# THE CASE FOR ITERATIVE STATUTORY REFORM: APPRAISAL AND THE MODEL BUSINESS CORPORATION ACT

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## I

## INTRODUCTION

Appraisal may be the Model Business Corporation Act's (MBCA) most distinctive and creative corporate law product in its sixty year history.[1] This right of shareholders to require the corporation to pay them the fair value of shares upon some mergers or other fundamental changes does not seem a likely candidate for a statutory success story. It is a policy provision that does not exist widely outside the United States,[2] its initial purpose has essentially disappeared, its statutory language is often the most convoluted of any section of a corporations code, and its history has been a series of statutory and judicial steps to gut its provisions.[3] Yet, through a series of changes, beginning in the late 1970s and early 1980s, and continuing through revisions in 1999 and 2006, the MBCA has shown the value that can come from an ongoing revision process of corporate law. It took several efforts to produce a remedy directed towards conflict of interest rather than providing liquidity, and there were missteps

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1. "Distinctive" is used here to characterize the efforts of the MBCA that differ from Delaware, the other primary source of corporate statutes in America. "Creative" is used here to identify a statutory provision that differs from those that went before in both substance and importance. My list of most important MBCA provisions would include the following: (1) appraisal, (2) the involuntary dissolution–oppression statute in subchapter C of chapter 14, (3) the distributions provisions of chapter 6, (4) the standards of conduct and standards of liability approach of subchapter C of chapter 8, (5) the indemnification provisions of subchapter E of chapter 8, (6) the conflicting interest provisions of subchapter F of chapter 8, (7) the demand–derivative suit procedures of subchapter D of chapter 7, (8) exculpation in section 2.02(b)(4), (9) permitting majority voting limits to the usual plurality voting in section 10.22, and (10) shareholder bylaws in section 2.06. In the last three, for example, the MBCA has followed Delaware's lead; in the middle four, changes were made in conjunction with Delaware or building on Delaware precedents or changes. *See* Jeffrey M. Gorris, Lawrence A. Hamermesh & Leo E. Strine, Jr., *Delaware Corporate Law and the Model Business Corporation Act: A Study in Symbiosis*, 74 LAW AND CONTEMP. PROBS. 107, 107–08 (Winter 2011) (discussing the overlap between the MBCA and Delaware). It is the first three where the MBCA has made its most distinctive contribution.

2. *See* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 200–02 (2d ed. 2009) (explaining that European jurisdictions have never turned to appraisal rights as a general remedy, although Germany and Italy provide remedies that resemble appraisal; Japan also has an appraisal remedy).

3. *See* discussion *infra* Part II.

along the way. Yet, the result has brought coherence to a topic where it has been sorely lacking; the product seems to have staying power even though it has not yet been widely adopted by the states. This article examines how this shift came about, looking first at the challenges that have long plagued appraisal statutes, and then evaluating the product that has resulted from the MBCA approach.

## II

## THE CHALLENGES PRESENTED TO LAW REFORMERS BY THE TRADITIONAL APPRAISAL STATUTES

The appraisal process has long appeared dysfunctional to commentators and many judges.[4] In one sense, this is because there is no longer a social consensus behind the law's original purpose that a merger or other fundamental change should be a trigger to permit individual shareholders to demand that the corporation repurchase their stock, a liquidity that investors in the corporate form usually lack.[5] The array of appraisal avoidance techniques receiving legal sanction has grown over the decades in topsy-turvy ways that have undermined any coherent functioning of the appraisal process or an understanding of its purposes. An even larger contributor to this dysfunctionality is that, as this liquidity use of appraisal has diminished to the point of invisibility, appraisal has grown dramatically in a different transactional context where shareholders are guaranteed liquidity for their investment, but need protection against the conflict of interest of those in control of the corporation who are setting terms at which the minority shareholders must exit. The traditional procedures of the appraisal statute, originally put in place to make it harder for shareholders choosing to get out, now work to exacerbate the difficulty of a minority shareholder being forced out of the enterprise on terms set by the majority. Legislators have been slow to update appraisal statutes, and courts, even if more attuned to the need to keep corporate law current, have been uneven in the extent to which they have captured this fundamental shift.

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4. *See, e.g.*, Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 241 (1962) (explaining that indiscriminate application of appraisal is pernicious); ERNEST L. FOLK III, THE DELAWARE GENERAL CORPORATION LAW: A COMMENTARY AND ANALYSIS 373 (1972) (arguing that appraisal is of decreasing importance and it "would not be surprising to see it eliminated altogether").

5. Appraisal is an outlier among corporations' policies in terms of what it seeks to accomplish. Most statutory provisions reflect the core corporate characteristics of centralized control, majority rule, and entity permanence. Corporate decisions are left to the board of directors, and majority shareholders can control the board. Minority shareholders must go along with these centralized decisions and usually have no right to require the corporation to return their money until the board chooses to do so. In contrast to this approach, appraisal permits an individual shareholder who dissents from a decision made by the directors and the majority of shareholders to obtain the fair value of the shares from the corporate treasury.

