation with a check on corporate misconduct.[98] However, the statute remains poorly designed for that purpose.[99]

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under fiduciary duty claims after the 1967 DGCL revisions).

[88] Under the "fiduciary duty appraisal," the court would have stopped at fair process if it were found to be fair. Under a § 262 appraisal, which the court conducted in *Dell*, the court determined that the process affected price in a certain way, and then proceeded to determine *what* the price was. *See Dell*, 2016 WL 3186538, at *37.

[89] *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. Mar. 14, 2014) (defining the test as one of fair process).

[90] *Dell*, 2016 WL 3186538, at *37.

[91] In *Dell*, if the entire fairness test had been conducted, the fair process standard would have likely been met, and the court may not have ruled in "favor" of the arbitrageurs.

[92] LISA M. FAIRFAX, SHAREHOLDER DEMOCRACY 3–12, 30–35 (California Academic Press, 2011).

[93] *See infra* Part II; *see also* FAIRFAX, *supra* note 92, at 3–12, 30–35.

[94] *See infra* Part III.B.

[95] *See infra* Part II (tracing the history and development of share ownership rights and remedies).

[96] The seminal *Weinberger* case highlighted this convergence. *See* CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 727–28 (7th ed. 2014) ("Faced with . . . the shareholder-plaintiffs-bar's continuing avoidance of the appraisal remedy, the Delaware Supreme Court used the [*Weinberger*] case below to modernize the appraisal remedy and reshape the rules governing fiduciary-duty-based review of cash-out mergers.").

[97] *See infra* Parts II.A.–II.C.

[98] *See infra* Parts II.A.–II.C.

[99] Hecht & Bodnar, *supra* note 73.

III. CONVERGING JURISPRUDENCE: THE ENTIRE FAIRNESS TEST

The development of both fiduciary duties and appraisal rights have centered around an age-old rivalry over shareholders' rights and remedies.[100] The tension between majority and minority control has shifted back and forth in light of changing views on corporate governance.[101] One of the earliest conflicts related to the process of fundamental corporate changes,[102] which disturbed shareholder ownership rights.[103]

A shareholder has two types of ownership rights: (1) the right to vote[104] and (2) the right to exit.[105] In addition, a shareholder is owed fiduciary duties by those who govern the company: the board of directors.[106] Although the text of section 262 has not changed substantially over time,[107] its basis for entitlement has morphed considerably. Section 262 began as a reflection of the right to vote, but the statute soon became recognized as the right to sell.[108] In later years, plaintiffs began using section 262 for something entirely different: the "right to fair value."[109] In assessing fair value, courts necessarily reviewed fair process, which is Delaware's definition of entire fairness.[110]

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[100] *See generally* FAIRFAX, *supra* note 92, at 3–12, 30–35 (presenting the historical bases for shareholder rights).

[101] *See* THOMPSON & O'NEAL, *supra* note 61, at §§ 5-3, 5-10, 5-15 (discussing "the extent and the terms on which majority shareholders can use fundamental actions to force a minority out of the business" followed by "state corporation statutes [that] provide dissenters' rights which permit shareholders who dissent from specified fundamental changes . . . .").

[102] Fundamental corporate changes are defined as charter amendments and mergers. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 n.8 (Del. 1985).

[103] This is the first conflict addressed by appraisal rights. *See* In re Transkaryotic Therapies, Inc., 2007 WL 1378345, at *5 (Del. Ch. 2007) (citing R. FRANKLIN BALOTTI & JESSE A FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 9.42 (Aspen Law & Business, 3d ed. 2005)).

[104] The right to vote was historically based on the view that a corporation was a contract between shareholders and the corporate entity. More recently, the right to vote has been recognized as the right to hold or control one's property. *See* THOMPSON & O'NEAL, *supra* note 61, at §§ 5-3, 5-18, 5-19 (citing Keller v. Wilson & Co, 190 A. 115, 125 (Del. Ch. 1936)); Dalia Tsuk Mitchell, *The End of Corporate Law*, 44 WAKE FOREST L. REV. 703, 708 (2009) (discussing the views of Berle and Means, who qualified that passive control further surrendered the "control and responsibility over active property").

[105] The right to exit is the right to liquidity, or the ability to sell on the market. *See* FAIRFAX, *supra* note 92, at 30–32.

[106] PINTO & BRANSON, *supra* note 70.

[107] *See* R. FRANKLIN BALOTTI & JESSE A FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS §§ 262, 250-E–250-H (Aspen Law & Business, 11th ed. 2017) (showing § 262's amendments over time).

[108] *See* THOMPSON & O'NEAL, *supra* note 61, at §§ 5-3, 5-20 to 5-21.

