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FAIR VALUE AND FAIR PRICE IN CORPORATE ACQUISITIONS

RUTHEFORD B CAMPBELL, JR.*

In statutory corporate acquisitions, dissenters' rights entitle shareholders of acquired corporations to obtain a "fair value" for their consideration, while common-law fiduciary duties ensure that such shareholders receive a "fair price" in the transaction. Courts, however, have had difficulty defining and measuring fair value and fair price, leaving this area of the law in disarray. This Article reviews the current framework of appraisal rights and fiduciary duties and proposes refined definitions of fair value and fair price that are based on attractive moral and economic values widely shared by society. The proposal respects the expectations of shareholders and provides guidance for the proper measure of valuations in acquisitions.

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INTRODUCTION

In a statutory corporate acquisition,¹ the stockholders of the acquired corporation are entitled to receive adequate consideration for their stock.² This right is protected by state appraisal statutes, pursuant to which stockholders who are unhappy with the terms of the acquisition can exercise their dissenters' rights³ and thereby receive cash equal to the "fair value" of their shares.⁴

Stockholders of the acquired corporation also are protected by common-law fiduciary duties, which ensure that they receive a "fair price" for their shares. The term "fair price" grew out of the common law of corporate fiduciary duties as applied in affiliated acquisitions, in which a court is required to consider fair price as a part of its evaluation of the acquisition under the intrinsic fairness test.⁵ Even

1. Most corporate statutes provide expressly for acquisition through merger, share exchange, and sale of assets. See, e.g., MODEL BUS. CORP. ACT §§ 11.01-12.01 (1998). Today, approximately 24 states have adopted some form of the Model Business Corporation Act (MBCA or "Model Act"), and seven states have corporate acts based on an earlier version of the MBCA. See MODEL BUS. CORP. ACT ANN. at xxvii (Supp. 1997).

2. Stockholders on the acquiring side of the transaction also may be entitled to receive fair value through appraisal in certain instances. See, e.g., MODEL BUS. CORP. ACT § 13.02(a)(1).

3. See, e.g., *id.* § 13.02(a)(1)-(3).

4. See, e.g., *id.* § 13.01(3) (defining "fair value"); *id.* § 13.02(a) ("[S]hareholder[s] . . . [are] entitled to . . . fair value.").

5. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-15 (Del. 1983); see also *infra*

non-affiliated, arm's length acquisitions, however, generate a fair price requirement,⁶ as the directors of Trans Union Corporation learned in *Smith v. Van Gorkom*.⁷ Fundamentally, the Trans Union directors in *Van Gorkom* failed their common-law fiduciary duty because they did not take reasonable steps to ensure that the stockholders of Trans Union received a fair price for their stock in an arm's length transaction.⁸

Resolving matters of fair value and fair price is difficult for courts.⁹ For example, cases involving the resolution of what constitutes fair value and fair price require courts to make financial calculations involving complex judgmental¹⁰ and theoretical¹¹ issues

note 32 and accompanying text (describing the intrinsic fairness test).

6. See *infra* note 33 and accompanying text (explaining a manager's obligation to ensure a fair price for the shareholders).

7. 488 A.2d 858, 893 (Del. 1985).

8. In *Van Gorkom*, the board of Trans Union approved, subject to a shareholder vote, the acquisition of Trans Union by the Pritzker interests at \$55 per share. The court noted that the "high and low range [for the trading price of Trans Union's stock] for 1980 through September 19 (the last trading day before announcement of the merger) was \$38 1/4 to \$29 1/2." *Id.* at 866 n.5. The Delaware Supreme Court held that, even though the sales price was well above the trading price the day before the merger, the board's approval of that acquisition violated the business judgment standard because the board had not used reasonable care to investigate the proposed acquisition. See *id.* at 874; see also *infra* note 30 (providing a concise statement of the business judgment standard). Subsequently, the Trans Union director-defendants became parties to a \$23.5 million settlement of the Trans Union stockholders' claims. See WILLIAM L. CARY & MELVIN ARON EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 627 (7th ed. 1995).

9. Commentators also try to define and explain fair price and fair value. Predictably, those who are devotees of the law and economics movement ("Contractarians") are driven by their fundamental assessment of the dominating importance of economic efficiency and the need to get assets into the hands of the most efficient users. See, e.g., Benjamin Hermalin & Alan Schwartz, *Buyouts in Large Companies*, 25 J. LEGAL STUD. 351, 370 (1996) (arguing against protection for minority shareholders in buyout transactions because such protection prevents optimal asset investment). Contractarians, accordingly, are less concerned about a "fair" sharing of value than about providing sufficient economic incentives for, and removing all impediments to, the flow of assets into the hands of the most efficient users. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 700-15 (1982) (arguing in favor of, and defending as fair, an unequal sharing of gains from corporate control transactions).

Other commentators opposed to, or at least strongly suspicious of, the Contractarians' views and factual assumptions ("Regulators") consider major corporate restructuring as a transaction rich in opportunities to treat certain stockholders unfairly. Regulators, therefore, as compared with Contractarians, typically have an expansive view of fair price and fair value and define those terms in ways designed to ensure some "fair" sharing of the benefits of transactions with all stockholders. See, e.g., Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 345 (1974) (arguing fairness requires that gains from mergers be shared among all interested parties).

10. Present value calculations require many factual predictions or guesses about future events. The Securities and Exchange Commission (SEC) opinion in the *Atlas*

that can be puzzling for courts unaccustomed to the world of corporate finance. Nevertheless, courts in recent years have done much better in dealing with such issues, especially in states such as Delaware, where much of this litigation takes place.¹² With some facility, courts now often deal with financial concepts as complicated as the Capital Asset Pricing Model,¹³ a circumstance that is a far cry from the primitive analyses utilized by courts in earlier periods.¹⁴

Notwithstanding such progress by courts in the area of financial calculations, fair value and fair price cases continue to be perplexing, and some of the most difficult issues for courts involve the allocation

Pipeline case, although not involving an acquisition, provides a classic example of such guesswork. See *In re Atlas Pipeline Corp.*, 9 S.E.C. 416, 421-40 (1941). In *Atlas Pipeline*, the SEC significantly underestimated the value of Atlas apparently because the SEC judged inaccurately the probability that the United States would enter into World War II. See VICTOR BRUDNEY & WILLIAM W. BRATTON, BRUDNEY AND CHIRELSTEIN'S CASES AND MATERIALS ON CORPORATE FINANCE 31-32 (4th ed. 1993) (providing information regarding the unpredicted commercial success of Atlas during the wartime economy).

11. "Theoretical" matters are not always distinct from "judgmental" matters. The intent here, however, is to establish a "theoretical" rubric that includes, for example: (1) whether present value should be determined by utilizing earnings calculated under generally accepted accounting principles or, alternatively, whether cash flows should be used to establish present value, see Walter J. Blum & Wilber G. Katz, *Depreciation and Enterprise Valuation*, 32 U. CHI. L. REV. 236, 238-42 (1965); and (2) whether an appropriate capitalization rate for a company should include unsystematic or unique risk, this latter issue arising when valuation of a company is measured by some form of the Capital Asset Pricing Model, see RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 183-88 (5th ed. 1996).

12. Professors Macey and Miller reported some years ago that 40% of all New York Stock Exchange Companies were incorporated in Delaware and that 82% of all reincorporations went to Delaware. See Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 483 (1987). Various theories are offered for the preeminence of Delaware in corporate charters. For a description of these theories, see *id.*, *passim*, and Roberta Romano, *The State of Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 720-25 (1987).

13. See, e.g., *Cede & Co. v. Technicolor, Inc.*, No. Civ. A. 7129, 1990 WL 161084, at *23-24 (Del. Ch. Oct. 19, 1990) (mem.), *rev'd on other grounds*, *Cede & Co. v. Technicolor, Inc.* ("Technicolor IV"), 684 A.2d 289 (Del. 1996). For an explanation of the Capital Asset Pricing Model, see BREALEY & MYERS, *supra* note 11, at 183-88, 990.

14. Earlier cases in which courts provided inadequate analyses for their valuations of corporations or ownership interests in corporations include *Hottenstein v. York Ice Machinery Corp.*, 136 F.2d 944, 952-53 (3d Cir. 1943), *Bailey v. Tubize Rayon Corp.*, 56 F. Supp. 418, 422-25 (D. Del. 1944), *Barrett v. Denver Tramway Corp.*, 53 F. Supp. 198, 205 (D. Del. 1943), *aff'd*, 146 F.2d 701 (3d Cir. 1944), *Goldman v. Postal Telegraph, Inc.*, 52 F. Supp. 763, 771 (D. Del. 1943), *Porges v. Vadsco Sales Corp.*, 32 A.2d 148, 151-52 (Del. Ch. 1943), *State v. Bechtel*, 31 N.W.2d 853, 864 (Iowa 1948), *Dratz v. Occidental Hotel Co.*, 39 N.W.2d 341, 347-50 (Mich. 1949), *Wessel v. Guantanamo Sugar Co.*, 35 A.2d 215, 216-17 (N.J. Ch. 1944), *aff'd*, 39 A.2d 431 (N.J. 1944), *Kamena v. Janssen Dairy Corp.*, 31 A.2d 200, 202 (N.J. Ch. 1943), *Zobel v. American Locomotive Co.*, 44 N.Y.S.2d 33, 37 (N.Y. Sup. Ct. 1943), *Bove v. Community Hotel Corp. of Newport, R.I.*, 249 A.2d 89, 99-100 (R.I. 1969), *Matteson v. Ziebarth*, 242 P.2d 1025, 1033-36 (Wash. 1952) (en banc).

of the significant financial gains often generated by acquisitions.¹⁵ In such instances, courts must resolve the matter of how much, if any, of the value created by an acquisition is included in fair value and fair price and accordingly shared with the shareholders of the acquired corporation.

To a significant extent, courts' difficulties in dealing with such matters are the result of their inability or unwillingness to articulate fundamental underlying principles for fair value and fair price determinations. Without such principles, outcomes lack consistency and predictability and also may lack sound moral or economic footing.

The impact of unprincipled decision-making falls in the first instance on the parties involved in corporate acquisitions. Consider, for example, a simple affiliated transaction in which a subsidiary corporation is to be merged into its parent, and, under the terms of the definitive merger agreement, the minority public shareholders of the subsidiary are to receive \$10 per share in cash for their stock. The board of directors of the subsidiary typically is required to evaluate the offer and, if the deal is to go forward, must recommend the merger to the subsidiary's shareholders.¹⁶ If the offer of \$10 per share is less than a fair price for the stock of the subsidiary, the board is in danger of violating its fiduciary duty to the subsidiary's shareholders if it recommends the transaction. The board, therefore, must measure its conduct against the criterion of fair price. As a corollary, shareholders of the subsidiary, in voting on the acquisition, also will evaluate whether the offer of \$10 per share amounts to fair value and fair price. If the offer falls short of fair value or fair price, then the shareholders are not limited to the proffered exchange and may have valuable claims against the corporation and its managers.

The definitions of fair value and fair price, however, have significance beyond the particular parties to the transaction. Because the meanings assigned to fair value and fair price impact both the allocative efficiency¹⁷ of society's assets and the fairness of the

15. See *infra* notes 72–96, 107–28 and accompanying text.

16. For example, under the Model Act, the board of the acquired corporation is required to “adopt” the plan of merger and “recommend” the plan to the corporation's shareholders. See MODEL BUS. CORP. ACT §§ 11.01, .03.

17. In this piece, economic efficiency is used to mean an allocation of assets or rights to those who are willing and able to pay most for them. This definition is widely used. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 12–16 (5th ed. 1998). I do not mean to imply that Judge Posner believes that the pursuit of economic efficiency is necessarily morally attractive. Other definitions of economic efficiency are discussed in Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509,

distribution of those assets among its citizens, society also has a strong interest in the proper definition of those terms.

Using the simple example above, the parent is encouraged to undertake the merger if it is able to freeze out the public minority shareholders at a low price, because the lower the price is the more the parent nets from the transaction. If one assumes that the parent is the most efficient user of the subsidiary's assets (an assumption, of course, that is not legitimate in all cases), the low price encourages the movement of assets into the hands of the most efficient user.¹⁸ The low price under those factual assumptions, therefore, promotes an efficient allocation of assets.

At the same time, however, the distributive impact on the parties involved in a freeze-out of the minority shareholders at a very low price may be morally unacceptable to some. Assume an extreme case in which the market value of the subsidiary stock prior to the affiliated merger is \$10 per share and the parent undertakes the freeze-out at \$1 per share. The distributive impact of that transaction, even if it leads to an economically efficient allocation, may be morally unacceptable to many.¹⁹ Setting fair value and fair price at an amount well above \$1 per share in such a transaction is one way society can eliminate such distributive inequality.

The purpose of this Article is to articulate fair value and fair price in a manner that is intelligible, as well as morally and economically attractive. The principles underlying this analysis are

512 (1980).

18. This type of analysis also is proffered as support for an argument against management's deployment of antitakeover tactics in the face of a hostile bid for a company. Because such takeovers are viewed as a situation in which assets (the target) flow into the hands of more efficient users, and because defensive tactics can increase the price that the bidder will have to pay for the target, some commentators argue that defensive tactics will reduce the economic incentive for more efficient users to attempt to acquire underutilized assets. Much of the thinking and debate on these matters can be found in Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981), Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978), and Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982).

19. In *Economic Analysis of Law*, Judge Posner specifically disavows an opinion on the morality or desirability of pursuing economic efficiency (i.e., pursuing an allocation of assets in which assets are in the hands of those willing to pay most for the assets). He views his book as a positive work and admits, or at least suggests, that a state of economic efficiency may or may not be morally attractive. See POSNER, *supra* note 17, at 15, 30. In another work, however, he defends the moral attractiveness of economic efficiency as a goal of society. See Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 488-502 (1980).

based on a reasonably strong version of consent. If one is able to find that the corporate constituencies, shareholders in this case, consent to a particular measure of fair value and fair price, then holding the shareholders to their bargain is morally attractive and economically sound. Morally, permitting shareholders voluntarily to allocate rights to share in wealth in the event of an acquisition of their company is consistent with principles of both utilitarianism²⁰ and Kantianism.²¹ Similarly, permitting shareholders to trade with regard to such rights is the very essence of the creation of economic wealth.²²

20. To use a simple example, assume initially that Shareholder A has the right to receive all the corporate synergy generated by an acquisition. If Shareholder A prefers cash to the synergy right and Shareholder B prefers the synergy right to cash, a purchase of Shareholder A's synergy right by Shareholder B must make each happier, otherwise they would not trade. Total utility, therefore, is increased by the trade, assuming that the trade generates no disutility for third parties. Utilitarianism in a modern setting is discussed in J.J.C. SMART & BERNARD WILLIAMS, *UTILITARIANISM, FOR AND AGAINST* (1973), and H.L.A. Hart, *Between Utility and Rights*, 79 COLUM. L. REV. 828, 829-31 (1979). It is worth noting, however, that utilitarianism has been subjected to intense criticism from various quarters. See, e.g., POSNER, *supra* note 17, at 13 ("The fact that one person has a greater capacity for pleasure than another is not a very good reason for a forced transfer of wealth from the second to the first."); Coleman, *supra* note 17, at 511 (summarizing popular criticism of utilitarianism); Ronald M. Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191, 216 (1980) ("[U]tilitarianism, as a general theory of either value or justice, is false and its present unpopularity is well-deserved.").