## A. The Decline of the Traditional Liquidity Function of Appraisal Statutes

Appraisal statutes appeared in state statutes at the time that general incorporation statutes first gave majority shareholders in corporations a clear route to approve a merger or other fundamental change by less than a unanimous shareholder vote.[6] These statutes provided minority shareholders the ability to exit from an enterprise when the majority owners fundamentally shifted the entity's business.[7] This remedy provided, as continues to be common today, that the minority shareholders would receive the value of their shares at the time just before the merger, exclusive of any change due to the merger, thus preserving the investment value as it existed prior to the change to which the minority objected.[8]

Concern over the adverse impact on the continuing business from the corporation having to shrink the size of its capital by giving back cash to dissenters was visible early on in the appraisal context and grew over the twentieth century.[9] The statutes contained (and still contain) a series of strict procedural requirements that a dissenting shareholder must complete to "perfect" dissenters' rights.[10] These statutes were strictly construed so that if a shareholder missed one or more of these steps, the shareholder lost the right to appraisal and was relegated to the consideration specified in the merger.[11]

Over the twentieth century, the law moved more firmly in the direction that one who invests in a corporation has agreed to business decisions being made by the directors or majority shareholders, even for changes previously seen as fundamental.[12] Private planners achieved success in using alternative structures of business deals to avoid appraisal rights in statutory mergers.[13] For example,

6. *See* Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 14–15 (1995) (describing the implementation of appraisal statutes across the country). For a discussion of unanimous consent requirements, majority rule, and the early use of appraisal, see William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purpose,* 1980 AM. B. FOUND. RES. J. 69 (1980); *see also* Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 86–90 (1995) (discussing less than unanimous requirements inserted in charters prior to the change in corporate law itself and appraisal-type relief sought from common law courts).

7. *See, e.g.*, Norman D. Lattin, *A Reappraisal of Appraisal Statutes*, 38 MICH. L. REV. 1165, 1181 (1940) (explaining that appraisal is used to balance interests "between the modern corporation with its tremendous powers to make change and the shareholder who is unwilling to keep his stake in the company when there is radical change").

8. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262(h) (2001).

9. *See* Manning, *supra* note 4, at 241 ("Every extension of the appraisal remedy increases the burdens on the going enterprise.").

10. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262(d) (2001).

11. *See* Thompson, *supra* note 6, at 40 n.175 (citing exemplary cases).

12. *E.g.*, Shlensky v. Wrigley, 237 N.E.2d 776, 778–79 (Ill. App. Ct. 1968) ("Every one purchasing or subscribing for stock in a corporation impliedly agrees that he will be bound by the acts and proceedings done or sanctioned by a majority of the shareholders or by the agents of the corporation duly chosen by such majority, within the scope of powers conferred by the charter . . . .") (quoting Wheeler v. Pullman Iron & Steel Co., 32 N.E. 420, 423 (Ill. 1892)).

13. *See, e.g.*, George S. Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares*, 19 CAL. L. REV. 349, 350 (1931) (stating it was fashionable to use statutory sale of assets rather

corporations statutes permitted a sale of assets on the acquiring side by the board, acting alone, without shareholder voting or dissenter's rights;[14] Delaware went further by denying appraisal to *selling* company shareholders in a sale of assets.[15] Yet, it is fairly easy to combine the acquiring corporation's purchase of all of the assets of a target company in exchange for cash or other consideration, with the dissolution of the target company and the distribution of the consideration from the corporate treasury to the target shareholders, such that the transaction is the financial equivalent of a merger. Delaware courts have refused to apply the de facto merger doctrine to such a deal, thus permitting planners to structure their transaction so as to avoid appraisal rights.[16] In states outside Delaware where statutes typically do provide for appraisal for selling company shareholders, some courts have applied the de facto merger doctrine to an "upside down" transaction, where planners have labeled the target as the nominal buyer (so shareholders would lack appraisal rights), but this nominal buyer is giving up so many shares as consideration for the assets being acquired that it is effectively being purchased without the appraisal rights usually provided to selling shareholders.[17]

Using the sale-of-asset form has become less necessary since the acceptance of the triangular-merger form of acquisition.[18] In a triangular merger, the acquiring corporation sets up a wholly owned subsidiary, usually funds the subsidiary with stock of the parent, and then causes the subsidiary to merge with the target under a regular statutory merger. Pursuant to the usual merger requirement, shareholders of each constituent entity vote and get appraisal. Since only the newly formed subsidiary and the target are parties to the merger, shareholders of the parent are denied any appraisal rights.[19]

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than consolidation or merger); FOLK, *supra* note 4, at 318 ("Prior to 1967, the merger technique was a second choice for Delaware corporate counsel . . . .").

14. *See, e.g.*, DEL. CODE ANN. tit. 8, § 271 (2001) (requiring shareholder vote only on the selling side in a sale of asset statute).

15. DEL. CODE ANN. tit. 8, § 262 (2001) (omitting sale of assets from transactions generating appraisal).

16. *See* Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963) (holding that the sale of assets statute and merger statute are independent and of equal dignity).

17. *See* Applestein v. United Bd. & Carton Corp., 159 A.2d 146, 156 (N.J. Super. Ct. 1960) ("[W]hile United appears to be acquiring Interstate, the converse is probably more true in practical effect. We cannot blind ourselves to the realities . . . ."); Farris v. Glen Alden Corp. 143 A.2d 25, 31 (Pa. 1958) ("[W]e will not blind our eyes to the realities of the transaction. . . . Glen Alden does not in fact acquire List, rather List acquires Glen Alden, and under [the statute] the right of dissent would remain with the shareholders of Glen Alden."); *see also* Terry v. Penn Cent. Corp., 668 F.2d 188, 194 n.7 (3d Cir. 1981) (rejecting de facto merger doctrine under Pennsylvania law, but leaving open the possibility of a different result if the transaction was structured as a minnow swallowing a whale).

18. Similarly, planners of an acquisition can structure an acquisition as a sale of the target's assets to the acquiring company instead of a merger. Under usual state law, only the shareholders of the selling company receive voting rights and appraisal rights in such a structure.

19. There is only one shareholder of the subsidiary—the parent corporation, and pursuant to usual rules of corporations law, the parent's board decides how the subsidiary votes on the merger and if it wants to exercise appraisal rights. The answer to the last question is, of course, no.