[109] Unlike the right to vote and sell, a shareholder has no inherent rights to a particular price just by owning shares. *See* FAIRFAX, *supra* note 92.

[110] *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644–45 (Del. 2014).

A. A History of Appraisal Rights

Much against modern intuition, section 262 was created as a result of Delaware's attempt to give more power to majority shareholders.[111] In the early twentieth century, with the view of shareholder ownership as a right to vote, Delaware required unanimous consent of all shareholders when a corporation undertook fundamental corporate changes like a merger or consolidation.[112] At that time, corporations were much smaller and managerial control of significant decisions was dispersed among shareholders.[113] However, minority control grew too strong as a result.[114] Often, a small minority could establish "a high 'nuisance' value for their shares and exact unfair concessions from the majority by blocking or threatening to block desirable corporate change."[115] In response, Delaware created statutes that allowed for majority vote in a planned merger.[116] Concurrently, Delaware passed section 2093 of its 1935 General Corporation Law, which was the precursor of today's section 262. [117] To compensate for allowing majority shareholders to decide on mergers,[118] section 262[119] provided a remedy to minority shareholders in squeeze-out deals, also known as freeze-outs and cash-outs.[120] At that time, Delaware did not permit cash as consideration for a merger.[121] When shareholders received stock in a freeze-out, they were stuck in a company they did not want to be a part of unless they cashed out their shares in a court appraisal.[122]

By the mid-twentieth century, share ownership became associated with the right to exit.[123] The right to a unanimous vote did not comport with the centralized management structure of larger corporations.[124] However, appraisals

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[111] *See* THOMPSON & O'NEAL, *supra* note 61, at §§ 5-3, 5-20.

[112] *Id.* §§ 5-3, 5-18 (citing Irving J. Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L. REV. 420 (1930)).

[113] Eric Hilt, *When Did Ownership Separate from Control? Corporate Governance in the Early Nineteenth Century*, 68 J. ECON. HIST. 645, 663–64 (2008).

[114] *See* THOMPSON & O'NEAL, *supra* note 61, at §§ 5-3, 5-19.

[115] *Id.*

[116] *See id.* §§ 5-3, 5-20 (discussing early Delaware statutes authorizing mergers and consolidations).

[117] The Delaware Court of Chancery cited appraisal in 1944's *Root v. York Corp.* case, which was based on section 61 of the General Corporation Law § 2093 Rev. Code 1935. *See* In re Transkaryotic Therapies, Inc., 2007 WL 1378345, at *5 (Del. Ch. 2007).

[118] *See* Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective,* 56 N.Y.U. L. REV. 624, 630 (1981).

[119] Section 262 hereinafter refers to the current statute and its predecessor(s).

[120] DALE A. OESTERLE, MERGERS AND ACQUISITIONS IN A NUTSHELL 81 (West Academic Publishing, 2d ed. 2006).

[121] O'KELLEY & THOMPSON, *supra* note 96, at 718.

[122] *See id.*

[123] *See* THOMPSON & O'NEAL, *supra* note 61, at § 5-3, 5-20 to 5-21.

[124] *See* Dalia Tsuk, *From Pluralism to Individualism: Berle and Means and 20th-Century Ameri-*

were still relatively straightforward.[125] A court would determine whether the shares were traded on a public market,[126] and, if not, the court would conduct an appraisal of fair value for those shares.[127] Although the theory underlying the remedy's purpose changed, plaintiffs showed injury under the statute in the form of dissent.[128]

After the 1967 DGCL revisions permitted cash consideration in mergers,[129] a shift occurred. History shows that "unhappy minority shareholders increasingly sought to challenge cash-out mergers via class actions, rather than . . . in an appraisal."[130] Although section 262 did not accommodate class action joinder,[131] fiduciary duty class actions gave small, individual shareholders a means to fund their claims against a cash-out merger.[132] While these actions were previously limited to statutory appraisal as the exclusive remedy, courts began to entertain the claims under common law.[133] In their suits, plaintiffs alleged that their deals were conducted *for the sole purpose* of squeezing out the minority at "a grossly unfair price."[134] Consequently, the debate began over whether a court appraisal should be a price-based remedy or something more.[135] Delaware courts opted for something more.[136] In these cases, plaintiffs continued to allege injury by dissenting to the merger price.[137] It was not until the appraisal arbitrageurs got in the game that plaintiffs, in those cases, failed to show actual injury and standing.[138]

Given the overwhelming new litigation, Delaware adopted the business purpose requirement to scrutinize cash-out mergers.[139] This required companies and their controlling shareholders to show a business purpose for the squeeze-out, which placed the burden on defendants in court.[140] To determine business

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can Legal Thought, 30 L. & SOC. INQUIRY 179, 215 (2005) (discussing Berle & Means's theory and the nexus of contracts school of thought).