21. See JEFFRIE G. MURPHY & JULES L. COLEMAN, *PHILOSOPHY OF LAW: AN INTRODUCTION TO JURISPRUDENCE* 70-82 (rev. ed. 1990), in which the authors present a compact and thoughtful discussion of Kantianism as a basis for legal rules. Broadly, Kantianism refers to analyses based on the work of Immanuel Kant, although Murphy and Coleman warn that what they present as "Kantianism" "is in no sense attempted to be a literal presentation of the views of Immanuel Kant." Instead, they present "a kind of moral view that is highly Kantian in spirit." *Id.* at 99 n.6.

The following quotations from Murphy and Coleman are helpful to illuminate the meaning of Kantianism, as it is used in this Article: "Kantianism . . . is the view that the rational choice in ethics is always the choice that respects the rights of autonomous persons freely to determine their own destinies, even if respect is bought at the cost of a loss of happiness or well being." *Id.* at 71. Kantianism is respect for individual autonomy, based on "our status as free and autonomous creatures with the capacity to make choices that are rational in a special sense." *Id.* at 77. If, therefore, individuals consent to a particular allocation of rights in the event of acquisitions, and society respects their bargain or trading on the matter, then society is acting in a manner that is respectful of individuals and their autonomy and, thus, in a manner that broadly is consistent with Kantianism.

Judge Posner has used a somewhat similar argument to link consent with Kantianism and ultimately with his view of the moral attractiveness of the pursuit of wealth maximization. See Posner, *supra* note 19, at 488-502.

On Kant more generally, see JEFFRIE G. MURPHY, *KANT: THE PHILOSOPHY OF RIGHT* (1970) (presenting a critical discussion of Kant's philosophy).

22. Judge Posner, for example, describes trading as a "basic economic principle" necessary to achieve economic efficiency and to create wealth. See POSNER, *supra* note 17, at 12-17. This is easily explained. If one defines economic efficiency as an allocative

Part I of this article is a brief overview of appraisal rights and corporate fiduciary duties applicable in acquisitions. Part II highlights the confusion and uncertainty of present definitions of fair value and fair price and provides a foundation for later discussions by parsing the corporate value that is available for division among stockholders in acquisitions. Part III then describes the present state of the law regarding stockholders' rights to fair value in appraisal proceedings and fair price in fiduciary duty cases. The Part, to a large extent, explains today's rules by reference to the corporate value parsed in Part II. Part IV offers refined definitions of fair value and fair price. These refined definitions also are described by reference to the parsed value of Part II and, hopefully, are founded on attractive moral and economic values that are widely shared by society.

I. APPRAISAL RIGHTS AND FIDUCIARY DUTIES IN ACQUISITIONS

Both appraisal statutes and fiduciary duty rules protect the right of an acquired corporation's shareholders to receive some fair measure of corporate value in a statutory acquisition. Accordingly, a brief overview of appraisal rights and fiduciary duties as they apply to corporate acquisitions is a helpful way to begin.

A. *Appraisal Rights*

Corporate statutes provide appraisal rights for stockholders whose companies are acquired in statutory acquisitions.²³ Appraisal rights are predicated solely on the nature of the particular transaction and are available without regard to any wrongdoing or conflict of interest on the part of persons or entities involved in the particular covered transaction.²⁴ Accordingly, a dissatisfied stockholder of a

state in which resources or rights are in the hands of those willing to pay the most for them, then economic value or wealth is created by moving resources or rights from the hands of those who are not willing to pay most into the hands of those who are willing to do so. Rules that facilitate such trades, therefore, lead to economic efficiency and the creation of economic wealth or value.

23. See 2 AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 291-99 (1994) [hereinafter ALI CORP. GOV.] (describing the history of appraisal proceedings, the breadth of the remedies available in various states, and the actual use of appraisal proceedings in acquisitions).

24. The Model Act, for example, permits stockholders to exercise appraisal rights in several transactions, including mergers, share exchanges, sales of substantially all assets other than in the regular course of business, and certain amendments to the company's articles of incorporation that significantly affect the rights of stockholders. See MODEL BUS. CORP. ACT § 13.02.

All states provide for statutory appraisal rights. See ALI CORP. GOV., *supra* note 23, at 292. Not unexpectedly, variations appear among states. See Hideki Kanda & Saul

corporation acquired, for example, in a statutory merger is entitled to have the acquiring company pay her or him cash for the securities that are exchanged in the acquisition,²⁵ provided, of course, that the dissatisfied stockholder follows the complex procedures that typically are part of the state's appraisal regime.²⁶

Shareholders of an acquired corporation who perfect their appraisal rights are entitled to receive cash equal to the "fair value" of their shares.²⁷

B. *Fiduciary Duties*

Shareholders of acquired corporations are also protected by fiduciary duty principles. Fiduciary duty claims by disgruntled shareholders of corporations that are acquired in arm's length acquisitions typically are evaluated under the business judgment standard.²⁸ The standard requires corporate managers to perform their tasks, including the facilitation of acquisitions, in good faith and without any significant conflict and reasonably to investigate the proposed action.²⁹ If these criteria are met, the ultimate decision of an acquired corporation's managers to pursue a particular acquisition of their company under particular terms violates their fiduciary duty

Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429, 445-61 (1985) (examining the variety in various appraisal statutes by contrasting appraisals in Delaware, New Jersey, and New York). The Reporter's Notes to the American Law Institute *Principles of Corporate Governance* observe generally that "[a]ll jurisdictions grant dissenters' rights in at least some mergers" and specifically that "[f]orty-four jurisdictions expressly grant an appraisal remedy in connection with certain sales amounting to all or substantially all the firm's assets," while "[t]wenty-five jurisdictions expressly grant an appraisal remedy for certain amendments to the certificate of incorporation." ALI CORP. GOV., *supra* note 23, at 296-97. For an outstanding description of the evolution of the appraisal remedy, see Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 11-23 (1995).

25. The Commentary to the *Principles of Corporate Governance* states that the "better justification" for the right to appraisal is "that it can curtail unfair conduct by those controlling the corporation through an ex ante provision that does not involve high monitoring costs." ALI CORP. GOV., *supra* note 23, at 293.

26. See, e.g., MODEL BUS. CORP. ACT. §§ 13.20-31.

27. See *id.* § 13.02(a). Recently, proposed amendments to the appraisal provisions of the Model Act were promulgated. These amendments, if adopted by the states, would change both the scope of the appraisal proceedings availability and the definition of "fair value." See MODEL BUS. CORP. ACT. §§ 13.01-31 (Proposed Changes 1998), available in *Proposed Changes in the Model Business Corporation Act—Appraisal Rights*, 54 BUS. LAW. 209, 251-67 (1998).

28. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), is probably the most famous case applying the business judgment test to acquisitions. See *supra* note 8.

29. See *infra* note 30.

only if that judgment is so bad as to amount to something similar to gross negligence.³⁰

On the other hand, an acquisition undertaken in a conflict of interest setting, such as a corporate parent's acquisition through a statutory merger of a public minority's interest in its subsidiary, is evaluated under the intrinsic fairness test.³¹ Under the intrinsic fairness test, the decisions of the acquired (subsidiary) corporation's managers and its controlling stockholder (parent) to facilitate or undertake the acquisition are evaluated against a more general concept of fairness. In considering whether the acquisition is fair, courts look at two elements, fair price and fair dealing. In the final analysis, however, fairness is considered as a whole and not as a function of its individual elements.³²

In all cases, whether or not a conflict is present, managers' conduct in acquisitions is measured against some fair price criterion. In cases without a conflict, corporate managers' facilitation of an acquisition of their company at an unfair price will violate their fiduciary duty under the business judgment standard, unless the managers are able to defend the loss flowing from their malfeasance by establishing some level of due diligence. This defense, of course, does not detract from the primary obligation of managers to garner a

30. The *Principles of Corporate Governance* state that a director or officer meets his duties under a business judgment test if the director or officer "makes a business judgment in good faith" and:

- (1) is not interested . . . in the subject of the business judgment;
- (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
- (3) rationally believes that the business judgment is in the best interests of the corporation.

ALI CORP. GOV., *supra* note 23, § 4.01(c).

The standard under the *Principles of Corporate Governance* by which the actual judgment of the director or officer is evaluated is described in section (3), above, as "rationally believes." The Delaware Supreme Court defines that standard as one of "gross negligence." This Article uses the Delaware Supreme Court's definition. *See, e.g., Van Gorkom*, 488 A.2d at 873. The difference between "rationally believes" and "gross negligence" is uncertain.

31. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983).

32. *See id.* Later language, however, clouds the applicability of this approach. In *Cede & Co. v. Technicolor, Inc.* ("*Technicolor II*"), 634 A.2d 345 (Del. 1993), the court stated that, under an intrinsic fairness analysis, the defendants "must establish . . . that the transaction was the product of both fair dealing and fair price." *Id.* at 361 (emphasis added). The language was repeated in *Cinerama, Inc. v. Technicolor, Inc.* ("*Technicolor III*"), 663 A.2d 1156, 1162 (Del. 1995). Later in the *Technicolor III* opinion, however, the court referred to the "unified approach to entire fairness mandated by established Delaware law" and, still later, to the "non-bifurcated components of entire fairness." *Id.* at 1172.

fair price for the acquired corporation, but instead merely protects directors if their fault level is low. Cases involving a conflict apply the intrinsic fairness doctrine, and the fair price obligation is even more direct. In these cases, unless managers of the acquired corporation obtain a fair price for the stock of the acquired corporation, the managers risk a determination that the transaction was not intrinsically fair.³³

C. The Relationship Between Appraisal Rights (Fair Value) and Fiduciary Duties (Fair Price)

Courts generally have determined that the measure of fair price is different from the measure of fair value.³⁴ With the possibility of two different measures of recovery, depending upon the path a disgruntled shareholder takes, cases inevitably arise addressing whether a disgruntled stockholder subjected to an acquisition may obtain one remedy or the other.³⁵

Stated succinctly, courts usually hold that appraisal with its fair value remedy is the exclusive remedy for disgruntled stockholders in an acquisition, unless the transaction involves some measure of unfair dealing.³⁶ Accordingly, when the controversy is only about price and

33. Although the fiduciary standard by which managers' conduct is evaluated appropriately changes, depending on whether such managers are acting in a conflict or a non-conflict setting, the constancy of the fair price requirement across all such decisions makes sense. Fundamentally, the fair price requirement is based on the managers' broad obligation to maximize shareholder wealth, and that obligation of managers is ubiquitous. Thus, managers' approval of any acquisition of their company, irrespective of the existence of conflict, always must maximize shareholder wealth in order to meet the managers' fiduciary obligation. In other words, managers must always ensure that shareholders receive a fair price for their shares.

The discussion in the balance of this Article relies primarily on affiliated acquisitions, which typically involve managers in conflict decisions and thus subject them to the intrinsic fairness test. No attempt is made to distinguish or discuss separately conflict and non-conflict cases. Notwithstanding this emphasis in the discussion, the analyses and this Article's ultimate proposal respecting the appropriate measure of fair price are intended to be applicable to both conflict and non-conflict situations.

34. See *infra* notes 45-132 and accompanying text.

35. In *Cede & Co. v. Technicolor, Inc.* ("Technicolor I"), 542 A.2d 1182, 1188-89 (1988), the court held that a disgruntled shareholder may pursue both appraisal and a breach of fiduciary claim in one lawsuit, although double recovery is not permitted.

36. See *Rabkin v. Phillip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1104-05 (Del. 1985); *Weinberger*, 457 A.2d at 714; *Seagraves v. Urstadt Property Co.*, No. Civ. A. 10307, 1996 WL 159626, at *8 (Del. Ch. Apr. 1, 1996) (mem.); *Cooper v. Pabst Brewing Co.*, No. Civ. A. 7244, 1933 WL 208763, at *2 (Del. Ch. June 8, 1993) (mem.). Statutes also typically deal with the exclusivity of appraisal proceedings. See, e.g., MODEL BUS. CORP. ACT § 13.02(b) (stating that the appraisal is exclusive, unless "the action is unlawful or fraudulent"). Professor Thompson argues that "[a]ppraisal should not be exclusive until there is a comprehensive legislative treatment of the remedy." Thompson, *supra* note 24,

not about process, unhappy stockholders are entitled only to pursue their appraisal remedies and receive fair value.³⁷ Apparently this outcome holds even if the price offered in the acquisition is extremely unfair.

II. PARSING SYNERGY

This Part of the Article parses the additional economic value, or synergy,³⁸ created by corporate acquisitions that move assets into more efficient hands.³⁹ This parsing is undertaken through the use of the following factual pattern, which, although hypothetical, is meant to be representative of recurring reality.⁴⁰ This analysis is later used in Part III as a framework to consider the present definitions of fair value and fair price, and Part IV uses the analysis to propose an appropriate definition of fair value and fair price.

Assume that an acquiring corporation ("Acquiring Corporation") merges an acquired corporation ("Acquired Corporation") into itself through a statutory merger for a cash price equal to \$10 for each of Acquired Corporation's outstanding shares of common stock. Prior to the merger, Acquired Corporation has one million shares of common stock outstanding. Acquiring Corporation owns 51% of the Acquired Corporation's outstanding shares of common stock, and the remaining 49% of Acquired Corporation's common stock is publicly owned. An Acquired Corporation stockholder, Ms. C, is unhappy with the terms of the acquisition and believes her one share of Acquired Corporation is worth considerably more than \$10.

As to the value of Acquired Corporation, assume the following facts exist immediately before the acquisition:

- (1) Acquired Corporation's common stock is selling in an

at 54.

37. On the other hand, when the case involves unfair dealings, courts are willing to allow disgruntled shareholders to pursue fiduciary remedies. See Thompson, *supra* note 24, at 24 n.102 (acknowledging and listing "[a]t least eleven Delaware cases in the last decade [that] apply the fair dealing/fiduciary duty standard from *Weinberger* without relegating the plaintiff to appraisal").

38. "Synergy," as used in this article, means total additional value created by moving assets into new hands.

39. See *supra* note 22.

40. The parsing in this section is similar in structure to the approach Professors Gilson and Black take in their fine teaching materials. See RONALD J. GILSON & BERNARD S. BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS*, 253-638 (2d ed. 1995). Their book provides an excellent discussion of the economic and legal aspects of most of the Additives discussed in this Article. Their materials are rich in legal and economic analyses and citations.

efficient market⁴¹ for \$10 per share.

(2) Acquired Corporation has not disclosed the material fact that it just signed a lucrative government contract to supply the parts for a new jet fighter. If disclosed, this fact would increase the market price of Acquired Corporation's common stock by \$1 per share. The increase in value of Acquired Corporation's stock that would be generated by the disclosure of the information is referred to herein as the "Information Additive."

(3) During the last year, the managers of Acquired Corporation made an unwise, discrete decision that violated the managers' fiduciary duties to Acquired Corporation. Assume, for example, that the company's board of directors caused Acquired Corporation to invest in a project that was a total loss and that the decision to invest was so unwise as to violate the business judgment standard applicable to the decision. No move has been made to pursue legal recourse against the legally culpable managers. As a result of this breach of duty, the company suffered damages that, if reasonably pursued through legal means, would increase the market price of Acquired Corporation's common stock by \$1 per share. The increase in value in Acquired Corporation's stock that would be generated by pursuing a legal remedy is referred to herein as the "Discrete Mismanagement Additive."