Eventually, legislatures approved broadened exceptions to appraisal, excluding appraisal rights from surviving corporations in the merger without the need to resort to the sale-of-asset form or a triangular merger. In some states that follow the language of the post-1999 MBCA, no surviving shareholders have appraisal rights; in Delaware and states using earlier versions of the MBCA, shareholders of surviving corporations retain appraisal rights for deals where the number of outstanding shares increases by more than twenty percent.[20] The lessened rights for the shareholders of a surviving corporation as compared to a disappearing company could be supported if there were a noticeable difference in the risk of the two sets of shareholders, such that there was a greater need for legal protection of one set more than the other. Professor Ron Gilson provided an explanation for why that might be so: shareholders in the surviving corporation continue to have access to a variety of market and private ordering constraints on their managers to align the interests of the manager and shareholder, but in the disappearing corporation, managers are in a "final period" without continuous monitoring from those sources such that additional legal protection could be appropriate.[21]

The judicial acceptance of triangular mergers, judicial reluctance to apply the doctrine of de facto merger, and the spread of statutes providing an explicit denial of appraisal rights for shareholders of the surviving corporation, mean that appraisal rights will only exist for the surviving corporation if the planners want them to exist. In effect, it is an optional, not a mandatory, rule.

As to the target company being acquired, the same freedom to avoid appraisal has not been accorded by the doctrines just discussed. There has, however, been a significant pullback from the availability of appraisal on the target-corporation side because of market-out exceptions that now appear in Delaware, the MBCA, and a large majority of states.[22] Under these provisions, a shareholder of a corporation whose shares are traded in an active market does not get appraisal if the shareholder receives merger consideration that is also actively traded stock. This is partially consistent with a liquidity function in that the law does not need to provide liquidity if the market already does.

So what we are left with is that appraisal regularly is not provided to shareholders of a surviving company in a merger, and is not provided to target companies if there is an alternative liquid market. Shareholders of non-public target companies who get non-liquid consideration remain protected by appraisal. This ends up being a fairly small area of coverage for appraisal and one that does not seem worth the effort that the statute requires. There is, however, one more group that gets appraisal. As discussed below, some shareholders who receive liquid consideration in the form of cash for their

20. *See* DEL. CODE ANN. tit. 8, § 262(b)(1) (2001) (referencing § 251(f)).

21. RONALD J. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 579 (1986).

22. *See* DEL. CODE ANN. tit. 8, § 261(b)(1) (2001); MODEL BUS. CORP. ACT § 13.02(b) (2008); MODEL BUS. CORP. ACT ANN. statutory comparison at 13-34 (2008) (reporting thirty-six states with market-out provisions).

shares still receive appraisal, reflecting a policy that has nothing to do with liquidity and everything to do with conflict of interest, even though that is not stated in the Delaware statute.

### B. The Rise of Appraisal in a Cash-Out Merger Setting as a Remedy for Majority Conflict and Oppression of Minority Shareholders

A second core cause of dysfunctionalism in appraisal statutes is that, at the same time that there has been a decrease in the traditional exit-providing function for fundamental corporate changes, there has been a dramatic surge in appraisal being used in the opposite factual context, where shareholders are assured liquidity in the merger, but have reason to question how the amount was determined. Private planners took advantage of changes in corporations statutes in the 1960s that, for the first time, allowed cash as consideration for mergers as well as stock or other securities.[23] Even more importantly, in corporations where there already existed a majority shareholder, planners put forward, and courts permitted, deals with merger terms that specified that cash would be paid only to minority shareholders so that they were effectively forced out of the business.[24] These shareholders had appraisal rights, either in Delaware because of an exception to the market-out that excluded cash deals, or in other states where there was no market-out.[25] Yet appraisal had terms unfavorable to a minority shareholder in such a situation. The definition of valuation, as of the day before the merger, encouraged majorities to time a merger when the stock was undervalued and to exclude synergies that might be created by the merger.[26] The procedural requirements worked to ensure that some percentage of minority shareholders would not pursue their appraisal rights and would be left with the terms provided in the merger. In effect, the original procedural rules that had been included to prevent minorities from taking advantage of majorities when the minority was seeking to exit had now been flipped and were positioned to disadvantage minorities when the majority was forcing them to exit. Majority shareholders, seeing the advantages that appraisal offered in minimizing the costs of acquiring the minority, have benefited from cases holding that appraisal should be the exclusive remedy.[27]

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23. The historical context is covered well by Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 626–57 (1981).

24. *See, e.g.*, Stauffer v. Standard Brands, Inc., 187 A.2d 78, 80 (Del. 1962).

25. *See* DEL. CODE ANN. tit. 8, § 262(b)(2) (2001). Market-out does not apply if shareholders are required to accept anything other than four types of permitted consideration. Cash is not one of the named non-appraisal-generating types of consideration (unless given in lieu of fractional shares). That is to say, the four named types of consideration exhaust the non-appraisal-generating consideration. Any other consideration, including cash in a cash-out, is appraisal-generating.

26. *See, e.g.*, Green v. Santa Fe Indus., Inc. 533 F.2d 1283, 1297 n.4 (2d Cir. 1976), *rev'd on other grounds,* 430 U.S. 462 (1977) ("In short, the controlling shareholders have every incentive to freeze out the outsiders since, even if the appraisal system functions perfectly, by the terms of the statute, the insider alone captures all of the prospective gains associated with the merger.").

27. *See, e.g.*, Stringer v. Car Data Sys., Inc., 841 P.2d 1183, 1190–91 (Ore. 1992) (holding that plaintiff could only pursue appraisal for claim that shares were worth fifty times the amount of the

The switch in the context in which appraisal was used was dramatic. In the decade after the *Weinberger* decision (discussed below) the number of appraisal cases increased dramatically over the previous decade.[28] More than eighty percent of those cases involved cash-out mergers, confirming the shift that had occurred in the appraisal context.[29] At this point, some courts, but certainly not all, sought to address the discontinuity of appraisal in this new context. *Weinberger v. UOP, Inc.*, the still classic 1983 Delaware case, is a prominent example, in which a fifty-one percent majority shareholder had accomplished a merger that forced the minority out of the entity on terms chosen by the majority.[30] After a report that was completed by two officers of the parent (who also served as directors of the subsidiary) described the synergies that could flow from such a combination and the advantages "of ousting the minority at a price range of $21 to $24 per share," the merger went through at twenty-one dollars per share.[31] The court held that the merger did not meet the test of fairness. In the process, it threw out then-existing Delaware law that relied exclusively on a mechanistic "Delaware block" method to determine fair value in an appraisal context and inserted in its place "a more liberal approach [that] must include proof of value by any techniques or methods which are generally considered acceptable in the financial community."[32]