[125] *See* THOMPSON & O'NEAL, *supra* note 61, at § 5-3, 5-20–5-21.

[126] As defined by the specifications in § 262(b)(1). *See* DEL. CODE ANN. tit. 8, § 262 (2016).

[127] *See, e.g.*, Cole v. Nat'l Cash Credit Ass'n, 156 A. 183, 187 (Del. Ch. 1931).

[128] *Id.*

[129] O'KELLEY & THOMPSON, *supra* note 96, at 718.

[130] *Id.*

[131] This is still the case today. *See* Hecht & Bodnar, *supra* note 73.

[132] *See* O'KELLEY & THOMPSON, *supra* note 96, at 719.

[133] *See id.*

[134] *Id.*

[135] Under the appraisal exclusivity rule, unless it was clear that the underlying dispute in a transaction amounted to something more than "a difference of opinion as to value," appraisal was the only remedy available. *Id.* Defendants argued that this rule put § 262 in the position of a price-based remedy. *See id.*

[136] Singer v. Magnavox, Co. 380 A.2d 969, 980 (Del. 1977), *overruled by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[137] *Id.*

[138] *See supra* Part I.B.

[139] *See supra* Part I.B.

[140] CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 723 (7th ed. 2014).

purpose, the courts investigated "the circumstances for compliance with the . . . rule of 'entire fairness.'"[141] This was when fiduciary duties entered the equation and when courts began to review corporate conduct under appraisal-eligible claims.[142] With cost-savings and potential higher awards associated with fiduciary claims,[143] plaintiffs disfavored traditional statutory appraisals even more.[144]

B. The Development of Fiduciary Duties

Before Delaware courts adjudicated appraisals under fiduciary duty claims, the fiduciary duty doctrine developed within Delaware's foundations of corporate liberalism.[145] Delaware implemented the business judgment rule as *Shlensky* articulated, which held that "courts will not step in and interfere with honest business judgment of the directors unless there is a showing of fraud, illegality or conflict of interest."[146] Business judgment was considered integral to discharging a director's fiduciary duties, which gave rise to director liability in a breach of the duty of care or the duty of loyalty.[147]

Courts used the duty of loyalty to address conflicts of interest.[148] A conflict of interest transaction is subject to the entire fairness test *before* directors get the business judgment presumption.[149] Since most freeze-out mergers involve conflicts of interest, these claims were adjudicated under the entire fairness test.[150]

In 1983, entire fairness was articulated in the seminal *Weinberger v. UOP, Inc.* case, which notably reviewed an appraisal claim.[151] In its ruling, the court abandoned the business purpose requirement[152] but created three aspects of improved recovery for plaintiffs.[153]

First, the case liberalized Delaware's historical valuation method[154] to allow for inclusion of "all relevant factors," including the company's "future pro-

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[141] *Id.*

[142] *See id.*

[143] ALAN R. PALMITER, CORPORATIONS EXAMPLES & EXPLANATIONS 745 (7th ed. 2012).

[144] *See* CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS, *supra* note 140, at 718.

[145] *See* Seligman, *supra* note 68.

[146] Shlensky v. Wrigley, 95 Ill. App. 2d 173, 177 (Ill. App. Ct. 1968).

[147] EDWARD P. WELCH, ROBERT S. SAUNDERS, ALLISON L. LAND, JENNIFER C. VOSS & ANDREW J. TUREZYN, FOLK ON THE DELAWARE GENERAL CORPORATION LAW: FUNDAMENTALS 135 (Wolters Kluwer Legal & Regulatory U.S. 2017).

[148] *Id.* at 138.

[149] *See* PALMITER, *supra* note 143, at 251, 281–86 (defining conflict of interest and applying it to the business judgment rule).

[150] *See* PINTO & BRANSON, *supra* note 70, at 283–87 (describing freeze-outs between parent and subsidiary corporations).

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

[152] *Id.* at 715.

[153] *Id.* at 714–15.

[154] This was the "Delaware Block Method." *Id*. at 712.

spects," in calculating fair value.[155] Second, *Weinberger* included in "all relevant factors" the "elements of rescissory damages if the Chancellor considers them . . . appropriate to all the issues of fairness before him."[156] These two factors led to both higher valuations and higher recoveries in appraisals conducted post-*Weinberger*.[157] Third, the case created the "quasi-appraisal,"[158] which "attempts to 'mirror as best as possible the statutory appraisal remedy' when minority holders are hindered from exercising their traditional rights."[159]