(4) Acquired Corporation owns an expensive machine used in its operations and currently uses only fifty percent of the machine's capacity. Managers of Acquired Corporation could reduce this overcapacity inefficiency through a number of means, including selling the machine and outsourcing the particular function, renting the excess capacity to other manufacturing companies that need the function, entering into strategic alliances with other companies, or merging with a company, such as Acquiring Corporation, that can use the excess capacity. These steps, if reasonably pursued by Acquired Corporation's managers, would create an operational savings that would increase the market price of Acquired Corporation's stock by \$1 per share. This increase in value in Acquired Corporation's stock is referred to herein as the "Operational Savings Additive."

41. "Efficient market," as used in this Article and unless otherwise indicated, means only that the market for the particular stock is sufficiently active to absorb information effectively into the price of stock and to reflect the preferences of traders. The term does not mean that necessarily all information about the stock and the company is available to the market. For instance, some information may be unknown and thus not impounded in price. Scholars have developed various measures and descriptions of market efficiency. See, e.g., BREALEY & MYERS, *supra* note 11, at 321-27.

(5) In addition to the foregoing, Acquired Corporation is significantly and broadly mismanaged or undermanaged. Assume, for example, that the board fails to monitor senior management, thereby enabling senior managers to divert too much corporate value to themselves, fails to make efficient investments in technology, fails to capitalize on expansion opportunities, permits bickering among top employees that significantly and adversely affects production levels, and fails to uncover significant theft and diversion of assets by top employees. As a result, the efficient market reduces the price it is willing to pay for the stock of Acquired Corporation. If the company were managed at a reasonable level of skill and integrity—that is, at a level that approximates the minimum level required by fiduciary standards—the market price of Acquired Corporation's common stock would increase by \$1 per share. The increase in value in Acquired Corporation's stock that would be generated by such better management is referred to herein as the "Reasonable Management Additive."

(6) If Acquired Corporation were broadly managed at a super-reasonable level—that is, at a level that approximates the finest available management—the market would increase the value of Acquired Corporation's common stock by an additional \$1 per share. The increase in value in Acquired Corporation's stock that would be generated by the finest available management is referred to herein as the "Super-Reasonable Management Additive."

(7) By moving Acquired Corporation's assets into the hands of different managers, 500 of Acquired Corporation's present employees could be eliminated. One way, but not the only way, to accomplish this cost saving is through Acquired Corporation's merger into Acquiring Corporation. Terminating the 500 employees without cause is legal, although some may feel morally troubled by such a firing of workers without cause.⁴² The total savings from the elimination of such jobs would result in an increase in value equal to \$1 per share for each share of Acquired Corporation common stock outstanding and is referred to herein as the "Labor Reduction Additive."

(8) To effect the acquisition, Acquiring Corporation, or other acquirers of Acquired Corporation's assets, will borrow heavily. As a result of the additional leverage, the existing creditors of Acquired

42. For example, an interesting body of scholarship argues that such conduct on the part of the corporation may violate an implied contract with workers. See *infra* note 167 and accompanying text.

Corporation will lose significant value, which will be captured by the equity holders of Acquired Corporation and Acquiring Corporation.⁴³ The total value that will be transferred from creditors to equity owners as a result of this additional leverage amounts to \$1 for each outstanding share of Acquired Corporation's stock and is referred to herein as the "Creditor Value Reduction Additive."

While all of this hypothetical background is admittedly tedious and somewhat complex, parsing the total value, or synergy, created by moving the assets of Acquired Corporation into new hands advances the analysis offered in this Article in a number of ways. First, it demonstrates that acquisition synergy does not spring from any single source, but is instead generated by various economic considerations. The parsing also illuminates the principal bases for the synergy generated by corporate acquisitions.⁴⁴

More broadly, the parsing facilitates an examination of the allocative and distributive implications of rules governing the sharing of synergy and further assists the evaluation of the moral and economic force of the arguments various claimants may make for that synergy. One is able to anticipate, for example, that Ms. C will lay claim to her proportionate share of the synergy, arguing, perhaps as a matter of distributive equality or "fairness," that she has a legitimate

43. The highly leveraged transactions of the 1980s attracted much attention in the legal and financial literature. Authors report both the loss to creditors that resulted from such transactions, *see, e.g.*, Marcel Kahan & Michael Klausner, *Antitakeover Provisions in Bonds: Bondholder Protection or Management Entrenchment?*, 40 UCLA L. REV. 931, 933 n.2 (reporting that between 1984 and 1988, the bonds of 183 companies "lost value as a result of mergers, acquisitions or leveraged buyouts"), and the gains to shareholders resulting from such transactions, *see, e.g.*, Bernard Black & Joseph A. Grundfest, *Shareholder Gains from Takeovers and Restructurings Between 1981 and 1986: \$162 Billion Is a Lot of Money*, J. APPLIED CORP. FIN., Spring 1988, at 5 (estimating that the wealth of stockholders increased \$162 million during the period between 1981 and 1986 as a result of takeovers).

44. The parsing in this section does not necessarily exhaust the sources of gain or synergy generated by acquisitions. For example, Professors Gilson and Black state that tax benefits are a "common explanation" for the incentive to acquire. GILSON & BLACK, *supra* note 40, at 454. Gilson and Black go on to say, however, that "the accuracy of the claim that a significant number of acquisitions are tax-motivated . . . has remained hard to assess." *Id.*; *see also* ALAN J. AUERBACK & DAVID REISHUS, *The Impact of Taxation on Mergers and Acquisitions*, in MERGERS AND ACQUISITIONS 69, 70 (Alan J. Auerback ed. 1988) (claiming that although tax incentives may play a role in acquisitions, convincing evidence is limited). In another article, Professor Black opines that "[t]ax effects are most important in [leveraged buyouts], where they may explain perhaps a third of the observed premiums, although estimates vary." Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 611 (1989).

In any event, the elements of value separated by the parsing in this section are sufficient for the purposes of this Article, because any additional sources of value, such as tax savings, can be allocated by reference to the analysis this Article provides.

claim to a payment amounting to \$17 for her one share of Acquired Corporation stock. Parsing facilitates the evaluation of the legitimacy of her claim.

III. THE MEASURE OF FAIR VALUE AND FAIR PRICE UNDER TODAY'S LAWS

This section describes and analyzes today's laws regarding the calculation of fair value and fair price, with attention paid to the obligation to share synergy. What emerges from this discussion is a series of discrete rules that cannot be explained by reference to any unifying principle.

A. *Appraisal Rights and the Right to "Fair Value"*

1. The Model Business Corporation Act

Under the Model Business Corporation Act (MBCA), shareholders of an acquired corporation who dissent normally are entitled to receive, in lieu of the consideration offered in the acquisition, cash equal to the "fair value" of their stock. Fair value is stated to be "the value of the shares immediately before the effectuation of the [acquisition] . . . , excluding any appreciation or depreciation in anticipation of the [acquisition] . . . unless exclusion would be inequitable."⁴⁵

The ambiguities in the critical terms of this definition of fair value are apparent.⁴⁶ "Value" is undefined,⁴⁷ leaving unanswered, for

45. MODEL BUS. CORP. ACT § 13.01(3). Recently a proposal was made to amend this definition of fair value as follows:

"Fair Value" means the value of the corporation's shares determined:

- (i) immediately before the effectuation of the corporate action to which the shareholder objects;
- (ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and
- (iii) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section 13.02(a)(5).

MODEL BUS. CORP. ACT § 13.01(4) (Proposed Changes 1998), *supra* note 27, at 251.

46. See Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 627 (1998) (discussing the limited guidance available in the language of appraisal statutes with respect to the determination of fair value).

47. California defines appraisal value as "fair market value." CAL. CORP. CODE § 1300(a) (West 1990 & Supp. 1998). The act goes on to define further the timing and method of calculation: "The fair market value shall be determined as of the day before the first announcement of the terms of the proposed reorganization or short-form merger,

example, the fundamental question of whether "value" should be computed as liquidation value or going concern value. "Appreciation," which normally is excluded from fair value under the terms of the definition,⁴⁸ is also an undefined term. Thus, returning to the parsing of synergy described in Part II of this Article, an issue exists as to whether the statute intends that all of the Additives be considered "appreciation" and accordingly beyond the reach of dissenting stockholders. Finally, the term "inequitable" is undefined, once more leaving uncertain the matter of whether it is "inequitable" to exclude dissenting shareholders from sharing in some or all of the Additives described in Part II.

The Official Comment to the MBCA provides some guidance for dealing with these ambiguities, stating that the statute "leaves to the . . . courts . . . the details by which 'fair value' is to be determined."⁴⁹ Regarding the impact of pre-existing common law on the calculation of fair value, the Comment states that the MBCA leaves "untouched the accumulated case law."⁵⁰

The drafters of the MBCA, therefore, purposefully left critical terms in the appraisal statute ambiguous. The intent apparently was to delegate to courts the task of determining the essential components of, and methodologies for, calculating fair value and to reaffirm, or at least leave unchanged, the existing jurisprudence on these matters.

2. Cases Interpreting Fair Value

Courts faced with interpreting ambiguous appraisal statutes have articulated a number of rules regarding the calculation of fair value.⁵¹

excluding any appreciation or depreciation in consequence of the proposed action" *Id.*

48. New York law, however, allows sharing of such appreciation with dissenters. *See* N.Y. BUS. CORP. LAW § 623(h)(4) (McKinney 1986); *see also* Cawley v. SCM Corp., 530 N.E.2d 1264, 1267 (N.Y. 1988) (interpreting New York law as including in appraisal value elements of future value derived from the merger); *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 27 (N.Y. 1984) (same).

49. MODEL BUS. CORP. ACT § 13.01, official cmt. 3.

50. *Id.* Recent proposed changes in the Model Act also change the Official Comment on fair value. *See* MODEL BUS. CORP. ACT § 13.01(4), official cmt. 2 (Proposed Changes 1998), *supra* note 27, at 255. The Comments to the Proposed Changes state, for example, that the new definition of fair value "permits consideration of changes in the market price of the corporation's shares in anticipation of the transaction, to the extent such changes are relevant." *Id.* The Comment goes on to approve valuation techniques for fair value that include "assigning a higher valuation to corporate assets that would be more productive if acquired in a comparable transaction, but excluding any element of value attributable to the unique synergies of the actual purchaser of the corporation." *Id.* at 256.

51. For an outstanding discussion of how courts have dealt with fair value cases, *see* Wertheimer, *supra* note 46, at 626-702.

These rules, however, generally are limited in scope and appear to have no unifying principles. Predictably, such rules lead to problematic and inconsistent outcomes.⁵²

a. Going Concern Value

One rule that seems well settled in case law is that fair value is based on going concern value and not on the liquidation value of the corporation.⁵³ Intuitively, this rule seems correct. Stockholders

52. One problem for courts is the nearly dizzying array of valuation techniques that may be offered by the parties in a single case. For example, in *Cooper v. Pabst Brewing Co.*, No. Civ. A. 7244, 1993 WL 208763 (Del. Ch. June 8, 1993) (mem.), the dissenters' experts offered three separate methods of valuation to the court. See *id.* at *3-7. In another example, *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213 (Del. 1992), the expert for the dissenting stockholders offered three separate valuations of Shell, each based on a different valuation methodology, and the company's expert also offered three additional valuation methods for calculating the fair value of Shell. See *id.* at 1216-17.

When faced with an offering of multiple methodologies for the determination of fair value, a court must either select from the methodological offerings of the litigants or, perhaps, reject all such offerings and utilize the court's own methodology. Thus, for example, from the six analyses offered by the parties in *Shell Oil*, the Vice Chancellor selected one methodology, referred to in the case as the "present value of equity analysis," and determined that analysis to be "entitled to the greatest weight." *Id.* at 1218. The Vice Chancellor, however, finally arrived at fair value by discounting the "present value of equity analysis" by 20%. See *id.* In *Cooper*, also mentioned above, the court found none of the proffered valuation methods persuasive and thus used its own, different fair value methodology, which was "based upon an estimate of the actual market value of the stock as determined from . . . [the] successful tender offer price" for the company. *Cooper*, 1993 WL 208763, at *8. Although the courts in both *Shell Oil* and *Cooper* attempted to explain the selection of their particular fair value methodology, neither was successful. Neither court provided any meaningful principle for the selection of one methodology over the other.

To some extent, the opinion in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), explains the parties' proffering of multiple valuation methodologies. *Weinberger* eliminated the Delaware block method as the "exclusive" method for determining present value in Delaware and practically solicited future parties to offer any method of valuation that was reasonable. See *id.* at 703-04. For a description of the Delaware block method and the valuation computation under that method, see the authorities cited in *infra* notes 55-56. More fundamentally, however, the proffer of multiple methodologies by litigants and the difficulty courts have in articulating criteria for selection from among the various offerings may best be explained by the absence of principles. Unconstrained by clear and sensible principles, litigants naturally offer differing valuation methodologies that suit their particular preferences. Without a theoretical anchor, courts, especially when faced with such multiple methodologies, are likely to make inconsistent selections over time and, thus, provide no guidance for future litigants. The cycle, therefore, repeats itself, as future litigants are able to select their preferred methodologies from prior unprincipled decisions.

Surveying all this, Professor Wertheimer nevertheless concludes that "the most prominent method of valuation in Delaware has been the discounted cash flow . . . method." Wertheimer, *supra* note 46, at 627.

53. In Delaware, this rule goes back many years, see, e.g., *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950), and continues to be applied uniformly today. See, e.g., *Cede & Co. v. Technicolor, Inc.* ("Technicolor IV"), 684 A.2d 289, 298 (Del. 1996) (stating

invest in anticipation of participating in the value that a corporation generates as a going concern. Thus, to the extent that appraisal is designed to compensate stockholders for what is taken from them, going concern value, and not liquidation value, seems the appropriate measure of fair value.⁵⁴

Even this most fundamental idea, however, is applied unevenly. For example, some courts allow liquidation value to seep into going concern value calculations by considering liquidation value as a component of going concern value. Such is the case with the Delaware block approach,⁵⁵ under which liquidation value or, as it is called, "asset value," is typically accorded significant weight in the present value calculation.⁵⁶

that liquidation value is not appropriate as the sole measure); *Shell Oil*, 607 A.2d at 1218-19 (same); *Rapid-American Corp. v. Harris*, 603 A.2d 796, 803 (Del. 1992) (same).

54. Liquidation value, however, should be considered a part of going concern value if there is some probability that liquidation may in fact occur. In such a case, the anticipated proceeds from liquidation comprise a part of the company's cash flows that are discounted to a present value. To use a simple example, assume it is anticipated that Acquired Corporation will generate cash flows of \$100 in each of years one and two, will generate no cash flows in year three, and will be liquidated for net value of \$100 at the end of year three. The going concern value of Acquired Corporation should be the discounted value of \$100 per year in each of the next three years. The liquidation value of \$100, therefore, merely becomes a part of the anticipated cash flows of Acquired Corporation. The approach that the SEC used to value Atlas in *In re Atlas Pipeline Corp.*, 9 S.E.C. 416, 437-38 (1941), provides an example of the use of this methodology.

Similarly, liquidation value is relevant to going concern value because a high liquidation value may reduce the risk of the investment. Financial economists generally view risk as the range of the dispersion of probable outcomes. See WILBUR G. LEWELLEN, *THE COST OF CAPITAL* 8-18 (1969) (providing a utilitarian explanation for risk aversion and an explanation why investors, therefore, accept risk only if paid to do so); see also BREALEY & MYERS, *supra* note 11, at 143-66 (explaining risk in terms of variance or standard deviations). A high liquidation value may compress the lower range of outcomes from an investment, thus reducing the variance in possible outcomes and accordingly reducing risk and increasing the present value of a company or its stock.