The court was very direct as to the deficiencies of the existing "clearly outmoded" Delaware appraisal process, and declared "it is time we . . . bring our law current."[33] Its most specific change was to significantly narrow the statutory provision that value must exclude "any element of value arising from the accomplishment or expectation of the merger."[34] This is the part of the traditional appraisal statute, drawn from its origins in providing liquidity, that is most out of place in a statute used in a cash-out setting, a phrasing that would easily facilitate the statute being used oppressively against minority shareholders. The court declared this clause to be "a very narrow exception," excluding only "projections of a speculative variety," and permitting a wide variety of elements of future value, which are known or susceptible of proof as

consideration specified in the merger); Yeager v. Paul Semonin Co., 691 S.W.2d 227, 229 (Ky. Ct. App. 1985) (holding that an allegation that a transaction was for the sole purpose of freezing out minority shareholders does not state a claim for fraud or illegality to support remedy beyond appraisal).

28. Joel Seligman reported nineteen state court appraisal cases in the ten years leading up to the *Weinberger* decision in 1983. Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829, 829 n.3 (1984). Thompson, surveying appraisal cases in the decade that followed *Weinberger*, found 103 reported cases covering eighty separate transactions. *See* Thompson, *supra* note 6, at 25.

29. Only six of the eighty transactions involved two independent companies merging. *See* Thompson, *supra* note 6, at 27 tbl.1.

30. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

31. *See id.* at 708, particularly item three in the outline of the benefits expected to flow from the merger.

32. *Id.* at 712–13.

33. *Id.* at 712.

34. *Id.* at 714.

of the date of the merger.[35] The result was to adapt the appraisal statute to the new context without legislative action required.[36]

The opinion suggested that appraisal, as modernized, would be the usual or even exclusive remedy for a cash-out merger, but it also provided that in times of conflict, appraisal would be inadequate, and fiduciary duty examination via a focus on fair dealing and fair price would be appropriate.[37] Subsequent Delaware opinions have confirmed the result that, in regular mergers where there is a conflict of interest, Delaware shareholders have a choice of appraisal or fiduciary duty;[38] fiduciary duty remains available to permit minority shareholders to seek relief in contexts where they feel appraisal might be inadequate.[39] In short-form mergers, where the controlling shareholder already owns ninety percent or more of the outstanding stock, Delaware's statute makes appraisal exclusive, but the Delaware courts have graphed several fiduciary-duty-type protections onto the bare bones of the statute to make the statutory protection more like what has evolved for breaches of fiduciary duty under common law.[40]

Outside of Delaware, states have split on when appraisal is the exclusive remedy,[41] the appropriateness of discounts for lack of marketability or for minority status,[42] the appropriateness of considering alleged majority misconduct in appraisal,[43] and the procedural terms for determining value.[44] The

35. *Id.* at 713.

36. The court relied on the statutory reference to take into account "all relevant factors." *Id.* at 714. That term, while new to the statute, was a part of existing Delaware case law. *See, e.g.*, Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 114 (Del. 1952).

37. *Weinberger*, 457 A.2d at 714.

38. *See, e.g.*, Kahn v. Lynch Commc'n Sys., Inc. 638 A.2d 1110, 1113–14 (Del. 1994).

39. *See, e.g.*, *In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ.A. 16415, 2004 WL 1305745, at *38 (Del. Ch. June 4, 2004) (discussing appraisal and breach of fiduciary duty claims in a cash-out setting).

40. *E.g.*, Glassman v. Unocal Exploration Corp., 777 A.2d 242, 246 (Del. 2001) (holding that appraisal valuation may consider issues typically raised in unfair dealing claims and that the duty of full disclosure remains); Berger v. Pubco Corp., 976 A.2d 132, 145 (Del. 2009) ("[T]he majority stockholder's duty of disclosure provides important protection for minority stockholders being cashed out in a short form merger. This protection—the quasi-appraisal remedy for a violation of that fiduciary disclosure obligation—should not be restricted by opt in or escrow requirements.").

41. *See, e.g.*, Fleming v. Int'l Pizza Supply Co., 676 N.E.2d 1051, 1057 (Ind. 1997) (holding that appraisal is exclusive even in conflict transactions and that the statute strongly favors majority rule and finality of corporate transactions). *See generally* F. HODGE O'NEAL & ROBERT B. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 5.33 (rev. 2d ed. 2010).

42. *See* Stanton v. Republic Bank, 581 N.E.2d 678, 682 (Ill. 1991) (upholding trial court discount for both). Most courts have rejected such discounts. MODEL BUS. CORP. ACT § 13.01(4)(iii) (2008) (defining fair value to exclude discounts for lack of marketability and minority status); *see also* AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE § 7.22 (excluding discounts for both). *See generally* O'NEAL & THOMPSON, *supra* note 41, at § 5.32.

43. *Compare* Sieg Co. v. Kelly, 568 N.W.2d 794, 801 (Iowa 1997), *with* Steinberg v. Amplica, Inc. 729 P.2d 683, 690 (Cal. 1986). *See generally* O'NEAL & THOMPSON, *supra* note 41, at § 5.32.

44. The Delaware Supreme Court recently noted "case law is replete with examples where the dissenting minority shareholders that failed to comply strictly with certain technical requirements of the appraisal statute, were held to have lost their entitlement to an appraisal [that] . . . effectively allowed

result is that the degree to which appraisal protects minorities or is a vehicle of majority misuse varies from state to state. There remains not just diversity, but real confusion in the application of appraisal.