Although the plaintiffs in *Weinberger* failed to meet the statutory requirements of section 262, quasi-appraisal still allowed for adjudication on fair value, the same issue that would have been decided under a section 262 claim.[160] In fact, the court extended its ruling to all section 262 claims thereafter, although this mandate only governed "the financial remedy."[161] The court's core determination in assessing that remedy was the extent of fair process, i.e. how the parties determined the price.[162] However, the court did not extend the fair process component to section 262 because it simply could not have done so—the court could not legislate a new requirement into the statute, even if the fair process determination was essential to the issue.[163] Nonetheless, *Weinberger*'s entire fairness test concurrently assessed process and price because "the test of fairness is not a bifurcated one as between fair dealing and price."[164]

Later courts agreed with the essential nature of fair process. Like the typical appraisal arbitrage action,[165] *Kahn v. M&F Worldwide Corp.* involved a conflict-of-interest transaction where the fiduciary sat on both sides of the deal.[166] In that case, the court ruled that the business judgment standard of review would only apply if two primary procedural protections were met: (1) the company established a special committee, which would increase the minority stockholders' bargaining power, and (2) the deal required a favorable vote from the majority of the minority stockholders, which would ensure adequacy of the special committee's negotiation.[167] The court held that "the dual procedural protection merger structure . . . and the entire fairness standard of review both converge and are

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[155] *Id.* at 713.

[156] *Id.* at 714.

[157] *See* Mark E. Betzen & Matthew R. Shurte, *An Ounce of Prevention: Managing the Increased Threat of Appraisal Proceedings Under Delaware Law*, JONES DAY (Summer 2005), http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=c68a16e3-21fb-437a-b0c0-165011300af6.

[158] *Weinberger*, 457 A.2d at 714.

[159] George S. Geis, *An Appraisal Puzzle*, 105 NW. U.L. REV. 1635, 1648 (2011) (quoting Berger v. Pubco Corp., 976 A.2d 132, 137 (Del. 2009)).

[160] *See Weinberger*, 457 A.2d at 714.

[161] *Id.* at 715.

[162] *Id.* at 711.

[163] *Id.* at 704.

[164] *Id.*

[165] *See* Jiang et. al., *supra* note 15.

[166] Kahn v. M&F Worldwide Corp., 88 A.3d 635, 642 (Del. 2014).

[167] *Id.*

fulfilled at the same critical point: price."[168] As such, Delaware established that entire fairness today equates to procedural fairness,[169] which then gets to fair price.

C. Modern-Day Appraisals

While the text of section 262 stayed relatively constant,[170] the scope of appraisal claims has broadened over time.[171] Although section 262 only addresses fair price, appraisal claims usually involve more.[172] The fact that appraisal arbitrage investors target conflict-of-interest transactions makes sense given that process is an essential consideration in price.[173] To accommodate overlapping cases, courts permit consolidation of appraisal and fiduciary duty actions.[174] In these combined actions, courts require assessment of the fiduciary duty and entire fairness standard prior to, and in aid of, the fair value determination.[175] Given the overlap of claims and the statute's questionable use, Delaware should consider writing the entire fairness test into section 262. But, how should this be done, and who should do it?

IV. DELAWARE'S LEGAL FRAMEWORK AND JUDICIAL PREDOMINANCE

A. The Role of Delaware Courts

Delaware legal experts say that its corporate law, "like that of most other American states, has a structure that entrusts a great deal of policymaking authority in the courts."[176] Courts not only control common law development, but they also determine statutory interpretation.[177] The late Judith S. Kaye said that "the common-law process remains the core element in state court decision making."[178] In addition, on issues of legislation, the late F. Reed Dickerson advised

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[168] *Id* at 644–45.

[169] *See id.*

[170] *See infra* Part III.B.

[171] *See supra* Parts II.A.–II.C.

[172] *See* Explanatory Paper, *supra* note 20; *see also* Jiang et. al., *supra* note 15. Appraisal actions specifically target conflict-of-interest transactions. *See* Explanatory Paper, *supra* note 20; *see also* Jiang et. al., *supra* note 15.

[173] *See generally Kahn*, 88 A.3d at 635; *Weinberger*, 457 A.2d at 701.

[174] WELCH, *supra* note 147, at 1002.

[175] *Id*. at 1003 ("Delaware courts have made clear that, in trying a consolidated fraud and appraisal actions, the fraud claims should be evaluated first.").

[176] Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 501 (2002).

[177] *Id.* at 25.

[178] Judith S. Kaye, *State Courts at the Dawn of the New Century: Common Law Courts Reading Statutes and Constitutions*, 70 N.Y.U. L. REV. 1, 6 (1995).

that "courts have not only a law-*finding* function . . . but . . . a law-*making* function that engrafts on the statute meaning appropriate to resolving the controversy . . . ."[179]

If a statute's meaning is unclear,[180] its context and intent must be considered.[181] Indeed, modern statutory interpretation recognizes that "the overriding object of statutory construction has been to effectuate statutory purpose as expressed in the law's text,"[182] and courts should "construe the details of an act in conformity with its dominating general purpose."[183] Given section 262's evolution and the incredible practice of appraisal arbitrage today, it would make sense for Delaware to revisit its appraisal statute and consider the law's original and current purpose.