55. Prior to *Weinberger*, 457 A.2d at 701, the Delaware block method (or, as it also was called, the weighted average method) of valuation was the exclusive method for valuation in Delaware. See, e.g., *Francis I. DuPont 7 Co. v. Universal City Studios, Inc.*, 312 A.2d 344, 349-50 (Del. Ch. 1973), *aff'd*, 334 A.2d 216 (Del. 1975); *In re Delaware Racing Ass'n*, 206 A.2d 664, 670 (Del. Ch.), *aff'd*, 213 A.2d 203 (Del. 1965). Writing in 1984, Dean Joel Seligman observed that "in the post-World War II period, virtually all states followed the Delaware block-valuation approach." Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829, 841 (1984). Delaware courts have correctly noted that *Weinberger* did not prohibit the use of the Delaware block approach, but instead only eliminated the methodology's exclusivity. See *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 940 (Del. 1985). Other jurisdictions apparently continue to rely on the Delaware block approach. See, e.g., *Walter S. Cheesman Realty Co. v. Moore*, 770 P.2d 1308, 1311 (Colo. Ct. App. 1988).

56. For an outstanding discussion of the Delaware block approach and the way courts handled this valuation methodology around the time *Weinberger* was decided, see

In other instances, courts have reached an improper measure of going concern value by applying too literally the rule that fair value is determined by going concern value. In *Bell v. Kirby Lumber Corp.*,⁵⁷ for example, minority stockholders were frozen out of Kirby Corporation in a short-form merger at a price of \$125 per share.⁵⁸ Applying the Delaware block approach, the Chancellor found that the earnings value of Kirby was \$120 per share but that the asset value of Kirby was \$456 per share.⁵⁹ The Chancellor weighted earnings at 60% and assets at 40% and thus arrived at a weighted average value of \$254.40 per share, which the Delaware Supreme Court affirmed.⁶⁰

Kirby's assets should have received 100% of the weight, and thus the going concern value of Kirby for appraisal purposes should have been at least \$456. This result follows from the principle that corporate managers owe a duty to stockholders to maximize stockholder wealth. Kirby's managers should have sold the assets of Kirby and divided the proceeds among stockholders.⁶¹ It is nearly too simple to observe that corporate managers who can manage the company only to a value of \$120 per share should sell the company's assets to other managers who can manage at \$456 (or more) per share.⁶² Corporate stockholders benefit from the sale, and society profits from the moving of assets into the hands of more efficient users. In this instance, going concern value should have been based on an assumption of appropriate management of the assets by Kirby's managers, an assumption which leads to a going concern value of \$456 per share.

Even the simplest of the discrete rules of fair value, therefore, is

Seligman, *supra* note 55, at 841-56; see also J. Steven Rogers, Note, *The Dissenting Shareholder's Appraisal Remedy*, 30 OKLA. L. REV. 629, 641-42 (1977) (presenting a chart to illustrate the percentage weight applied by various courts during valuation proceedings); Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1468-71 (1966) (discussing the weight allocation applied by Delaware courts in valuation cases).

57. 413 A.2d 137 (Del. 1980).

58. *See id.* at 139.

59. *See id.* at 147 n.3.

60. *See id.* at 145-46.

61. For a different opinion on such cases, see Seligman, *supra* note 55, at 850 (arguing that asset values have no necessary significance in calculations of the value of a minority shareholder's interest, because minority shareholders have no power to compel liquidation).

62. In *Rapid-American Corp. v. Harris*, 603 A.2d 796, 802-03 (Del. 1992), the Delaware Supreme Court reaffirmed *Bell*. See also *Cede & Co. v. Technicolor, Inc.* ("Technicolor IV"), 684 A.2d 289, 298 (Del. 1996) (relying on *Bell* in its valuation analysis).

often misunderstood and misapplied by courts.

b. Proportionate Share of the Entity

Another broad issue facing courts in appraisal proceedings is the question of whether fair value should be measured by the value of a dissenting shareholder's proportionate interest in the entire company or by the value of the dissenting shareholder's individual shares. One way this issue may arise is in relation to minority interests in a publicly traded company that has an identifiable majority stockholder.⁶³ An efficient market may discount such minority shares,⁶⁴ in part because the market fears that the majority shareholder will forcibly acquire the minority interest at an unfairly low price.⁶⁵ The question that courts face in such a case is whether fair value should impound the so-called minority discount or, alternatively, whether dissenting stockholders are entitled to some part of the control premium.

A similar issue comes up in the context of appraisals involving closely held corporations. In these cases, the company may argue that the fair value of the stock should be discounted because there is no active market for the sale of the securities.⁶⁶

Courts differ as to whether fair value should be reduced to reflect a minority discount or a nonmarketability discount, although most appear to conclude that such discounts should not be considered in fair value calculations.⁶⁷ Thus, in broadly mechanical terms, courts

63. An example of this is *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213 (Del. 1992), in which Royal Dutch Petroleum Company owned 94.6% of Shell at the time of the freeze-out merger. See *id.* at 1216.

64. See Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact on Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 478 (1990); see also J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 5 (1977) (arguing that an outside buyer will discount the value of the shares to account for the risk that the majority will reduce the rate of return).

65. See Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CAL. L. REV. 1073, 1099 (1983); Theodore N. Mirvis, *Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues*, 38 BUS. LAW. 485, 489 (1983); Carole B. Silver, *Fair Dealing Comes of Age in the Regulation of Going Private Transactions*, 9 J. CORP. L. 385, 396 (1984).

66. See, e.g., *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144-45 (Del. 1989) (rejecting the company's argument that nonmarketability discounts should be applied); *In re Valuation of Common Stock of McLoon Oil Co.*, 565 A.2d 997, 1003 (Me. 1989) (same).

67. The following are examples of cases that measure fair value by the dissenter's proportionate share of the entity as a whole: *Shell Oil*, 607 A.2d at 1218; *Rapid-American*, 603 A.2d at 802; *Cavalier Oil*, 564 A.2d at 1144; *McLoon Oil*, 565 A.2d at 1004. In *Ford v. Courier-Journal Job Printing Co.*, 639 S.W.2d 553 (Ky. 1982), however, the Kentucky court used a "marketability discount" of 25% in arriving at fair value for a closely held

calculate the going concern value for the corporation as a whole and then award a dissenting shareholder value equal to his or her proportionate ownership interest in the company.⁶⁸

In determining whether or not to include a minority or nonmarketability discount in fair value, courts typically fail to articulate meaningful principles, offering instead only the most general explanations as to why they exclude or include such discounts in their fair value calculation. Courts, for example, often support the exclusion of such discounts as a way to promote "fairness,"⁶⁹ avoid a result that "unfairly enriches the majority shareholders who may reap a windfall from the appraisal process,"⁷⁰ or avoid a "transfer of wealth from the minority shareholders to shareholders in control."⁷¹

Once again, one may have a sense that courts are essentially on sound ground in not allowing minority or nonmarketability discounts, even though the extremely general reasoning supporting such outcomes may be less than satisfying. One may, for example, conclude that disallowing a minority discount is consistent with corporate fiduciary obligations. As described above, the minority discount, at least to a large degree, is thought to be the result of the pricing by the efficient market of the expropriation risk, which includes, for example, the risk that the minority shareholders will be frozen out at an unfairly low price. Such a freeze-out is inconsistent with the fiduciary duties the majority shareholder and the acquired corporation's managers owe to minority shareholders. Accordingly, disallowing the minority discount removes the incentive to exploit this potentially unfair advantage and promotes conduct consistent with corporate fiduciary obligations.

c. Sharing Synergy

Today's law regarding the obligation to share synergy in appraisal proceedings can best be explained by reference to the parsing analysis offered in Part II of this Article. As described earlier, the MBCA excludes from fair value "any appreciation . . . [in

corporation. See *id.* at 556-57. Recently promulgated proposed amendments to the MBCA reject minority and nonmarketability discounts in appraisal proceedings. See MODEL BUS. CORP. ACT § 13.01(4)(iii) (Proposed Changes 1998), *supra* note 27, at 251.

68. One court explained that it has an obligation to establish "the best price a single buyer could reasonably be expected to pay for the firm as an entirety[.] The court then prorates that value for the whole firm equally among all shares of its common stock. The result is that all of those shares have the same fair value." *McLoon Oil*, 565 A.2d at 1004.

69. *Id.*

70. *Cavalier Oil*, 564 A.2d at 1145.

71. *McLoon Oil*, 565 A.2d at 1004.

the value of the dissenter's stock] in anticipation of the [acquisition] ... unless exclusion would be inequitable."⁷² Delaware statutes exclude from fair value⁷³ "any element of value arising from the accomplishment ... of the merger."⁷⁴ Under such statutory language, however, the obligation to share synergy with dissenters is poorly defined. It is unclear which of the Additives described in Part II's parsing discussion qualify as, in the words of the statutes, appreciation in value that is "in anticipation of" or "arising from" the amalgamation of the companies.

Cases provide some help, indicating that the Information Additive (the value added by correcting misinformation about the Acquired Corporation) and the Discrete Mismanagement Additive (the additional value created by pursuing a breach of fiduciary duty claim against Acquired Corporation's managers) should be included in fair value. Stated alternatively and in the language of the appraisal statutes, the cases hold that the value represented by those two Additives should not be excluded from fair value as being in "anticipation of" or "arising from" the acquisition.

Regarding the Information Additive, the court in *Cede & Co. v. Technicolor, Inc.* ("*Technicolor I*"),⁷⁵ for example, stated directly that fair value must reflect "all relevant information regarding the

72. MODEL BUS. CORP. ACT. § 13.01(3). Proposed amendments to the MBCA would change this language. Specifically, the language of the proposed amendments requires that fair value be "determined ... immediately before the effectuation of the corporate action to which the shareholder objects." MODEL BUS. CORP. ACT. § 13.01(4)(i) (Proposed Changes 1998), *supra* note 27, at 251. Obviously, this language provides no explicit exclusion of appreciation. The Official Comments state that "section 13.01(4) permits consideration of changes in the market price of the corporation's shares in anticipation of the transaction, to the extent such changes are relevant." *Id.* § 13.01(4), official cmt. 2.

73. Recently, the Delaware court was required to determine the point at which fair value is calculated in a second step, clean up merger. The case, *Cede & Co. v. Technicolor, Inc.* ("*Technicolor IV*"), 684 A.2d 289 (Del. 1996), involved a two-step, friendly acquisition in which MacAndrews & Forbes Group Inc. (MAF) acquired 82% of Technicolor in the first step and then froze out the minority stockholders in a second-step merger. *See id.* at 293. Between the completion of the tender offer and the second-step merger, MAF took control of Technicolor and began to implement a plan of operation that improved the value of Technicolor. *See id.* The question for the court was whether the exclusion of "value arising from the ... merger" from fair value excluded the new value generated by MAF's business plan. *Id.* at 294 (quoting DEL. CODE ANN. tit. 8, § 262(h)). The court took a literal reading of the statute and held that fair value was determined on the day of the merger, which, as a result, impounded in fair value the value of the improvements made between the tender and the second step merger. *See id.* at 298-99.

74. DEL. CODE ANN. tit. 8, § 262(h) (1991 & Supp. 1998).

75. 542 A.2d 1182 (Del. 1988).

company and its shares.”⁷⁶ The court explained that if the value added by the Information Additive were not included in the fair value calculation, dissenting shareholders might “be deprived of part of the true investment value of their shares.”⁷⁷

Similarly, cases provide support for including the Discrete Mismanagement Additive in fair value.⁷⁸ In *Cavalier Oil Corp. v. Harnett*,⁷⁹ for example, the Delaware Supreme Court held that the value of a usurped corporate opportunity must be considered in arriving at fair value. Fair value, the court concluded, must include the present value of the earnings lost as a result of the usurpation of the opportunity.⁸⁰ A related rule comes from *Porter v. Texas Commerce Bankshares, Inc.*,⁸¹ in which the Chancellor stated that “[i]f the company has substantial and valuable derivative claims, they, like any asset of the company, may be valued in an appraisal.”⁸²

76. *Id.* at 1187 (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)). The court expanded the scope of the information that would be impounded in fair value beyond the materiality standard. The court stated that fair value includes “bits and pieces of nonmaterial information that have value as a totality.” *Id.* at 1187 n.8.

77. *Id.* Both *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1143–44 (Del. 1989), and *Porter v. Texas Commerce Bankshares, Inc.*, No. Civ. A. 9114, 1989 WL 120358, at *6 (Del. Ch. Oct. 12, 1989) (mem.), which are discussed in *infra* notes 78–82 and accompanying text, provide support for including the Information Additive in fair value.

Disclosure of material information generally is considered a part of the fiduciary duty of corporate managers. *See, e.g.*, *Kahn v. United States Sugar Corp.*, No. Civ. A. 7313, 1985 WL 4449, at *4–6 (Del. Ch. Dec. 10, 1985) (finding a breach of duty by corporate fiduciaries because of a disclosure failure in connection with a self-tender). As a result, allowing minority shareholders of Acquired Corporation to participate in the value generated by correcting managers’ nondisclosures seems similar to allowing minority shareholders to participate in the value generated by correcting prior discrete acts of mismanagement.

78. An interesting question faced by courts is whether excessive salaries paid to top executives can be considered in determining fair value. The argument is that the difference between the actual, excessive salary and the fair market value of executive services should be considered as part of the earnings of the corporation and thus a part of fair value. Often, this matter has arisen in valuation of smaller corporations, in which control persons attempt to take large salaries in order to acquire a tax benefit for the corporation. *See, e.g.*, *Gonsalves v. Straight Arrow Publishers, Inc.*, No. Civ. A. 8474, 1996 WL 483093 (Del. Ch. Aug. 22, 1996) (mem.) (asserting that capitalizing excessive compensation is no different than capitalizing future cash flows), *rev’d on other grounds*, 701 A.2d 357 (Del. 1997); *Raskin v. Walter Karl, Inc.* 514 N.Y.S.2d 120, 121 (N.Y. App. Div. 1987) (stating that, to reflect true earning power, excess capitalization should be eliminated from corporate expenses).

79. 564 A.2d 1137 (Del. 1989).

80. *Id.* at 1144. The court accepted the lower court’s determination that, but for the usurpation, the corporation’s earnings “would have increased resulting in a higher per share valuation at the time of the merger.” *Id.*

81. No. Civ. A. 9114, 1989 WL 120358 (Del. Ch. Oct. 12, 1989) (mem.).

82. *Id.* at *5.