### C. The Extent of Appraisal's Dysfunctional Nature Illustrated

The dysfunctional nature of appraisal has been compounded because the statutory language is among the most confusing of all corporations statutes. Take Delaware's appraisal statute as an example. It begins with a simple (and broad) declarative statement in section 262(b) that appraisal rights are available for shareholders in both of the constituent corporations to a merger, a straightforward declaration of the world circa the early 1900s.[45] Section 262(b)(1) immediately asks readers to reverse direction by removing appraisal for publicly traded shares.[46] After an easy-to-overlook semicolon, a second exception is tucked into the same paragraph, removing appraisal for shareholders of the surviving corporation so long as its shareholders do not get to vote on the merger as determined by section 251(f). A review of the shareholder voting requirements in section 251 reveals that subsection (c) begins with a global requirement for voting by shareholders of both corporations in a merger, but then, subsection (f) reverses that rule if three conditions are met.[47] The most relevant of the three is the last one, which removes a vote if the number of shares to be issued in the merger does not exceed twenty percent of the previously outstanding shares. Thus, to this point, two exceptions have been made available by the statute: the first potentially applies to both acquiring and target corporations whose shares are publicly traded, and the second only applies to shareholders of the corporation surviving a merger. Since surviving corporations with publicly traded shares are already covered by the first, or market-out, exception, the real impact of the second clause is to preserve appraisal for shareholders of non-public surviving corporations who, pursuant to the terms of the merger plan, have issued shares surpassing twenty percent of their preexisting total.

It would be possible to argue that sections 262(b) and 262(b)(1), as to surviving corporations in a merger, reflect a definition of which transactions are so fundamental as to generate the exit right for shareholders of a surviving corporation, that is, those that would reflect a substantial change to their enterprise, as measured by a twenty percent dilution of their ownership position. But that would be an illusion. Planners can avoid appraisal rights for

the corporation to retain the entire difference between fair value and the merger price." Berger v. Pubco Corp., 976 A.2d 132, 144 (Del. 2009). The court reasoned from that precedent that "fairness requires that the corporation be held to the same strict standard of compliance." *Id.* An alternative approach would be for the legislature to recognize how out of date its statute is and bring it current with fairness for both sides. *See generally* O'NEAL & THOMPSON, *supra* note 41, at § 5.31.

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

46. *See id.* § 262(b)(1) (defined by the statute to be shares traded on a national securities exchange or held of record by more than 2000 shareholders).

47. *Id.* § 251.

these shareholders simply by structuring the deal as a triangular merger between the target company and a wholly owned subsidiary of the acquiring company.[48] The complexity (and mandatory appearance) of the statute does nothing to guarantee appraisal for any surviving corporation shareholder beyond what planners may voluntarily choose to provide.

That leaves the possible impact on shareholders of the disappearing corporation. The language of sections 262(b) and 262(b)(1) suggests that shareholders of disappearing corporations, too, will lose appraisal if they have liquidity in the form of a market for their shares. But section 262(b)(2) then requires an additional 180 degree turn. Its initial clause, "[n]otwithstanding paragraph (1)" suggests it will reverse both exceptions in subsection (1)—the market-out and the out for surviving corporation shareholders without a vote—but parsing the words that follow reveals the subsection only applies to shareholders of the disappearing company (that is, "holders . . . required by the terms of an agreement of merger . . . to accept" specified consideration for their shares).[49] Since shareholders of the surviving company will continue to hold their existing shares, they will not be covered by this clause and cannot regain appraisal rights.

Section 262(b)(2) is written to reinstate appraisal rights for shareholders of the disappearing corporation if they are required to accept any consideration *except* four named kinds of consideration. In other words, after requiring two 180 degree reversals of direction, the statute defines the coverage in the negative, requiring readers to make one additional reversal of position. Thus, the four named kinds of consideration are consideration that a shareholder can be required to accept and get no appraisal. They include shares of the surviving corporation, shares of another corporation if it is publicly held, cash (but only in lieu of fractional shares), or any combination of the first three. The crucial substantive effect derives from the consideration outside this list: those unnamed forms which are "appraisal-generating" consideration. Cash is the most important of the appraisal-generating consideration, a choice that is a bit bizarre given that, in the earlier period, appraisal was triggered to provide shareholders liquidity. The most common place that cash is used in mergers today is in the cash-out context where an existing majority shareholder is forcing the minority owners out of the entity on terms chosen by the majority. This, of course, is a classic conflict-of-interest context, which is a legitimate basis for legal intervention, but not one described in the Delaware statute, or one that is part of the historical justification for appraisal, or one that the procedural and substantive rules of the statute reflect very well.

48. Stock exchange listing requirements can require a shareholder vote in a triangular setting because of inclusion of "any transaction or series of related transactions" that increase the number of outstanding shares by twenty percent. *See* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 312.03(c) (2009). But such a requirement does not provide appraisal rights, which turn on voting entitlement under the state statute. DEL. CODE ANN. tit. 8, § 251 (2001).

49. DEL. CODE ANN. tit. 8, § 262(b)(2) (2001).

Outside of such a conflicted transaction, there remain two examples in Delaware where the shareholder of a disappearing company can pursue appraisal. In an arm's-length merger, where two independent sets of managers have negotiated a merger plan, a shareholder who disagrees with the terms that its management negotiated and its majority shareholders approved, can pursue a judicial valuation alternative if (1) the disappearing company is a non-public corporation, or (2) the disappearing company is a public company and the planners have provided that cash is the consideration to be used. In the second category, if the consideration is stock of the acquiring company or even stock of a third party public company, the shareholders lose their appraisal remedy. A statute providing that shareholders of a public company engaged in a non-interested merger transaction should have appraisal rights when they get cash, but not when they get shares, suggests a non-liquidity function of appraisal, but one that planners can easily avoid in most deals if they are not using cash.