B. Origins of the DGCL and Section 262

Since its creation in 1899,[184] the Delaware General Corporation Law (the DGCL) has remained relatively unchanged from its goal of being "the most favorable existing general corporate laws."[185] Other than the aforementioned revisions in 1967, the DGCL has not been significantly edited.[186] Perhaps unknown to outsiders, the DGCL was historically written by the General Assembly's standing committee, the Delaware Bar Association's Corporate Law Committee.[187] The current form of that standing committee is the Council.[188] Thus, Delaware's legislative power has always been delegated to a private body.[189] Although its subject matter expertise is helpful within Delaware's specialization, the Council does not offer a transparent legislative process.[190] As a result, the constituency input and representation available in typical lawmaking is not pre-

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[179] Reed Dickerson, *Statutory Interpretation: Dipping into Legislative History*, 11 HOFSTRA L. REV. 1125, 1153–56 (1983) (emphasis added) (citation omitted).

[180] The absurd results doctrine also prevents a statute from being interpreted in a ludicrous manner. *See, e.g.*, Public Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 470 (1989) (Kennedy, J., concurring).

[181] LARRY M. EIG, CONG. RESEARCH SERV., STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS 3–4 (2011), https://fas.org/sgp/crs/misc/97-589.pdf.

[182] *Id.* at 4.

[183] *Id.* (quoting Justice Jackson).

[184] Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 249 (1976).

[185] *Id.* at 271 (quoting Josiah A. Marvel).

[186] S. Samuel Arsht, *A History of Delaware Corporate Law*, 1 DEL. J. CORP. L. 1, 8–13 (1976), http://www.djcl.org/wp-content/uploads/2014/07/A-History-of-Delaware-Corporation-Law1.pdf; *see also* Seligman, *supra* note 184, at 279.

[187] Arsht, *supra* note 186, at 13–14.

[188] *See* Hamermesh, *supra* note 23, at 1754.

[189] *See id.*

[190] *See* Council, *By-Laws of the Section of Corporation Law of the Delaware State Bar Association* 4 (Apr. 21, 2016), http://media.dsba.org/sections/Corporation/CorpLawSectionByLaws2017.pdf (stating that the "[s]ection may not make public statements on proposed legislation or matters of public policy.").

sent in Delaware.[191] There exists very little legislative history to trace the DGCL's amendments over the years.

The 1967 revisions, however, did not go through the "normal process of corporation law amendment in Delaware,"[192] which was conducted by the standing committee. Instead, the revisions were a "product of a committee created as a result of special legislation."[193] The special revision committee retained Professor Ernest L. Folk to initiate the work and give his recommendations to the committee.[194] Professor Folk left behind a report of his conclusions,[195] which shed light on the first time section 262 itself was thoroughly reviewed.[196]

Strikingly, Professor Folk greatly opposed section 262 and called for its complete removal.[197] He called it "muddled theory and inconsistent treatment," and criticized how "a few transactions have been singled out to trigger cash payment rights" while other, equivalent events like a sale-of-assets do not trigger those rights.[198] Professor Folk cited two Delaware Supreme Court decisions that permitted the elimination of appraisal rights and asked that the "statutory revision confirm the result thus reached by judicial decision."[199] This recommendation speaks to the perceived predominance of the courts and Folk's belief that section 262 served little purpose.[200] Even at that time, there seemed to be no original intent left as recognizable in the statute: the right to vote no longer conformed to the structure of modern-day corporations,[201] and the right to liquidity was questionable given the statute's selectivity.[202]

On September 28, 1965, Professor Folk sent a letter to the special committee highlighting, in relation to appraisal rights, "the generally accepted concept of corporate law that a stockholder may not obtain a return of his investment in

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[191] *See id.* at 4.

[192] Arsht, *supra* note 186, at 13.

[193] *Id.*, at 13–14.

[194] *Id.* at 15.

[195] *See* Ernest L. Folk, Folk Report 196 (1967), http://delawarelaw.widener.edu/files/resources/folkreport.pdf (unpublished document); *see also* Donald E. Schwartz, *Delaware General Corporation Law—A Commentary and Analysis*, 3 CORNELL L. REV. 58 (1973) ("Folk's commentary is not official, and if one were dealing with a well-documented federal statute, one might not accord it very high priority. In view of the dearth of official Delaware authority, however, Folk's treatise is likely to perform the same function as official legislative source material, thereby giving the book even greater significance.").