Referencing the parsing analysis of Part II, one is able to conclude that fair value in the hypothetical transaction would probably be at least \$12 per share, because fair value would include the Information Additive and the Discrete Mismanagement Additive. What is much more difficult to establish under current law, however, is whether additional Additives would be included in fair value or would be excluded under the terms of the appraisal statute as appreciation arising from the acquisition. In quantified terms, the issue is whether a court faced with facts similar to those in the parsing hypothetical would be willing to establish fair value at an amount in excess of \$12 per share and perhaps as much as \$17 per share.⁸³

The case law bearing on this question is both conflicting and imprecise.⁸⁴ In one case, *Bell v. Kirby Lumber Corp.*,⁸⁵ the evidence was that, if liquidated, Kirby had a net asset value of around \$456 per share.⁸⁶ The court nonetheless determined fair value to be only \$254 per share.⁸⁷ Obviously excluded from the court's measure of fair value was most of the synergy that could have been generated by moving Kirby's assets into more efficient hands. Thus, although not discussed in terms of the various components of synergy described through the parsing in Part II, most of the Additives that may have been in play in that acquisition were excluded from fair value.⁸⁸

In contrast to *Bell*, the outcome in *Cooper v. Pabst Brewing Co.*⁸⁹ appears to include in fair value most of the synergy generated by that

83. See *supra* notes 41–44 and accompanying text.

84. In addition to *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980), and *Cooper v. Pabst Brewing Co.*, No. Civ. A. 7244, 1993 WL 208763 (Del. Ch. June 8, 1993) (mem.), which are discussed in the text, a third case deserves mention, although the court's disposition of the case does not materially advance this discussion. In *David J. Greene & Co. v. Dunhill International, Inc.*, 249 A.2d 427 (Del. Ch. 1968), the court in an appraisal proceeding refused to increase earnings for valuation purposes based on the prospective elimination of losses from an unprofitable operation. See *id.* at 432–33. The court seemed to base its decision on the uncertainty that the loss elimination would actually materialize. See *id.*

85. 413 A.2d 137 (Del. 1980). This case is discussed elsewhere in this Article. See *supra* text accompanying notes 57–62; *infra* notes 164–65 and accompanying text.

86. See *Bell*, 413 A.2d. at 139–40, 147–48.

87. See *id.* at 145–48.

88. Based on a literal interpretation of the Delaware appraisal statute, the outcome in *Bell* may appear correct. As described previously, the Delaware statute excludes from fair value “any element of value arising from the accomplishment or expectation of the merger.” DEL. CODE ANN. tit. 8, § 262(h) (1991 & Supp. 1998). Because apparently the only way a value for Kirby of \$456 per share could be achieved was by moving Kirby's assets out of the hands of present managers and into the hands of new managers, the higher value of \$456 per share arguably was possible only “from the accomplishment or expectation of the merger.” See *Bell*, 413 A.2d at 139–40.

89. No. Civ. A. 7244, 1993 WL 208763 (Del. Ch. June 8, 1993) (mem.).

acquisition.⁹⁰ Pabst was selling at around \$14 per share when it became the subject of a bidding contest for control. Ultimately, Heileman won the bidding contest, paying a blended value of \$29.50 per share.⁹¹ In an appraisal proceeding, the Chancellor rejected the \$14 pre-bidding market price as an appropriate measure of fair value because that price had prevailed more than a year before the merger and for other "various reasons" that the court never explained.⁹² The court also rejected Heileman's winning bid of \$29.50 per share as the measure of fair value because that price most likely contained "a control premium unrelated to the value of [Pabst] ... as a going concern."⁹³ The court, essentially without further explanation, concluded that fair value of the Pabst stock was \$27 per share.⁹⁴

As a result, the dissenting Pabst shareholders were permitted to share in most of the value created when the Pabst assets were moved into more efficient hands. Specifically, of the \$15.50 per share difference between the pre-bidding price for Pabst (\$14 per share) and the fully bid price for Pabst (\$29.50 per share), dissenters participated in synergy amounting to \$13 per share and were denied participation in synergy equaling only \$2.50 per share.⁹⁵

Cooper, therefore, cannot be reconciled with *Bell*. The *Bell* court excluded from fair value nearly all the gains that could be recognized by moving assets into more efficient hands, while the *Cooper* court included nearly all of these gains in fair value.

Attempting to fit the *Cooper* outcome into the language of the applicable Delaware appraisal statute also is an interesting exercise, because the statute excludes from fair value "any element of value arising from the accomplishment ... of the merger."⁹⁶ Interpreting this language literally, one might conclude that the entire \$15.50 per share in synergy generated by the transaction in *Cooper* falls within that exclusionary language and that, accordingly, fair value of the Pabst stock should have been set at \$14 per share (the pre-bidding price). On the other hand, such a literal approach to the meaning of

90. See *id.* at *10.

91. The bids were all front-end loaded. Heileman's successful bid was \$32 in cash on the front end and \$24 in debentures on the back end, which amounted to a blended value of \$29.50 per share. See *id.* at *8.

92. See *id.* at *9.

93. *Id.* at *8-9. The Delaware court in other cases uses the term "control premium" interchangeably with synergy. See, e.g., *Cede & Co. v. Technicolor, Inc.* ("Technicolor IV"), 684 A.2d 289, 298 (Del. 1996).

94. See *Cooper*, 1993 WL 208763, at *8.

95. See *id.* at *9.

96. DEL. CODE ANN. tit. 8, § 262(h) (1991 & Supp. 1998).

the language of appraisal statutes may also lead to the exclusion of the Information Additive and the Discrete Mismanagement Additive from fair value, and we saw previously that courts are unwilling to accede to such exclusions.⁹⁷

The right of dissenting shareholders to share in the synergy generated by acquisitions, therefore, is uncertain. Although the cases do indicate that fair value includes both the Information Additive and the Discrete Mismanagement Additive, and thus fair value within the parsing hypothetical in Part II would be at least \$12 per share,⁹⁸ the inclusion of other Additives in fair value is uncertain and subject to apparently conflicting rules. Within the parsing hypothetical, one is unable to determine whether fair value for Acquired Corporation's shares under current law should be \$12 per share, \$17 per share, or some value between these two figures.

3. Summary

Appraisal statutes are designed to be vague and to rely on courts to establish their critical terms, including the definition of fair value. Courts, however, have been unable to articulate meaningful principles to guide them in fair value cases. As a result, the few discrete common-law rules defining fair value are confusing and, in some instances, irreconcilable.

B. Fiduciary Duties and the Right to "Fair Price"

While the fair value obligation in appraisal proceedings is rooted in statute, the obligation of fair price has developed through the common law. Notwithstanding these differing origins, the discrete common-law rules respecting the determination of fair price are in many respects similar to the discrete rules respecting fair value. In at least one way, however, rules of fair price and fair value appear to differ significantly. Specifically, the rhetoric in fair price cases, unlike the rhetoric in fair value cases, seems to require the inclusion of some measure of synergy generated by the challenged transaction.⁹⁹

97. See *supra* notes 75–83 and accompanying text.

98. The \$12 per share is comprised of the \$10 initial price, plus \$1 for the Information Additive, and \$1 for the Discrete Mismanagement Additive.

99. Already, though, we have seen that some (but not all) fair value cases may award a significant portion of the synergy to dissenting shareholders. See *supra* notes 79–98 and accompanying text.

1. Specific Rules of Fair Price

a. Going Concern Value

As in the fair value cases, courts determine fair price as going concern value and not as liquidation value,¹⁰⁰ and some courts indicate a willingness to apply this rule even in situations in which liquidation value exceeds the going concern value for the entity.¹⁰¹ This latter outcome, refusing to consider liquidation value as fair price when liquidation value exceeds the market or going concern value, is subject to the same criticism described in the fair value section of this Article,¹⁰² in that such a result is inconsistent with managers' duty to maximize shareholder wealth and provides a disincentive to move assets into the hands of most efficient users.¹⁰³

b. Proportionate Share of the Entity

In calculating the fair price of a stockholder's shares in an acquired company, courts generally start with the plaintiff's "pro rata value of the entire firm as a going enterprise."¹⁰⁴ This calculation means that fair price, like fair value, normally does not impound any minority or nonmarketability discount in the event the shares are closely held or thinly traded.¹⁰⁵ While the refusal to reduce fair price by any minority or nonmarketability discount may seem attractive and, indeed, may be the better rule, courts typically arrive at this outcome in fair price cases, as they do in fair value cases, without the

100. See, e.g., *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 942 (Del. 1985). Courts also have held that book value is not a proper measure of fair price. See *Seagraves v. Urstadt Property Co.*, No. Civ. A. 10307, 1996 WL 159626, at *7 (Del. Ch. Apr. 1, 1996) (mem.); *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, 532 A.2d 1324, 1334-35 (Del. Ch. 1987).

101. In *Rosenblatt*, the complaining shareholder attempted to have fair price measured by liquidation value, under the theory that the real worth of an oil company is in its assets, principally in its reserves. See *id.* at 941. Obviously, the plaintiff was convinced that liquidation value was higher than going concern value. See *id.* at 941-92. The court rejected the shareholder's argument, stating that for fair price purposes, "a company is valued as a going concern, not on what can be obtained by its liquidation." *Id.* at 942.

102. See *supra* notes 61-63 and accompanying text.

103. See *id.*

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

105. See, e.g., *Ryan v. Tad's Enters., Inc.*, 709 A.2d 682, 693 n.14 (Del. Ch. 1996). The *Ryan* court also determined that market value was an inappropriate measure of fair value of the complaining shareholders' stock, given that the market price was depressed because of the "illiquidity [of the stock] due to the relatively small number of outstanding minority shares being traded." *Id.* at 693.

benefit of articulated principles.¹⁰⁶

c. Sharing Synergy

Although the product of a convoluted pedigree, the generally accepted rule is that fair price includes some portion of synergy.¹⁰⁷ To explain this apparently broad rule, reference again is made to the parsing of value described in Part II of this Article.¹⁰⁸ The discussion, therefore, is framed in terms of identifying those Additives or components of synergy that are a part of the fair price and that, accordingly, must be shared with the shareholders of Acquired Corporation.

Not surprisingly, cases provide support for including the gains represented by the Information Additive (the value added by correcting misinformation about Acquired Corporation) and the Discrete Mismanagement Additive (the additional value created by pursuing a breach of fiduciary duty claim against Acquired Corporation's managers) in the calculation of fair price. Accordingly, the court in *Kahn v. Tremont Corp.*¹⁰⁹ addressed the inclusion of the Information Additive by stating that "fair price is a price that is

106. *Kahn*, 1996 WL 145452, at *10, does, however, provide an interesting and economically sound explanation for the reason that the market, even if active, will discount minority shares when there is an identifiable majority block of stock. *Kahn* involved the parent's sale to a subsidiary of stock in a second subsidiary corporation. A stockholder of the purchasing subsidiary claimed that the price of the sister's stock was too high. Because the transaction involved a conflict on the part of the parent, the court analyzed the claim under the intrinsic fairness test and thus inquired whether the price of the sister's stock to the subsidiary was a "fair price." See *id.* at *9-15. The *Kahn* court stated that

the market may deeply discount or ignore possible future cash flows not reflected in established dividend patterns because the controlling shareholder may have other ways of getting increased corporate cash flows out of the enterprise. While fiduciary duties are designed to protect against that eventuality, that protection is expensive to invoke, slow and quite imperfect. Thus it is not at all irrational for markets to discount deeply potential non-dividend cash flows in some situations where a controlling shareholder exists.

Id. at *9 n.14.

107. In *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the court articulated the meaning of fair price, but it did so in an indirect manner by indicating that in certain instances the measure of damages for an intrinsic fairness violation includes rescissory damages. See *id.* at 714. For its definition of rescissory damages, the *Weinberger* court relied on *Lynch v. Vickers Energy Corp.*, 429 A.2d 497, 505 (Del. 1981), which essentially defined the term rescissory damages to include the synergy from the transaction. Putting these together, and because damages are co-extensive with the wrong, the measure of the obligation to offer a fair price to minority stockholders in affiliated acquisitions necessarily includes a portion of the synergy generated by the transaction.

108. See *supra* text accompanying notes 38-44.

109. No. Civ. A. 12339, 1996 WL 145452 (Del. Ch. Mar. 21, 1996) (mem.).

within a range that reasonable men and women *with access to relevant information* might accept."¹¹⁰

Regarding the obligation to include the Discrete Mismanagement Additive in fair price, a number of cases reject the idea that fair price can be discounted by the negative value of serious, past mismanagement.¹¹¹ In *David J. Greene & Co. v. Dunhill International, Inc.*,¹¹² the court held that fair price must include the recapture of the value lost through the usurpation of a corporate opportunity. In *Coggins v. New England Patriots Football Club, Inc.*,¹¹³ the court held that fair price included the value of wrongfully wasted corporate assets.¹¹⁴

In evaluating whether the other Additives are included in fair price under current law, one is required to look to more general rules from cases such as *Cinerama, Inc. v. Technicolor, Inc.*¹¹⁵ Technicolor became the subject of a friendly acquisition by MacAndrews & Forbes Group, Inc. (MAF). Immediately before MAF manifested its interest, Technicolor stock was selling at around \$11 per share.¹¹⁶ Ultimately, the Technicolor board of directors agreed that their company would be acquired by MAF at \$23 per share.¹¹⁷ In a prior

110. *Id.* at *1 (emphasis added).

111. In addition to the cases described in *infra* notes 112–14 and accompanying text, in *Berkowitz v. Power/Mate Corp.*, 342 A.2d 566 (N. J. 1975), the court indicated that fair price should not be reduced as a result of the excessive salaries the majority stockholders paid to themselves. *See id.* at 571. Also, in *Ryan v. Tad's Enterprises, Inc.*, 709 A.2d 682 (Del. Ch. 1996), fair price included the recapture of the value of consulting and non-competition agreements, which the court viewed as a mechanism that controlling stockholders used to divert corporate value to themselves. *See id.* at 694–95. The *Ryan* court held that the defendants, who had the burden on the matter, had not proven that the contracts were worth what the majority stockholders individually were paid for them. Thus, the presumption became that the contract price represented a diversion of corporate value to the majority stockholders. *See id.* at 690.

112. 249 A.2d 427 (Del. Ch. 1968).

113. 492 N.E.2d 1112 (Mass. 1986). In *Coggins*, the court determined that a freeze-out violated fiduciary duties, because it served no legitimate corporate purpose. The court ordered rescissory damages as a remedy, and thus dealt with fair price in that context. *See id.* at 1120.

114. *See id.* at 1120. The court noted that "[t]he present value of the Patriots . . . should include the amount wrongfully removed or diverted from the corporate coffers by the individual defendants." *Id.* More technically, *Coggins* held that rescissory damages must include a recapture of value lost through corporate waste. *See id.* As described above, the measure of rescissory damages and fair price should be considered co-extensive. *See supra* note 107.

115. 663 A.2d 1134 (Del. Ch. 1994), *aff'd*, *Cinerama, Inc. v. Technicolor, Inc.* ("Technicolor III"), 663 A.2d 1156 (Del. 1995).

116. *See Cede & Co. v. Technicolor, Inc.* ("Technicolor II"), 634 A.2d 345, 352 (Del. 1993).

117. *See id.* at 357.

decision, *Cede & Co. v. Technicolor, Inc.* ("Technicolor II"),¹¹⁸ the Delaware Supreme Court concluded, however, that Technicolor's board had not informed itself fully about the acquisition. Accordingly, the court held that the board's decision to approve the acquisition at \$23 per share did not get business judgment protection, but instead was to be evaluated under the intrinsic fairness test.¹¹⁹ On remand from *Technicolor II*, therefore, the Chancery Court in *Cinerama* considered whether the action of the board of Technicolor in approving the acquisition at \$23 per share met the intrinsic fairness test, which, in turn, required the *Cinerama* court to consider whether \$23 per share amounted to a fair price.¹²⁰

Consistent with other Delaware cases,¹²¹ the court in *Cinerama* defined fair price as "the highest value reasonably achievable" for the Technicolor stock.¹²² The court recognized that, in a competitive market for corporate control of Technicolor, a successful bidder would "be driven to pay a substantial part of the expected synergy value" over to the target's shareholders.¹²³ The court's reckoning on that matter is based on the simple economic fact that, in such circumstances, surrendering a substantial part of the synergistic gain to the seller is necessary in order for the successful buyer to out-bid its rivals.