Overall, this statute is as far from "plain English" as a statute can get and is the strongest argument for the need for Delaware to update its corporations code. The value of continuity of statutory language, structure, and numbering is insufficient to trump such a warren of confusion. Even if one were to correctly follow the operation of the statute through the twists and turns, the result is to provide appraisal rights in a series of transactions that cannot be explained by reference to a coherent policy. The statute does little more than provide a lucrative opportunity for Delaware lawyers to explain what the statute means and suggest ways around it. That seems a weak reed to support the continuity of this structure.

The actual litigation of appraisal claims only furthers the dysfunctionality argument. The proceedings are often long and expensive and results seem somewhat random.[50] Consider the well-known case of *Cede & Co. v. Technicolor, Inc.*[51] Technicolor had long been an icon in the movie business and an early pioneer in adding color to movies, but by the 1980s, had faced increasing competition in that business and declining prospects overall. Management implemented an ill-advised diversification into one-hour-photo locations leading to a decline in its stock from $22.13 to less than $8.37 over sixteen months. At that point, an outsider bidder (Ronald Perelman, who would gain fame for his takeovers of Revlon and other companies) offered to buy the shares for more than a 100% premium. Management and the board of directors (with no connection to Perelman) eventually agreed to an acquisition, as did eighty-five percent of the shareholders who tendered their shares for the specified premium. As set out in the deal structured between the parties, the

50. Manning compared a shareholder's appraisal remedy to having an Irish sweepstakes ticket: "not earned, unrelated to their work, usually worth nothing, and once in a great while a windfall." MANNING, *supra* note 4, at 261–62. The recent experience, outside of the interested transaction settings, seems similar.

51. Cede & Co. v. Technicolor, Inc., 684 A.2d 289 (Del. 1996). This is one of dozens of reported decisions as to the transaction between these parties.

acquirer followed the tender offer with a cash-out merger providing the remaining shareholders the same twenty-three dollar cash price. One shareholder, who had purchased when the stock traded at around ten dollars, sought a value even higher than the handsome premium negotiated by independent managers and accepted by an overwhelming majority of shareholders. Litigation lasted for more than twenty years. During that time, two chancellors of Delaware conducted separate valuation proceedings as part of lengthy trials, one valuing the shares at $21.60 and the other at $21.98, each below the consideration offered in the deal, so that the shareholders would have been worse off for their two decades of litigation. At this point, the Delaware Supreme Court, applied procedural rules to apply a financial assumption from the initial chancery valuation to the second chancellor's valuation, producing a new value exceeding twenty-eight dollars, a result that finally provided the plaintiff a higher judicial valuation than the market and disinterested corporate actors had produced twenty years before.[52] Litigation such as this does little to refute the aura of dysfunctionality about appraisal.

## III

## THE PROMISE OF THE MBCA APPROACH TO ONGOING STATUTORY REVISION

At the time the MBCA was first published in 1950, appraisal had not moved beyond its roots of blanket coverage for shareholders of both companies in a merger and strict requirements for perfection of appraisal rights. The common law developments of de facto merger and the lawyerly innovations of triangular mergers described above occurred beyond the range of the statute. The MBCA did adopt a market-out exception in 1969, but then fairly quickly retreated from that change.[53]

The first stirrings of reform occurred in 1978 with a series of amendments that reflected the growth of squeeze-out possibilities in cash-out mergers. For the first time, the company was required to pay its estimate of fair value at the time of the transaction as opposed to being able to deny shareholders any money until the conclusion of litigation.[54] More of the burden of litigation was shifted to the corporation, requiring it to bring the litigation, provide advance notice to the shareholders, provide a copy of the statute, and, in most

52. The interest award was even more amazing. At an earlier point in time, the Chancery Court applied an interest rate of 10.32% to apply through the 1990 ruling. The Supreme Court applied this interest through an additional fifteen years (which was a period of lower inflation) with the result that plaintiffs recovered interest that was eight times their principal.

53. *See* Alfred F. Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80 and 81)*, 33 BUS. LAW. 2587, 2595–96 (1978) (recalling that the committee that deleted the market-out in 1977 noted that the exception for surviving corporations with less than a twenty percent change in their stock outstanding addressed the context where the need for the stock market-out exception was strongest).

54. *See id.* at 2597–98.

circumstances, pay the costs of the proceedings.[55] These changes were incorporated into the 1984 "revised" act, the largest structural change in the MBCA's history, and one which spurred a larger number of states to reform their corporations code. As a result, the earlier appraisal reforms gained a wider footing in the states that is still visible today; the 1984 platform remains the most common format for state appraisal statutes.[56]

The MBCA's appraisal chapter was completely revised in 1999.[57] The 1999 language caught up to the developments of the prior thirty years in terms of significantly narrowing the transactions giving rise to appraisal. Shareholders in surviving corporations no longer had appraisal rights, not just for transactions in which the dilution of their shares was less than twenty percent, but even for changes of the largest magnitude.[58] Narrowing also occurred on the target side with the reinsertion of a market-out exception.[59] At the same time, the 1999 changes made some improvements relevant to minority shareholders who had been squeezed out against their will in a cash-out merger. Fair value was defined to remove the exclusion for value created by the merger,[60] discounts for lack of marketability or minority status (which had limited value received by minority shareholders in a number of cases) were forbidden, and the statute was expanded to provide interest.[61]

The American Law Institute's Principles of Corporate Governance, a fifteen-year project that concluded in the early 1990s, put conflict of interest at the center of its appraisal analysis, providing support for some of the 1999 MBCA's changes just discussed.[62] Yet, the MBCA's move from a traditional liquidity-providing statute to one focused on conflict of interest was not yet fully formed. Conflict of interest was mentioned somewhat indirectly as an

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55. *See id.*

56. The MBCA Annotated (2008) reports the MBCA as the basis for corporations statutes in thirty states. MODEL BUS. CORP. ACT ANN., intro. at ix (2008). Twenty-three states, four of which are not among the thirty noted above, rely on the 1984 statute as the basis for their law in the appraisal area and ten use the two later sets of amendments. MODEL BUS. CORP. ACT ANN. statutory comparison at 13-19 (2008).