[196] Folk, *supra* note 195, at 196.

[197] *Id.*

[198] *Id.*

[199] *Id.*

[200] *Id.*

[201] *See* Tsuk, *supra* note 124.

[202] Section 262's current cash exception to the exception makes liquidity an even more questionable basis for the statute's remedy. *See* Jetley & Ji, *supra* note 44 (describing the cash exemption in § 262(b)(2)).

exchange for his shares except in certain *extraordinary* circumstances . . . ."[203] Professor Folk supported limited use of section 262, which would not have contemplated appraisal arbitrage.[204] Notably, Professor Folk further recommended that the committee define the term "shareholders of record," given the "almost certain litigation over the scope of the term . . . on whether the section refers to . . . record or beneficial holders."[205] Indeed, this was the very issue that wrote out requirements of standing and injury under the statute.[206]

In another letter dated December 20, 1966, Professor Folk compared Delaware's section 262 to the Securities Exchange Act of 1934.[207] Professor Folk wrote that the Exchange Act also uses the term "shareholders of record," but pointed out that the SEC issued subsequent clarification.[208] Rule 12g5-1 specifically states "if the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the provisions of . . . the Act, the beneficial owners of such securities shall be deemed to be the record owners thereof."[209] Perhaps the SEC foresaw the issues of modern stock-trade processing.[210]

In the end, the special revision committee failed to adopt Professor Folk's proposal, although it is unclear exactly why.[211] In the only other document left by the revision team, the committee minutes mention that "Mr. Arsht discussed elimination of appraisal right where there is an established market price."[212] Correspondingly, the committee passed section 262(b)(1)'s initial market-out exception.[213] This documentation shows that if courts are to second-guess market price, there should likely be a justifiable reason and standard.[214] Otherwise,

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[203] Delaware General Corporation Law Special Revision Committee, Committee Documents 117 (1966), http://delawarelaw.widener.edu/files/resources/committeedocuments.pdf (emphasis added).

[204] *See generally id.*

[205] *Id.* at 117.

[206] *See supra* Part I.B.

[207] Delaware General Corporation Law Special Revision Committee, *supra* note 203.

[208] *Id.* (referring to Rule 12g5-1).

[209] 17 CFR 240.12G5-1 (2012).

[210] *See* George S. Geis, *An Appraisal Puzzle*, 105 NW. U.L. REV. 1635, 1650–51 (2015) (discussing the developments that led to the astounding decision in *In re Appraisal of Transkaryotic Therapies, Inc.*).

[211] Since automated stock trade processing rose after the 1960s with the consolidation of depositary trusts, it is possible the special revision committee was dissuaded from creating a burden on the relatively new trading environment. The committee had a mandate of ensuring that Delaware remain a "favorable climate" for businesses. *See* Geis, *supra* note 210 (stating the rise of centralized entities after "the system began to buckle" in the 1960s); *see also* Arsht, *supra* note 186, at 15 (quoting the revision committee mandate).

[212] Delaware General Corporation Law Special Revision Committee, Committee Minutes 94–95 (1967), http://delawarelaw.widener.edu/files/resources/committeeminutes.pdf.

[213] *Id.* at 94–95 (stating that "[t]he Committee approved as a matter of policy the elimination of a statutory right of appraisal for members of a class of stock which on the record date was either (1) registered on a National Securities Exchange or (2) had outstanding 2,000 or more shareholders; unless the corporate charter provides otherwise.").

[214] *See id.*

courts run the risk of administering regulation conducive to those who lack standing and injury under the statute.[215]

From this legislative history, it can be gleaned that (1) the original intent of the statute was not focused on granting claimants a particular price for their stock;[216] (2) the special committee relied on market price where available, consistent with the Efficient Capital Markets Hypothesis and SEC rules;[217] and (3) the issue that "record holders" may not be beneficial holders was potentially meant to be clarified.[218] The first two points highlight further reasons why fair value on its face could not have been section 262's intent. Additionally, the special committee may have anticipated future clarification on issues of standing and injury under section 262.

V. A CASE FOR THE COUNCIL

A. Reevaluation and Pullback

Who, exactly, should have clarified the definition of "record holder" is unclear.[219] Although Delaware law favors judicial interpretation,[220] the courts' hands are now tied on this strictly textual issue. Since *Salomon Brothers Inc. v. Interstate Bakeries Corporation* identified the burden of distinguishing between record and beneficial owners as a nearly impossible discovery problem,[221] courts have continued with their surface reading of section 262.[222] The court in *Salomon Brothers, Inc.* ruled on the basis of "expediency and certainty" that record holders have standing under the statute.[223] The court concluded that the corporation's list "would not establish whether . . . the same beneficial owners changed its record ownership from one nominee to another."[224] Processes were not in

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[215] This is the problem with appraisal arbitrage.