The court then applied this criterion by assuming that a bidder other than MAF would have been willing to pay \$25 per share for Technicolor. Even under that assumption, however, the court concluded that the acquisition price of \$23 per share "was certainly fair," given that the Technicolor stockholders, as the result of the sale to MAF at \$23 per share, garnered 86% of the total synergy that might be generated by selling Technicolor to the very highest possible

118. 634 A.2d 345 (Del. 1993).

119. See *id.* at 368-69.

120. See *Cinerama*, 663 A.2d at 1138-39.

121. See *Cinerama, Inc. v. Technicolor, Inc.* ("Technicolor III"), 663 A.2d 1156, 1162, 1177 (Del. 1995); *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 48 (Del. 1994); *Technicolor II*, 634 A.2d at 361.

122. *Cinerama*, 663 A.2d at 1143. At other points, the *Cinerama* court articulated its standard of fair price differently, stating, for example, that "fair price does not mean the highest price financeable or the highest price that fiduciary [sic] could afford." *Id.* Later, the court stated that fair price was one a "reasonable seller . . . would regard as within a range of fair" and, still later, described fair price as "one that such a seller could reasonably accept." *Id.* All of these definitions seem to be either alternate ways of stating, or at least not inconsistent with, what apparently is the basic criterion of fair price, which is that it be the highest value reasonably available under the circumstances.

123. *Id.*

bidder.¹²⁴

Initially, it is hard to understand how the fair price criterion articulated in *Cinerama*, which requires managers to get "the highest value reasonably achievable," is satisfied by an acquisition price that is \$2 (or 8%) less than the price the court assumes to be available from the highest bidder.¹²⁵ One possibility could be that the *Cinerama* court concluded without articulation that the search costs for additional bidders, including the costs associated with the risk that MAF would abandon its interest in Technicolor, exceeded \$2 per share.

Alternatively, one may reconcile the outcome in *Cinerama* to the broad rule from the case if the court determined, again, without articulation, that \$23 per share, although less than the maximum value available for the Technicolor stock, did not amount to a performance by managers that was so bad as to rise to the level of culpability necessary to support a finding that the managers had breached their fiduciary duty. Thus, for example, assuming that negligence were the standard by which we judge managers in this case, the failure to maximize shareholder wealth did not amount to a deviation from ordinary care.

A final explanation for the outcome may be the court's unarticulated assumption that competition in the market for corporate control of Technicolor was insufficient to drive the price to \$25 per share, even though the most efficient user actually could pay that price. For example, assume that a number of Technicolor competitors, including MAF, could develop sufficient efficiencies to make money by paying \$23 per share for Technicolor, but could not make money at any higher price. One super efficient competitor, however, could make money by paying up to, but not beyond, \$25 per share. The price under these assumptions respecting the market for corporate control would settle somewhere between \$23 per share and

124. See *id.* In *Cinerama*, as described in *supra* notes 115–23 and accompanying text, the pre-bidding market price of Technicolor was around \$11 per share, the merger price was \$23 per share, and the highest price the court supposed to be possible for Technicolor was \$25 per share. See *id.* "Synergy," therefore, was apparently considered to be the \$14 difference between the pre-bidding market price and the highest possible price. The old Technicolor shareholders received \$23 per share for their stock, which amounted to \$12 in synergy (\$23 merger price minus the \$11 pre-bidding market price), or 86% (12/14ths) of the synergy. See *id.*

Cinerama was affirmed by the Delaware Supreme Court in *Technicolor III*, 663 A.2d at 1156. The supreme court specifically affirmed both the lower court's standard of fair price and its application to the facts of the case. See *id.* at 1176–77, 1180.

125. See *Cinerama*, 663 A.2d at 1143.

\$25 per share. Thus, \$23 per share would be within the range, although on the low end, of the "highest value reasonably achievable."¹²⁶

Notwithstanding these possible explanations, the *Cinerama* opinion remains ambiguous concerning the meaning of fair price, even though the essence of the broad *Cinerama* formula may be attractive.¹²⁷ This confusion is due at least in part to the fact that it is impossible to determine which, if any, of the foregoing explanations is the basis for the decision. As a result, the value of *Cinerama* is limited, for example, when one attempts to apply *Cinerama* to a case such as the hypothetical situation in Part II.¹²⁸ Within the facts of that hypothetical, one is able to suppose only that fair price is somewhere between \$12 and \$17 per share and is perhaps closer to the latter amount.¹²⁹

2. Summary

The uncertainty regarding the proper measure of fair price is made significantly worse by the common-law rules limiting the broad availability of the fair price protection. Recall from the discussion in Part II.C of this Article that *Weinberger* and its progeny hold that the fair price obligation of the intrinsic fairness standard is inapplicable if the corporate fiduciaries have acted with procedural fairness.¹³⁰ In instances of fair dealing, *Weinberger* holds that complaining shareholders' exclusive remedy is appraisal, a remedy that seemingly denies shareholders full participation in synergy.¹³¹

126. *Id.* In order for the outcome under this analysis to be consistent with the broad rule of the case, one must assume that MAF is the second highest bidder and that the normal results of competition would mean that the super-competitor could acquire Technicolor without sharing any of the unique synergy (the \$2 between \$23 and \$25 per share) it would generate by the acquisition. The case contains no factual bases for such assumptions, however.

127. In fact, the *Cinerama* formula for fair price ("the highest value reasonable achievable") is quite close to the formula for fair value and fair price proposed in this Article. See *infra* text accompanying note 177.

128. See *supra* text accompanying notes 38–44.

129. The raw numbers of *Cinerama* would indicate that fair price in the hypothetical should be around \$16 per share. In the hypothetical, the synergy generated by the acquisition amounts to \$7 (this assumes, perhaps incorrectly, that all the Additives would be considered synergy within *Cinerama*); if *Cinerama* holds that the fair price obligation requires that at least 86% of such synergy be shared proportionately by the shareholders of the Acquired Corporation, shareholders of the Acquired Corporation would be entitled to approximately \$16 per share (\$10 market value plus 86% of \$7 in synergy).

130. See *supra* text accompanying note 36.

131. Recall, however, that this rule is uncertain. Some appraisal cases seem to permit shareholders to share in synergy. See *supra* notes 79–98 and accompanying text.

Consider the implications of the *Weinberger* rule for the hypothetical situation in Part II and the principal parties involved in that transaction. Acquiring Corporation, which controls Acquired Corporation, must first determine what price it is required by its fiduciary duties to pay for this acquisition. Similarly, Acquired Corporation's independent negotiating committee, which, in light of the *Weinberger* opinion, the Acquired Corporation's board will undoubtedly appoint in order to evaluate Acquiring Corporation's offer,¹³² must also determine the price it is able to approve consistent with its fiduciary duties.

The most difficult problem for both Acquiring Corporation and Acquired Corporation's independent negotiating committee is the matter of whether fair price, which apparently includes some measure of synergy, or, alternatively, fair value, which may not include synergy, is the standard by which the fiduciary obligations of Acquiring Corporation and the independent negotiating committee are to be judged. If fair price is the measure of the principal parties' fiduciary obligation, perhaps something close to \$17 per share may be required; if fair value is the measure of the principal parties' fiduciary obligation, perhaps something around \$12 per share may be sufficient. The uncertainty in all this is obviously troubling, not only to the parties, who may not be able to figure out what to do, but also to society, as such ambiguities may provide an incentive for resource allocations that are economically inefficient or otherwise morally unattractive.

IV. THE APPROPRIATE MEASURE OF FAIR VALUE AND FAIR PRICE

As described in the preceding parts, today's rules respecting fair value and fair price generally are confusing and appear to lack moral or economic foundations. The purpose of this part, therefore, is to propose rules of fair value and fair price that are founded on attractive moral and economic values widely shared by society, rules that also are sufficiently intelligible to enable parties to engage in ex ante planning with predictable outcomes.

A. *True Consent*

In developing principles to guide courts in fair value and fair price cases, one attractive analysis is founded on consent and thus focuses on the expectations of the parties.¹³³ Accordingly, when

132. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709 n.7 (Del. 1983).

133. Judge Posner proposes that consent provides moral support for the pursuit of

presented with the matter of whether a minority stockholder is permitted to share in any or all of the Additives described in Part II, a court utilizing this analysis attempts to reach an outcome that respects the ex ante expectations of the parties. If parties in the particular situation strike an ex ante bargain with regard to the sharing of the Additives and the bargain generates no third party effects, the consent to the transaction by those who are affected may go a long way in satisfying both moral and economic concerns that result from a particular outcome.

Assume, for example, that within the facts of the hypothetical in Part II, Ms. C purchases a share of common stock in Acquired Company believing that, in the event of an affiliated merger, she has the right to the market value of her stock (\$10 per share), plus the value of the Information Additive (which adds \$1 per share), the Discrete Mismanagement Additive (which adds another \$1 per share), and the Operational Savings Additive (which adds another \$1 per share). One may be content in that instance to hold Ms. C to the bargain she made and thus to award Ms. C \$13 as fair price or fair value in the case of an acquisition, because Ms. C consented to and priced the outcome through her willingness to purchase Acquired Corporation stock at, assume, \$10 per share. Morally, one may be satisfied with such an outcome, given that Ms. C ex ante voluntarily entered into a transaction that maximized her happiness and that was in furtherance of her personal autonomy.¹³⁴ Expressed in economic terms, such voluntary trades are the very essence of economic efficiency. Such trades, assuming no third party effects, by definition create economic wealth.¹³⁵

While clearly demonstrable consent to transactions is a powerful factor providing moral and economic legitimacy for particular outcomes, the difficulty with this criterion is that such true consent is rarely clearly demonstrable in these types of transactions. To state

economic efficiency. See Posner, *supra* note 19, at 488–502. He finds consent congenial to both a utilitarian regime and a Kantian regime. See *id.* at 489–90. Simplified, a voluntary (consensual), wealth-creating trade between two parties generates an increase in total utility (assuming no third party effects), see *id.* at 488; similarly, permitting such voluntary (consensual) trades also respects the autonomy of the trading parties as rational beings. See *id.* at 490. Thus, by permitting such pursuit of economic efficiency, Posner says that society “will produce an ethically attractive combination of happiness, of rights (to liberty and property), and of sharing with the less fortunate.” *Id.* at 487. Posner does not explain this last point in his article.

134. See *supra* notes 20–21 for a brief discussion of utilitarianism and Kantianism.

135. For the meaning of economic efficiency and the creation of economic wealth as used in this Article, see *supra* notes 17, 22.

the apparent, it is impossible to demonstrate that all the shareholders involved in a freeze-out merger of a publicly held company consented *ex ante* to a particular payout formula that includes none, part, or all of the elements of value described in Part II. More likely, most, and probably all, shareholders at the time they purchased their shares in Acquired Corporation were ignorant about that particular term in their investment contract. Without any such true consent respecting the matter of fair value and fair price, enforcing a particular outcome becomes more troubling, both morally and economically.

B. Contractarians' Version of Consent

Some scholars who follow the traditions of neoclassical economics ("Contractarians") are not slowed by the inability to demonstrate the 'true consent of the parties to a particular term. Instead, Contractarians generally are morally and economically satisfied with enforcing terms (i.e., allocating rights) that coincide with the terms to which the parties would agree, assuming transaction costs were zero.¹³⁶ Pursuing this line of reasoning, Contractarians propose that the parties, if able to bargain freely and without costs, would agree to terms that lead to allocative efficiency. In other words, absent transaction costs, the Contractarians propose that the parties through bargaining will agree to terms allocating a particular right to the party that is willing to pay most for the right.¹³⁷

Easterbrook and Fischel turn this line of thinking into an argument in favor of allowing Acquiring Corporation to grab all the synergy generated by the transaction.¹³⁸ They argue that all shareholders, including minority shareholders of Acquired Corporation, like Ms. C, would agree *ex ante* for Acquiring Corporation to get all the synergy generated by the acquisition.¹³⁹ Their reasoning is that such an outcome generates broadly

136. See, e.g., Easterbrook & Fischel, *supra* note 9, at 700 ("[T]he legal system *should* supply rules that mimic the *ex ante* agreements shareholders would reach if they could bargain for and enforce their agreements costlessly." (emphasis added)); Posner, *supra* note 19, at 491-97.

137. This form of analysis is used repeatedly and in various factual settings by law and economics scholars. For example, Judge Posner, in addition to using this analysis to interpret contracts, as I am doing here, see POSNER, *supra* note 17, at 105, also uses this analysis to discuss the economics involved in the incompatible uses of property rights. See *id.* at 55.

138. See Easterbrook & Fischel, *supra* note 9, at 708-10. Professor Cox critiques Easterbrook and Fischel's theories in connection with his article on derivative suits. See James D. Cox, *Compensation, Deterrence, and the Market as Boundaries for Derivative Suit Procedures*, 52 GEO. WASH. L. REV. 745, 749-52 (1984).

139. See Easterbrook & Fischel, *supra* note 9, at 711.

throughout society the maximum incentive to create economic value by moving assets into more efficient hands, as the more profit Acquiring Corporation is able to garner from the transaction, the more likely the transaction is to occur.¹⁴⁰

Easterbrook and Fischel argue that by holding a diversified portfolio, investors such as Ms. C are able to share broadly in the value created by such moves and to insulate themselves from any unfair treatment stemming from unequal sharing of gain in any one instance.¹⁴¹ With a diversified portfolio, investors like Ms. C sometimes will benefit from unequal sharing (by being shareholders in the acquiring corporation) and sometimes lose from the unequal sharing (by being shareholders in the acquired corporation), but over a diversified portfolio, these gains and losses should balance out.¹⁴² Consequently, the total additional gain from a rule of unequal sharing will enrich such diversified investors, because through diversification they will participate in the additional economic value created by the incentive to undertake the transactions.¹⁴³ From all this, Easterbrook and Fischel are willing to infer that shareholders such as Ms. C would consent to an unequal sharing of gains.¹⁴⁴

Easterbrook and Fischel's line of argument is problematic on a number of grounds. Perhaps the most apparent basis for criticism is the fact that not all investors hold portfolios that are sufficiently diversified to ensure that they will be losers and winners equally over time.¹⁴⁵

An even more difficult problem for this line of reasoning results from the failure to distinguish the various sources of synergy,¹⁴⁶ a

140. *See id.*

141. *See id.* at 712–13.

142. *See id.*

143. *See id.*

144. *See id.* at 713–14.

145. Easterbrook and Fischel, in response to this criticism, state that their argument is supported by “[t]he existence of diversification—not its employment.” *Id.* at 713. Diversification is, in their view, cheap (“available at a remarkably low cost”), and, thus, anyone choosing not to diversify has no moral basis for complaint (“have little claim that they were treated inequitably”). *Id.* In all events, Easterbrook and Fischel place a high value on encouraging value-maximizing transactions. *See id.* Not all would agree with such factual assumptions and moral reckonings, however. *See, e.g.,* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23, 29–30 (1982).