57. *See* MODEL BUS. CORP. ACT, intro. at xxvi (2008).

58. MODEL BUS. CORP. ACT § 13.02 (1999).

59. Comm. on Corporate Laws, *Proposed Changes in the Model Business Corporation Act—Appraisal Rights*, 54 BUS. LAW. 209, 219 (1998) (proposing MBCA section 13.02(b), adoption of which was reported at Comm. on Corporate Laws, *Changes in the Model Business Corporation Act Pertaining to Appraisal Rights and to Fundamental Changes—Final Adoption*, 55 BUS. LAW. 405 (1999)).

60. The pre-1999 MBCA language qualified the exclusion for value created by the merger "unless the exclusion would be inequitable." MODEL BUS. CORP. ACT § 13.01(3) (1998). Such a clause was the principal vehicle permitting courts in a cash-out merger setting to shape fair value to prevent misuse by majority shareholders. The changes to fair value in some sense serve a similar function, but there was no longer a specific pointer to courts to take into account conflict of interest.

61. Comm. on Corporate Laws, *supra* note 59, at 210.

62. *See, e.g.*, AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.22, cmt. c (1993) (explaining that appraisal exists "to assist shareholders to police conflicts of interest"). Another prominent source of reform in appraisal was California's statute which provided both broader appraisal rights and alternative rights for conflict transactions. *See* CAL. CORPS. CODE §§ 1300, 1312(b) (West 2008).

exception to the market-out exception to appraisal rights for target-company shareholders.[63] Fiduciary-duty challenges to conflicted cash-outs were made more difficult in that the exclusivity of appraisal was actually made stronger, with removal of language in the 1984 MBCA that had been used as the basis to expand recovery beyond appraisal.[64]

The 2006 changes make clear the shift of appraisal away from liquidity toward fiduciary-duty policing of conflict of interest. A conflicting-interest transaction was, for the first time, included in the definition section.[65] The market-out section received much clearer language, specifying that all conflicting transactions continued to have appraisal even in public companies.[66] The exclusivity of appraisal does not apply to an interested transaction unless there has been a "cleansing action," as specified in the general conflict-of-interest sections of subchapter F of chapter eight.[67]

With these most recent changes, it is clearer than it has ever been that the appraisal context is more about conflict of interest than liquidity. Appraisal will now only apply to a few arm's-length transactions, consistent with the decades-long move to accepting majority decision making in those settings. Valuation standards and some procedural changes have been made so that when appraisal is used in conflict transactions, the historical biases from the liquidity setting will not work to penalize minority shareholders who have been squeezed out.

In contrast to these dramatic changes, Delaware, during the same period, has made more than a dozen changes to its statute, but none have been large.[68] Instead, Delaware has relied on its case law in an effort to bring its law current. Valuation was changed by *Weinberger* as discussed earlier,[69] discounts have been precluded by other decisions,[70] exclusivity of appraisal was cabined by a combination of *Weinberger* and *Kahn*,[71] and common-law protections added to short-form mergers have considerably expanded protection against majority overreaching in that context.[72] The substance in Delaware clearly reflects the new context for appraisal; Delaware judges understand it, but legislatures and judges elsewhere still do not always get it.

The current MBCA is better positioned to communicate clearly the legal approach to appraisal. The statutory approach, informed by the guidance in the official comments, sets out the core principles behind the statute:

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63. Comm. on Corporate Laws, *supra* note 59, at 220 (proposing MBCA section 13.02(b)(4)).

64. *See supra* note 60 and accompanying text. *See* Comm. on Corporate Laws, *supra* note 59, at 210.

65. MODEL BUS. CORP. ACT § 13.01(5.1) (2008).

66. *Id.* § 13.02(b)(4).

67. *Id.* § 13.40(b)(3).

68. The most significant change has been three amendments to address interest, now providing a presumption of an interest rate that is five percent over the Federal Reserve Board's discount rate.

69. Weinberger v. UOP, Inc. 457 A.2d 701, 712–13 (Del. 1983).

70. Cavalier Oil Co. v. Harnett, 564 A.2d 1137, 1145 (Del. 1989).

71. *Weinberger*, 457 A.2d 701; Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110 (Del. 1994).

72. *See* cases cited *supra* note 43.

1. Appraisal (the right for an individual shareholder to require the corporation to pay a judicially determined fair value of the shares) exists only for fundamental changes and only for the subset of fundamental changes where "uncertainty" about the fair value of the shares casts doubt on the fairness of the transaction;[73]

2. Uncertainty is sufficiently reduced (for purposes of removing the need to provide shareholders this additional remedy beyond the usual protections provided by voting, gatekeepers, markets, et cetera) so long as shareholders can sell their shares in a market that is liquid and reliable;[74] and

3. Liquidity is measured by the efficiency of the market; reliability is measured by the absence of conflict.[75]

The last point (conflict) is the most important and easiest to apply. It means that shareholders can use appraisal to receive a judicial determination of value when the directors and majority shareholders push them out in an interested transaction. Shareholders are not forced to accept terms set by an interested party.[76]

The liquidity point is not as clear. As set out in the MBCA, it means that in an arm's-length (non-conflicted) transaction, shareholders can use appraisal to receive a judicial determination of value when directors or majority shareholders implement a transaction and the corporation is non-public. Shareholders who have a non-liquid investment are not forced to go along with the majority into a changed investment.

But this is where the current MBCA approach loses a bit of coherence. This liquidity protection for shareholders with non-publicly traded shares extends only to the disappearing corporation in the merger, not to the surviving corporation. It could be that the statute's drafters have implicitly accepted the final-period argument that while shareholders of the surviving corporation are

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73. MODEL BUS. CORP. ACT ANN. § 13.01 cmt. at 1 (2008). Otherwise, shareholders are relegated to the usual protections of voting, gatekeepers, and the various markets.