[216] This is clear from all three documents left by the special committee: the Folk Report, the Committee Documents, and the Committee Minutes. *See* Folk, *supra* note 195; *see also* Delaware General Corporation Law Special Revision Committee, *supra* note 203, at 211.

[217] *See* CHOI & PRITCHARD, *supra* note 64.

[218] *Compare* the above commentary from Professor Folk*, with* Folk, *supra* note 195.

[219] *See* Delaware General Corporation Law Special Revision Committee, *supra* note 203.

[220] Mr. Arsht of the 1967 DGCL revisions' special committee wrote, "Throughout this brief history of the Delaware General Corporation Law, I have sounded the trumpet for the Delaware judiciary and to some extent for those of us who have worked over the years to keep the Delaware statute attuned to the needs of the modem corporation." Arsht, *supra* note 186, at 21.

[221] Salomon Brothers, Inc. v. Interstate Bakeries Corp., 576 A.2d 650, 653 (Del. Ch. 1989).

[222] *See, e.g.*, In re Appraisal of Transkaryotic Therapies, Inc., 2007 WL 1378345, 4 (Del. Ch. 2007) (allowing depositary Cede & Co. to exercise appraisal rights as the record holder for all 10,972,650 shares).

[223] Salomon Brothers, Inc., 576 A.2d at 653.

[224] *Id*.

place to permit the parties to obtain the necessary information.[225] However, the limits of a trial need not be the limits of a century. It is certainly possible for depositaries and custodial banks to build their back offices to accommodate such record requests in the future, if the law so requires. That would call for legislation from the General Assembly, or, in practice, from the Council.[226]

Nonetheless, courts have spoken in the area of corporate conduct, for which they clarified the entire fairness test and applied it to appraisal claims where appropriate.[227] Given the use of section 262 by appraisal arbitrageurs, most appraisal claims currently implicate fiduciary duties.[228] However, arbitrageurs choose to pursue statutory appraisal[229] because common law requires share ownership for fiduciary duties to apply at the time of the merger. Hedge funds would lack common law standing as buyers after-the-fact.[230] Even more so, why argue about conduct if the court moves straight to price?

While hedge funds may wish to only pursue fair price, courts have necessarily reviewed aspects of conduct to get to price.[231] Although Delaware courts appear reluctant to adjudicate drawn-out trials over the parameters of fair process case-by-case, the state has favored clear prescriptions for appropriate conduct.[232] *Kahn v. M&F Worldwide Corp.* defines this precise conduct.[233]

B. An Example Proposal

Section 262's original purpose is lost today, but Delaware could still maintain the statute's current use for fair price. In order to do so, section 262 should be clarified on the issues of standing and injury. Most importantly, the overlap between statutory and fiduciary duty conflict-of-interest appraisals should be

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[225] *Id.*

[226] As mentioned, the Council drafts all legislation and almost always receives unanimous approval from the General Assembly. Hamermesh, *supra* note 23, at 1753.

[227] *See, e.g.*, Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).

[228] Numerous sources claim that appraisal arbitrageurs target conflict-of-interest transactions. *See, e.g.*, Charles Korsmo & Minor Meyers, *Reforming Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 285 (2016) (concluding that appraisal claims "more likely to involve an insider cash-out transaction.").

[229] These cases have all been litigated under § 262. *See* In re Appraisal of Dell Inc., 2016 WL 3186538,31 (Del. Ch. 2016); Merion Capital LP v. BMC Software, Inc., 2015 WL 6164771 (Del. Ch. 2015); LongPath Capital, LLC v. Ramtron Int'l Corp., 2015 WL 4540443 (Del. Ch. 2015); Merlin Partners LP v. AutoInfo, Inc., 2015 WL 2069417 (Del. Ch. 2015); In re Appraisal of Ancestry.com, Inc., 2015 WL 399726 (Del. Ch. 2015); Huff Fund Inv. P'ship v. CKx, Inc., 2013 WL 5878807 (Del. Ch. 2013).

[230] *But compare* Anadarko Petroleum Corp. v. Panhandle Eastern Corp., 545 A.2d 1171 (Del. 1988) (holding that with regard to a board and prospective shareholders, "the duty of loyalty arises only upon establishment of the underlying relationship.").

[231] *See supra* Parts II.B–II.C.

[232] *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (2016) (laying out appropriate conduct for related-party transactions, and therefore eliminating complicated litigation over parameters of required actions).

[233] Kahn v. M&F Worldwide Corp., 88 A.3d 635, 642–45.5 (Del. 2014).

addressed. Delaware could bridge the conflict by writing the entire fairness test's fair process standard into section 262.[234] If left unchanged, the risk and likelihood of different judgments on the same set of facts, analyses, and issue will continue.