146. My disagreement with Easterbrook and Fischel's conclusion that Acquiring Corporation should be able to seize all the synergy may be less dramatic than first appears. In their piece, they set “market value” as a “rule-of-thumb” for the minimum amount that shareholders, such as Ms. C, should receive. Easterbrook & Fischel, *supra* note 9, at 714–15. The balance of the value generated by an acquisition may, under their regime, be

matter that is best understood by reference to the parsing in Part II. Assume now that Ms. C is fully diversified and is frozen out in a merger of Acquired Corporation into Acquiring Corporation at \$10 per share.¹⁴⁷ To infer Ms. C's consent to this outcome, one must conclude that she (and all shareholders), in order to provide fuel for value maximizing transactions, consented *ex ante* to a freeze-out value that impounds disinformation, mismanagement, and non-value maximizing conduct on the part of their corporate managers. Relating this to the parsing in Part II, one must infer that Ms. C consented to forego the value of the Additives that could be attained by good management and full disclosure.

Obviously, an inference of consent on the part of investors to such conduct by managers is difficult to draw. In the first place, such an inference is inconsistent with society's mandatory corporate fiduciary duties, which require managers to pursue shareholder wealth maximization with some reasonable degree of care and vigor.¹⁴⁸ To restate slightly differently, such an inference of consent would also create a perverse incentive for Acquiring Corporation (the majority shareholder) to act through its agents (the managers of Acquired Corporation) to undermanage, mismanage, and fail to disclose facts about Acquired Corporation in order to maximize Acquiring Corporation's gain on the transaction. Indeed, the worse the management of Acquired Corporation, the greater the gain of Acquiring Corporation. This incentive may lead to conduct that is not only economically inefficient but also inconsistent with broadly shared societal values as manifested through our corporate fiduciary principles.

To relate this to the Additives described in Part II, it is most difficult to conclude that Ms. C consented *ex ante* to, or that society benefits from, Acquired Corporation's managers' failure, for example, to make complete disclosure (the Information Additive) or to pursue the reasonably attainable operational efficiencies (the Operational Savings Additive).

One, therefore, may be inclined to search for a regime based on a

shared unequally. If they were willing to accept my proposed definition of fair value and fair price as their definition of "market value" (i.e., they were willing to define "market value" as the value that an efficient market would put on the stock, assuming that the market had all material information and that the company were managed as required by fiduciary laws, *see infra* text accompanying note 155), then, obviously, I would have no quarrel with their analysis.

147. This amount, as described in Part II, equals the market price for Acquired Corporation's common stock.

148. *See supra* notes 28-32 and accompanying text.

version of consent that is more satisfying than that offered by the Contractarians.

C. Consent Through Corporate Fiduciary Principles

1. The Bases for the Theory

By considering the fiduciary obligations imposed on corporate managers, one generally is able to identify and respect the expectations of investors with regard to the allocation of value in the event of an acquisition. This approach facilitates an articulation of fair value and fair price based on a version of consent that is closer to true consent than the version offered by the Contractarians.

Pursuant to corporate fiduciary duties, corporate managers are obliged to make all moves that increase total stockholder wealth and to refrain from making moves that diminish stockholder wealth.¹⁴⁹ Under the duty of due care, managers avoid liability for any act or omission that does not so maximize stockholder wealth only if they act consistent with some level of due diligence, such as acting in a manner that is not negligent or not reckless.¹⁵⁰

Similarly, under the duty of loyalty, managers are forbidden to transfer wealth away from any stockholder or group of stockholders to another corporate constituency or to other stockholders.¹⁵¹ This principle explains why an unfair contract between a corporate officer and the corporation violates the officer's fiduciary duty¹⁵² and why an

149. See generally Rutheford B Campbell, Jr., *A Positive Analysis of the Common Law of Corporate Fiduciary Duties*, 84 KY. L.J. 455 (1995-96) [hereinafter Campbell, *A Positive Analysis*] (arguing that the fiduciary duties of corporate managers are best understood as obligations to make all moves that enhance total shareholder wealth and to refrain from making any move that diminishes the wealth of any shareholder, rules that the author characterizes and describes as the obligation to pursue Pareto efficiency on behalf of corporate shareholders).

150. Today corporate managers may be subject to a negligence standard respecting their monitoring duties. See, e.g., MODEL BUS. CORP. ACT § 8.30(a)(2); *Francis v. United Jersey Bank*, 432 A.2d 814, 817 (N.J. 1981) (holding corporate directors personally liable in negligence for the failure to prevent misappropriation of trust funds by other directors). For discrete decisions under the business judgment test, corporate managers may be required to act without negligence in investigating the action and without gross negligence at the decisionmaking stage. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985).

151. See Campbell, *A Positive Analysis*, *supra* note 149, at 474-78 (describing by reference to Pareto criteria the impact of the duty of loyalty on single company recapitalizations and affiliated mergers).

152. An example of this is the classic case, *Globe Woolen Co. v. Utica Gas & Electric Co.*, 121 N.E. 378 (N.Y. 1918). The Model Act now has significant provisions dealing with such conflict transactions. See MODEL BUS. CORP. ACT §§ 8.60-63.

unfair corporate freeze-out of minority stockholders by a majority stockholder also violates fiduciary duties owed to the minority stockholders.¹⁵³ Each represents a detrimental wealth transfer away from a stockholder or a group of stockholders to either the corporate officer in the first case or majority stockholder in the second case and, thus, violates the obligation to avoid moves that harm stockholders.

One can infer that investors, at least in a general sense, understand these fiduciary duties and, thus, price their stock purchases in light of their expectations about managers' fiduciary duties. After all, such general duties are longstanding and often are applied in highly visible situations in the business world—hostile takeovers, for example. If asked, nearly all stockholders likely would affirm their understanding that corporate managers are legally bound to look out for the stockholders' interests, that corporate managers must try to increase the value of the corporation, and that corporate managers are not permitted to give away any part of the stockholders' pro rata interests in the corporation to themselves, other stockholders, or other corporate constituencies.

One way to animate this is to assume that a hypothetical company, Alpha Co., is able to and does eliminate all of its fiduciary duties, that this change is widely published, and that no other company is able or willing to follow Alpha's lead in that matter. One would certainly anticipate that such a change would decrease the market value of Alpha's stock, as investors migrate to companies whose managers are subject to the basic fiduciary obligations to maximize wealth and avoid detrimental wealth transfers. Investors would likely be willing to remain invested in Alpha Co. only if paid a significant premium for the risk generated by rules permitting managers with complete legal impunity to undermanage the corporation and expropriate shareholder wealth for themselves and other favored constituencies.¹⁵⁴

153. Examples of affiliated merger cases include *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), *Schreiber v. Bryan*, No. 4250, 1979 WL 2706 (Del. Ch. Oct. 29, 1979), *Tanzer v. International General Industries, Inc.*, 402 A.2d 382 (Del. Ch. 1979), *Walter J. Schloss Associates. v. Chesapeake & Ohio Railway*, 536 A.2d 147 (Md. Ct. Spec. App. 1988), and *Gries Sports Enterprises, Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959 (Ohio 1986).

154. Not surprisingly, others have made similar observations in other settings. For example, in a piece on insider trading, Professor James D. Cox concludes that any harm to a corporation as a result of society's changing legal rules to permit insider trading would cause the market to "discount the value of . . . [the] firm." James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628, 637-39. In another piece dealing with international securities regulation, Professor Cox observes that investors trading in markets with high instances of "fraud, manipulation,

Thus, although conclusive proof is difficult to find, logic and analysis point strongly to the conclusion that investors, at least as a general matter, expect and price the basic fiduciary protections that managers are required by law to accord them. To measure fair value and fair price in a manner that is consistent with the fiduciary duties of corporate managers, therefore, can be legitimized by an attractive version of consent.

2. The Articulation and Application of the Theory

At this point, a more definite articulation of fair value and fair price is possible.

Shareholders subjected to an acquisition of their company should be entitled to fair value and fair price in an amount equal to the value that an efficient market would place on their proportionate interest in the company, assuming that the company is operated in a manner consistent with corporate managers' fiduciary duties and that the market has available all material information about the company. This broad principle for determining fair value and fair price amounts to an acceptable approximation of the parties' bargain and accordingly leads to outcomes that can be legitimized by a reasonably strong and, thus, attractive version of consent. The principle is also consistent with society's moral and economic values as reflected through our laws, specifically in the rules respecting the conduct of corporate fiduciaries.

To understand both the attractiveness of the formula and the likely outcomes from its application,¹⁵⁵ consider its application to the hypothetical situation described in Part II. Start, for example, with a consideration of the Information Additive (the value created by

unfairness . . . will discount the price of each security in that market by a greater amount than a comparable security in a market where they believe there is a lower incidence of such abuses." James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1201 (1999).

155. Two previously discussed matters deserve mention at this point. In Part III of this Article, we saw that, under today's laws, fair value and fair price usually do not include any nonmarketability discount or minority discount. *See supra* notes 63-71, 104-06 and accompanying text. These rules would continue under the author's proposed formula. Investors should anticipate that corporate managers, in furtherance of their obligations to maximize shareholder wealth, will move ownership configurations away from disadvantageous circumstances. A contrary rule of allowing minority discounts and nonmarketability discounts in fair value and fair price would create perverse incentives for a controlling shareholder to establish or maintain a non-maximizing ownership configuration in order to acquire the subsidiary at a bargain price. Creating such incentives is inconsistent with corporate fiduciaries' duties to maximize shareholder wealth.

correcting material misinformation) and the Discrete Mismanagement Additive (the value created by pursuing a recovery against corporate managers for a breach of their fiduciary duties).

Because legal rules prevent managers from exploiting undisclosed information¹⁵⁶ and require that managers adhere to standards of due care,¹⁵⁷ shareholders purchasing stock in a corporation can be considered reasonably to anticipate and, thus, price their investment based upon the assumptions of disclosure and reasonable management.¹⁵⁸ Fiduciary duties, supplemented by state and federal securities antifraud rules, therefore, provide acceptable bases for inferring an attractive version of consent to the right of shareholders to share in those two Additives. Quantified within the assumptions of the hypothetical situation described in Part II, consent comfortably underpins a value of at least \$12 per share for the corporation's stock, which amounts to the pre-bidding market value of the stock of Acquired Corporation (\$10 per share), plus \$1 each for the Information Additive and the Discrete Mismanagement Additive.¹⁵⁹

Additionally, including these two Additives in fair value and fair price is consistent with society's manifested moral and economic values. Perhaps the best way to demonstrate this is to consider the perverse incentives generated by a rule that excludes these Additives from fair value and fair price. In an affiliated acquisition, for example, such an exclusion would give majority stockholders and their surrogates—corporate managers—the incentive to withhold material positive information from the other shareholders and the market and the incentive to mismanage the corporation in order to

156. The most obvious source of this principle is Rule 10b-5 under the Securities Exchange Act of 1934. See 17 C.F.R. § 240.10b-5 (1998). A disclosure obligation is also part of managers' fiduciary duty. See, for example, *Weinberger*, 457 A.2d at 709, in which disclosure failures by fiduciaries was a part of the basis for finding a breach of fiduciary duty in connection with an affiliated acquisition. See *id.* at 709. Another example is *Kahn v. United States Sugar Corp.*, No. Civ. A. 7313, 1985 WL 4449 (Del. Ch. Dec. 10, 1985), in which the Chancellor found that, in connection with a self-tender, managers breached their fiduciary duty to selling shareholders by failing to disclose certain material facts to them. See *id.* at *1.

157. See *supra* notes 28–29 and accompanying text.

158. This sentence initially appears to refer to minority shareholders who are, for example, at risk of being frozen out of a corporation at an unfair price. This idea, however, applies both to minority and majority stockholders. Thus, majority shareholders should have no legitimate expectation that managers will undermanage or fail to disclose material information as a way to facilitate the majority shareholders' acquisition of the minority's portion of the Additives.

159. As described earlier, courts today seem inclined to include these Additives in fair value and fair price. See *supra* notes 75–82, 109–14 and accompanying text.

drive down the fair value or fair price of the stock. As noted earlier, the legal requirements of corporate fiduciary and antifraud principles manifest society's distaste for such nondisclosure and mismanagement.¹⁶⁰

Consider now whether fair value and fair price should include the Operational Savings Additive (the value created in our example by eliminating, perhaps through a merger with Acquiring Corporation, the overcapacity inefficiency of a major machine owned by Acquired Corporation) and the Reasonable Management Additive (the value created by increased efficiency in generalized management and monitoring of the corporation). The assumption in Part II for each of those Additives is that the value is created by moving the management of Acquired Corporation's assets out of the hands of poor managers and into the hands of managers who perform at the minimum level required by corporate fiduciary laws.

Formulated in this manner, the answer to the question of whether to include those two Additives in fair value and fair price once again can be based on the logic of the consent analysis used to include the Information Additive and the Discrete Mismanagement Additive in value.¹⁶¹ Shareholders, when purchasing stock in a corporation, can be considered reasonably to anticipate and, thus, to price their investment based upon the assumption that managers will comply with their fiduciary obligations to eliminate operational inefficiencies and generally to manage and monitor the corporation reasonably. Once again, therefore, fiduciary duties provide an acceptable basis for inferring an attractive version of consent for the right of shareholders to share in the Operational Savings Additive and the Reasonable Management Additive.

For the same reason, society's manifested moral and economic values support including these two Additives in fair value and fair price.¹⁶² Indeed, perverse incentives to undermanage or mismanage

160. Excluding the two Additives from fair value and fair price may be distasteful both to those concerned with distributive equality and those concerned with allocative efficiency. Persons who have a taste for distributive equality may feel that excluding minority shareholders from participating in the two Additives results in majority shareholders' receiving an unfairly large portion of the corporate value. Perhaps, although this is less certain, persons concerned with allocative efficiency may also object to excluding the Additives, because the assets of the company are, for a period of time, undermanaged and may be misallocated as a result of misinformation. A contrary argument, however, can be based on the discussion in *supra* text accompanying notes 138–45.

161. See *supra* notes 156–59 and accompanying text.

162. See *supra* note 160 and accompanying text.

the corporation are created by excluding these Additives from fair value and fair price. Exclusion of these Additives, therefore, would be inconsistent with societal values reflected in corporate fiduciary laws.

What becomes clear from this discussion is that fair value and fair price should include all of the so-called "synergies" that managerial conduct consistent with fiduciary obligations can garner. Quantified within the hypothetical situation of Part II, fair value and fair price should be at least \$14 per share, which includes the original market price of the Acquired Corporation's stock, plus the Information Additive, the Discrete Mismanagement Additive, the Operational Savings Additive, and the Reasonable Management Additive.

The Super-Reasonable Management Additive was defined in Part II as the value added by moving the assets of Acquired Corporation into the hands of the finest available management. The question of whether this particular type of synergy should be included in fair value and fair price, however, may appear not susceptible to a consent analysis and accordingly more problematic in its resolution. The argument against including the Super-Reasonable Management Additive in fair value and fair price relies on the fact that such a superior level of management exceeds the level required by law, which, in turn, appears to negate any assumption that shareholders of Acquired Corporation anticipate or price such fine management. As investors arguably do not invest with any expectation of such superior management, consent appears to be lacking.

Such an analysis, however, may be incomplete. While investors may not expect their corporate managers *themselves* to manage at the highest level, investors do expect managers to take reasonable steps to maximize the value of the corporation. Thus, if third party super-managers are better able than present management to manage the corporation's assets, the obligation of the present managers to engage in reasonable conduct may dictate that they sell the assets to the super-managers, who presumably will pay a price for the assets that exceeds the value of the assets in the hands of existing corporate managers.