74. *Id.* § 13.02 cmt. at 2.

75. *Id.* § 13.02 cmt. at 3.

76. There is an anomaly in the MBCA that is difficult to square with this approach in that the 2006 language seems to exclude from appraisal a short-form merger (permitted by MBCA section 11.05) in a publicly traded company, which is clearly an interested transaction. MODEL BUS. CORP. ACT § 13.01(5.1) (2008). The 2006 MBCA provides a market-out unless the transaction is an interested transaction, in which case appraisal will be available. "Interested transaction" is defined by new section 13.01(5.1) to mean a "corporate action described in section 13.02(a), other than a merger pursuant to section 11.05, involving an interested person." Since the short form is excluded, the market-out will apply, so that appraisal will not be available where a controlling shareholder owns more than ninety percent of the shares, the remaining shares are traded on a public market, and the parent implements a short-form merger on terms that the minority thinks is unfair. In this setting, Delaware says that appraisal is exclusive, with various procedural qualifications to ensure that the price is fair. *See, e.g.*, Berger v. Pubco Corp., 976 A.2d 132, 145 (Del. 2009); Glassman v. Unocal Exploration Co., 777 A.2d 242, 246 (Del. 2001). Under the MBCA, the opposite seems to be the case in that there would be no appraisal.

sufficiently protected because their managers and directors make that deal knowing that they will continue to be subjected to voting, gatekeepers, and market constraints that discipline their choices, the managers of the disappearing company are in a final period such that they will ignore the discipline from those forces and make a bad deal for shareholders (albeit one approved by a majority), such that an additional legal remedy is needed in the form of appraisal. Such a distinction practically disappears (although maintained by the statute) in a "merger of equals" context where two entities of similar size combine in a way that seeks to preserve the managers, directors, and employees of both even if the legal form is to have one entity merge into the other. The MBCA gives an extra legal protection to one group of shareholders in this deal, but not the other. Similarly, if planners have structured an upside-down transaction, where the ostensible surviving corporation is actually issuing enough shares that its shareholders will lose effective control to the ostensible disappearing company, the MBCA would not provide relief (absent a return of de facto doctrine, which the statute and comments do not mention). At one point, in discussing which types of amendments to the articles of incorporation should trigger appraisal, the Official Comment concedes that such line drawing is arbitrary and then provides appraisal for no amendments except for reverse stock splits (which reflects concern over conflicts of interest). A similar conclusion about the arbitrary nature of appraisal in non-interested transactions more generally seems appropriate.

The largest drawback to the MBCA approach is that the states have been slow to adopt it. Two have adopted the 2006 approach.[77] Only eight more have yet implemented even the 1999 changes with its partial embrace of the conflict context.[78] Twenty continue to follow the 1984 MBCA that ill equips judges to coherently deal with appraisals in a conflict context. Clearly, one disadvantage of an iterative approach to statutory reforms is the small number of states that are willing to revisit their corporations code on a recurring basis. It took three tries for the MBCA to get this far, and the result is that the thirty states that use the MBCA format are scattered across a spectrum between liquidity and conflict, so that their judges do not always get the full picture. Most of the remaining states have a market-out exception, but only have a few of the more

77. *See* MISS. CODE ANN. § 79-4-13.01 (2002); VA. CODE ANN. § 13.1-730 (2006). In addition, two states changed their appraisal statutes to incorporate the more conflict-oriented approach included in an amendment that was erroneously published as part of the MBCA in 2003, even though it had not been approved by the Committee on Corporate Laws. *See* 2003 Me. Laws, ch. 344, § B-107 (codified as amended at ME. REV. STAT. ANN. tit. 13-c., § 1305 (2003)) and S.D. § 47-1A-1302.3 (2005). The 2006 changes minimized this gaffe. *See* Comm. on Corporate Laws, *Changes in the Model Business Corporation Act—Proposed Amendments to Appraisal and Other Remedies*, 61 BUS. LAW. 659 (2006) (noting that the erroneous publication of proposed amendments to section 13.02 "afforded the Committee an opportunity to consider exclusivity").

78. MODEL BUS. CORP. ACT ANN. statutory comparison at 13-19 (2008).

recent innovations that reflect the modern context in which appraisal contests arise.

## IV
## CONCLUSION

Societal views as to when it is appropriate to let shareholders require their corporation to provide liquidity when undertaking fundamental changes, and the extent to which majorities can force minorities out of corporations in a form of eminent domain, have changed dramatically over the last century. We have seen two different models as to how the law responds to such changes in the underlying economy and society. Delaware has left its statute essentially static for more than four decades and relied upon its courts to make fundamental changes in the application of the words. The MBCA has, through a series of suggested changes to the statutory language, dramatically reshaped the legal rules and explained its new approach.

In its current language, the MBCA has made enormous strides toward an effective remedy for the modern "conflict" context of appraisal. A legitimate question is whether appraisal does anything that fiduciary duty, the traditional common-law regulator of conflict of interest, could not do if there were no appraisal chapter. To some extent, the appraisal statutes are a codified conflict-of-interest procedure that could become the basis for a more general conflicts statute. Delaware cases show the essential overlap between appraisal actions and common-law fiduciary duty claims for entire fairness.[79] The dispersion of statutory language in MBCA jurisdictions illustrates the continuing importance of judicial interpretations even when statutes are regularly reformed. But most importantly, the changes to the MBCA prevent the historical appraisal language and its outdated applications from distorting its application in the modern context of cash-out mergers, and provide a more coherent framework for addressing appraisal as a part of corporate governance in the modern corporation.

79. *See, e.g.*, *In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ.A. 16415, 2004 WL 1305745, at *38 (Del. Ch. June 4, 2004).