By adopting a clearer and more robust statute, Delaware would unify statutory and common law appraisal claims while also limiting section 262's use and abuse. The example amendments in the Appendix create: (1) standing in the form of beneficial ownership, (2) injury in the form of active dissent, and (3) a method for reviewing conflict-of-interest transactions by an adequate and precise fair process standard.[235] This standard would require conflict-of-interest transactions to be (i) vetted by an independent board of directors and (ii) consented to by a majority of the minority shareholders.[236]

VI. CONCLUSION

While most of Delaware corporate law is created by courts, this unique complication of Delaware fiduciary doctrine is and can only be addressed by the legislature. In Delaware's case, this means that it is up to the Council.

Although the Council is a private association, it certainly still has constituents. Aside from the one-million-plus business entities that have chosen Delaware as their "legal home,"[237] all those involved in business law also have a stake in Delaware's legal establishment.[238] This Note calls on all constituents to push forth the much-needed section 262 reform by reaching out to the Council.[239] Without a revamp of Delaware's appraisal statute, the cohesiveness of its corporate law cannot be maintained, and absurd results like statutorily-initiated appraisal arbitrage will continue to endure.

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[234] The suggested fair process standard is that which is articulated in *Weinberger* discussed above and throughout this Note.

[235] *See infra* Appendix.

[236] Kahn, 88 A.3d at 644.

[237] *About Agency*, STATE OF DELAWARE, http://www.corp.delaware.gov/aboutagency.shtml (last visited Apr. 10, 2017).

[238] According to a Southeast law firm, virtually all business lawyers come across Delaware law. *See The Basics of Corporate Governance*, HUTCHISON PLLC (Mar. 18, 2009), http://www.hutchlaw.com/library/the-basics-of-corporate-governance.

[239] The twenty-six Council members of the Delaware Bar Corporate Law Section are listed on its website. *See Corporate Law*, DSBA, https://www.dsba.org/sections-committees/sections-of-the-bar/corporation-law/ (last visited Apr. 7, 2017).

VII. APPENDIX

The Author recommends adoption of the following amendments to incorporate the entire fairness test into Delaware's appraisal statute. Only the proposed amendments denoted in red are the Author's work. All text below not red and/or not italicized are a reproduction of DGCL Title 8, § 262.

I. *Amend § 262(a) by making insertions as shown by underline and deletions as shown by strikethrough as follows:*

Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation, who has otherwise complied with subsection (d) of this section and who has voted against ~~neither voted in favor of~~ the merger or consolidation and refused consent ~~nor consented~~ thereto in writing pursuant to § 228 of this title shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock under the circumstances described in subsections (b) and (c) of this section. As used in this section, the word "stockholder" means a beneficiary holder of record of stock in a corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words; the word "holder" shall mean beneficiary holder of record; and the words "depository receipt" mean a receipt or other instrument issued by a depository representing an interest in 1 or more shares, or fractions thereof, solely of stock of a corporation, which stock is deposited with the depository.

II. *Amend § 262(d)(1) by making insertions as shown by underline and deletions as shown by strike through as follows:*

Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has voted against and refused consent to ~~not voted in favor of or consented to~~ the merger or consolidation of the date that the merger or consolidation has become effective; or

III. *Amend § 262(e) by making insertions as shown by underline and deletions as shown by strike through as follows:*

. . . . Within 120 days after the effective date of the merger or consolidation, any stockholder who has complied with the requirements of subsections (a) and (d)

of this section hereof, upon written request, shall be entitled to receive from the corporation surviving the merger or resulting from the consolidation a statement setting forth the aggregate number of shares voted against and refused consent to ~~not voted in favor of~~ the merger or consolidation and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. . . .

IV. *Amend § 262(g) by making insertions as shown by underline and deletions as shown by strikethrough as follows:*

At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings, provided that, if the merger or consolidation involved a conflict of interest for a member or members of the board of directors, the stockholders adequately demonstrate (1) the merger or consolidation was not approved by a well-functioning committee of independent directors, and (2) the transaction was not approved by an informed vote of a majority of the minority stockholders; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder. If immediately before the merger or consolidation the shares of the class or series of stock of the constituent corporation as to which appraisal rights are available were listed on a national securities exchange, the Court shall dismiss the proceedings as to all holders of such shares who are otherwise entitled to appraisal rights unless (1) the total number of shares entitled to appraisal exceeds 1 % of the outstanding shares of the class or series eligible for appraisal, (2) the value of the consideration provided in the merger or consolidation for such total number of shares exceeds $1 million, or (3) the merger was approved pursuant to § 253 or § 267 of this title.