Although incorrectly decided, the facts of *Bell v. Kirby Lumber Corp.*¹⁶³ can be used to illustrate this point. In *Bell*, the common stock of Kirby appears to have had a market price in the area of \$125 per

163. 413 A.2d 137 (Del. 1980).

share.¹⁶⁴ The court found, however, that the asset value of Kirby was \$456 per share.¹⁶⁵ It seems difficult to argue that, in such a situation, the Kirby shareholders consented to the managers' failure to sell the assets, even if one assumes that the old managers were managing the company at a level consistent with legally imposed fiduciary standards. The more likely assumption regarding shareholders' expectations, and certainly the assumption that creates incentives to move assets into more productive hands, is that the Kirby shareholders expected their fiduciaries, consistent with their obligation to maximize shareholder wealth, to sell the assets of Kirby to the more efficient user, who was willing to pay an amount equal to \$456 per share for the assets.

Perhaps if one attempts to refine the foregoing, the analysis does not lead to the inclusion of all of the Super-Reasonable Management Additive in fair value and fair price, given that the allocation of that Additive is the subject of bargaining between Acquired Corporation and Acquiring Corporation and accordingly is determined to a large degree by the strength of competition in the market for corporate control of Acquired Corporation. Nonetheless, shareholders of Acquired Corporation would reasonably anticipate that their managers would sell to the highest bidder, would exploit fully on their behalf the competitive strength of the market for corporate control of Acquired Corporation, and would bargain hard respecting the allocation of that part of the Super-Reasonable Management Additive that only can be achieved by Acquiring Corporation. In short, the managers' overarching obligation to maximize shareholder wealth would lead shareholders to expect reasonable managers to garner most of the Super-Reasonable Management Additive on their behalf.¹⁶⁶

164. See *id.* at 139. The market value of Kirby is somewhat difficult to glean from the various cases that were generated by the acquisition. It is apparent, however, that the market for Kirby stock was thin, as only 25,000 shares of Kirby were held by the minority, public stockholders. See *id.* Kirby, in its calculations of fair value, used \$125 as "market value." See *id.* In the Section 10(b) action resulting from this transaction, the Supreme Court reported that, between 1968 and 1973 (the actual transaction occurred in 1974), Santa Fe Industries had been purchasing shares of Kirby at prices between \$65 and \$92.50 per share. See *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 465 (1977). Nonetheless, while the exact market price is uncertain, it was obviously substantially below the value that could be recognized by liquidating the company.

165. See *Kirby*, 413 A.2d at 151.

166. Economic studies regarding the allocation of synergy between shareholders of the acquired corporation and the acquiring corporation support this resolution. Those studies indicate that, in fully negotiated deals, the shareholders of the acquired corporation are able to appropriate most of the gains generated by acquisitions.

The questions of whether the Labor Reduction Additive (value generated by the elimination of employees' jobs) and the Creditor Value Reduction Additive (value generated for shareholders at the expense of creditors by increasing leverage) are to be included in fair value and fair price generate additional complexities. In recent years, a portion of shareholders' gains in acquisitions has been, at least in the view of some commentators, at the expense of workers and creditors. For example, following an acquisition, the new owners of an acquired corporation may generate gains for themselves by eliminating workers and replacing them with less expensive machines or new, cheaper workers.¹⁶⁷ Similarly, through the use of highly leveraged acquisitions, shareholders are able to expropriate a portion of the value of creditors' investments in the acquired corporation. Commentators cite the numerous highly leveraged acquisitions that occurred during the 1980s as transactions involving transfers of corporate wealth from creditors to stockholders.¹⁶⁸ Even more than a

Regarding the appropriation of value by shareholders of the acquired corporation, Gilson and Black report on, and provide citations to, "many studies that find that takeovers are very, very good for target shareholders." GILSON & BLACK, *supra* note 40, at 258; see also Black & Grundfest, *supra* note 43, at 5 ("There is no shortage of research demonstrating takeover premiums averaging 30-50%."). Regarding the appropriation of synergy by the acquiring corporation and its shareholders, Gilson and Black also report numerous studies indicating that the acquiring corporation and its shareholders typically gain little if any from such acquisitions. See GILSON & BLACK, *supra* note 40, at 300-04. Gilson and Black then pose the question: "If there is synergy from combining acquirer and target, why don't acquirers earn a share of the gains . . . ?" *Id.* at 302. The explanations they offer are that the market for corporate control drives bidder returns to zero, that the managers may be able to grab part of the synergy, and that some transactions are just bad deals for the acquirer. See *id.* at 302-04.

167. A significant scholarly attack has been mounted against this and similar practices. One line of this scholarship argues that employees invest in their firms by underpricing their services in the early years of their employment in return for an implied promise that they will be repaid in the later years of their services, when their productivity may diminish. The fear is that the corporation has the economic incentive to expropriate workers' human capital investment by breaching the implied contract, firing the workers later in their careers, and replacing the fired workers with younger, less expensive workers. For explanations of these theories, see Maureen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1205-07 (1991), Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45, 48-53 (1991), Katherine Van Wezel Stone, *Policing Employment Contracts Within the Nexus-of-Contracts Firm*, 43 U. TORONTO L.J. 353, 363-69 (1993).

168. See *supra* note 43; see also Thomas R. Hurst & Larry J. McGuinness, *The Corporation, the Bondholder and Fiduciary Duties*, 10 J.L. & COM. 187, 190 nn.14-15 (1991) (finding 230 companies that, between 1984 and 1989, were involved in "event risk" transactions, which were defined as corporate activities that "result[] in a downgrading of the credit rating of corporate debt obligations"); Kahan & Klausner, *supra* note 43, at 933 n.2 (reporting that, from 1984 through 1988, the bonds of 183 companies "lost value as a

decade later, the most famous such case probably is the RJR Nabisco acquisition, in which estimates are that creditors lost forty million dollars following the announcement of the highly leveraged acquisition of that company.¹⁶⁹

The imperative to include the Labor Reduction Additive and the Creditor Value Reduction Additive in fair value and fair price can once again be based on the obligation of corporate managers to make all moves that enhance the wealth of stockholders. When they invest in corporations, stockholders count on managers to enhance the wealth of the stockholders to the extent possible from whatever legal sources may be available. Thus, to the same extent that stockholders expect managers to increase stockholder wealth by making profitable investments, stockholders also expect managers to increase stockholder wealth by expropriating value from other corporate constituencies, such as workers and creditors, so long as the expropriation is legal. Under such an analysis, the inclusion of the Labor Reduction Additive and the Creditor Value Reduction Additive in fair value and fair price, therefore, once more can be based on a consent notion.

The weakness of this position, of course, is that some observers consider expropriation of value from other corporate constituencies to be an immoral act.¹⁷⁰ Thus a number of commentators view harshly what they consider to be the expropriation through acquisitions of the workers' human capital investment in their corporations.¹⁷¹ Similarly, the expropriation of creditor value during the highly leveraged takeovers of the 1980s resulted in much unfavorable scholarly opinion.¹⁷²

Notwithstanding such concerns, courts for the most part have refused to extend the protection of broad fiduciary duties to workers¹⁷³ and creditors.¹⁷⁴ Instead, courts have defined the fiduciary

result of mergers, acquisitions or leveraged buyouts").

169. See Deborah A. DeMott, *Introduction—The Biggest Deal Ever*, 1989 DUKE L.J. 1, 1. It is reported that the announcement in 1992 by Marriott Corp. that it intended to effect a spin-off by splitting its business into two separate corporations may have cost creditors, at least in the view of one investment banking firm, as much as \$11 billion in lost value. BRUDNEY & BRATTON, *supra* note 10, at 220.

170. See *supra* notes 167–68 and accompanying text.

171. See Ruthford B. Campbell, Jr., *Corporate Fiduciary Principles for the Post-Contractarian Era*, 23 FLA. ST. U. L. REV. 561, 608–10 (1996) [hereinafter Campbell, *Corporate Fiduciary Principles*].

172. One writer referred to this as "possibly the largest expropriation of investors in American business history." Morey W. McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205, 206 (1988).

173. See generally Campbell, *Corporate Fiduciary Principles*, *supra* note 171, at 607–15

obligation of corporate managers as the requirement to promote only the interests of stockholders.¹⁷⁵ As a result, expropriative moves

(discussing further the implied contract theory under which managers should owe employees fiduciary duties).

174. Over the years, creditors have attempted to enforce fiduciary duty claims in both direct and derivative actions. Generally, both have been unsuccessful. Cases rejecting any direct claim include *Nuclear Corp. of America v. Hale*, 355 F. Supp. 193, 199 (N.D. Tex. 1973), *Skinner v. Hulsey*, 138 So. 769, 773 (Fla. 1931) ("Directors are not liable to the creditors on the theory of their being fiduciaries."), *Conrick v. Houston Civic Opera Ass'n* 99 S.W.2d 382, 385 (Tex. 1936) ("Directors are not personally liable to creditors for mismanagement, or for waste of assets except upon proof of the commission of such fraud."), *Equitable Life & Casualty Insurance Co. v. Inland Printing Co.*, 484 P.2d 162, 163 (Utah 1971), *Anderson v. Bundy*, 171 S.E. 501, 508 (Va. 1933), and *Wheeling Kitchen Equipment Co. v. R & R Sewing Center, Inc.*, 179 S.E.2d 587, 590 (W. Va. 1971). Statutes generally preclude creditors from suing derivatively to enforce fiduciary claims against management. See, e.g., MODEL BUS. CORP. ACT § 7.41(1) (predicating the right to institute a derivative suit on one's having been a "shareholder of the corporation at the time of the act or omission complained of"). The rules denying creditors direct or derivative recovery for managers' breaches of fiduciary duties are longstanding general rules. See HENRY W. BALLANTINE, CORPORATIONS § 72a, at 184-86, § 148, at 351 (rev. ed. 1946). Nevertheless, a few cases over the years have indicated that corporate managers do owe creditors fiduciary duties. See, e.g., *Pepper v. Litton*, 308 U.S. 295, 307 (1939); *Ford Motor Credit Co. v. Minges*, 473 F.2d 918, 920-22 (4th Cir. 1973) (applying North Carolina law); *W. H. Elliott & Sons Co. v. Gotthardt*, 305 F.2d 544, 545 (1st Cir. 1962); *United States v. AT&T*, 552 F. Supp. 131, 205 (D.D.C. 1982), *aff'd mem. sub. nom.* *Maryland v. United States*, 460 U.S. 1001 (1983); *Johnson v. Coleman*, 20 S.W.2d 186, 188 (Ark. 1929); *Sternberg v. Blaine*, 17 S.W.2d 286, 288 (Ark. 1929); *Great W. Producers Coop. v. Great W. United Corp.*, 613 P.2d 873, 878 (Colo. 1980) (en banc); *Francis v. United Jersey Bank*, 432 A.2d 814, 825 (N.J. 1981); *Underwood v. Stafford*, 270 N.C. 700, 702, 155 S.E.2d 211, 212-13 (1967); *Goodwin v. Whitener*, 262 N.C. 582, 583-84, 138 S.E.2d 232, 233 (1964); *Anthony v. Jeffress*, 172 N.C. 378, 379-80, 90 S.E. 414, 415 (1916). The overwhelming majority rule, however, is that creditors are owed no fiduciary duties. See, e.g., *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R.* 680 F.2d 933, 941 (3d Cir. 1982); *Harff v. Kerkorian*, 324 A.2d 215, 221-22 (Del. Ch. 1974), *rev'd on other grounds*, 347 A.2d 133 (Del. 1975) (per curiam). Professor Mitchell correctly states that "scholars supporting expanded bondholder rights do not have a great deal of law supporting them." Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. REV. 1165, 1168 n.11 (1990).

175. While this statement essentially is accurate, it is worth noting that so-called constituency statutes permit directors to consider the interest of other constituencies in takeover situations. For a discussion and evaluation of constituency statutes, see Alexander C. Gavis, *A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts*, 138 U. PA. L. REV. 1451 *passim* (1990), James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1227-30 (1988), James J. Hanks, Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97, 103 (1991). Also, in certain takeover cases, courts have indicated that directors, in determining whether to deploy takeover defenses, may consider the interests of other constituencies. See, e.g., *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1153 (Del. 1989) ("[D]irectors may consider, when evaluating the threat posed by a takeover bid, the 'inadequacy of the price offered, nature and timing of the offer, questions of illegality, [and] the impact on "constituencies" other than shareholders . . .'" (emphasis added) (citation omitted)).

against workers and creditors on behalf of stockholders are not only legally permissible, but also may be legally required of corporate managers in order for them to fulfill their obligation to maximize shareholder wealth.¹⁷⁶ One is able, therefore, to find a compelling version of consent respecting the sharing of such expropriative "gains," given that shareholders, when they invest in corporations, reasonably anticipate that managers will garner such expropriative "gains" on their behalf.

In sum, fair value and fair price should include a pro rata portion of all of the Additives, except, perhaps, some portion of the Super-Reasonable Management Additive in instances when the strength of the market for corporate control is less vigorous. Procedurally, this could be implemented by a presumption of a pro rata sharing of all synergy, unless the Acquiring Corporation were able to demonstrate that, in light of the vigor of the market for corporate control and through unfettered bargaining, it would be able to retain some disproportionate share of the Super-Reasonable Management Additive. The resulting outcome is consistent with the conclusion that corporate managers, in pursuit of maximizing shareholder wealth and acting consistent with fiduciary mandates, could capture nearly all the Additives, or synergy, for their shareholders. A rule requiring such a pro rata sharing of synergies, therefore, is supported by the consent of the parties and, thus, founded on attractive moral and economic values.

CONCLUSION

Although the courts' sophistication in evaluating fair value and fair price cases has increased dramatically over the years, many of the outcomes in these cases continue to be unsatisfactory, due in large part to the lack of any consistently applied principle. The purpose of this Article, therefore, is to propose a principle that will render a proper measure of fair value and fair price.

Fair value and fair price should be the price that an efficient market would place on the shareholders' proportionate interest in their company, assuming that the shareholders' company is operated in a manner consistent with corporate fiduciary duties and that the market has available all material information about the company.¹⁷⁷

176. See Campbell, *A Positive Analysis*, *supra* note 149, at 502-03.

177. Delaware courts at times have articulated a fair price formula that is similar to the one proposed in this Article. For example, in *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995), which is discussed at *supra* notes

This principle is based on a reasonably strong version of consent and, thus, is supported by both sound economics and moral theory. Investors and managers can be considered to anticipate and, thus, to consent to a measure of fair value and fair price that is consistent with the corporate fiduciary obligations society imposes on corporate managers and controlling shareholders. Establishing a measure of fair value and fair price that is consistent with such fiduciary duties, therefore, respects the ex ante bargain of the parties and is, thus, congenial to the creation of economic wealth and to the concepts of utilitarianism and Kantianism. Such a measure of fair value and fair price also is consistent with society's widely shared values, as reflected in society's rules respecting corporate fiduciary duties.

One result of the application of this principle is that shareholders of an acquired corporation essentially share pro rata in the synergy generated by acquisition transactions. Courts should be reluctant to allow less than full, pro rata sharing of synergy by such shareholders, because their reasonable expectations are that managers will garner for the shareholders nearly all of the value created by moving their corporate assets into new hands.

An application of the principle also leads to the elimination of a different measure for fair value, as compared to the measure for fair price. The premise of this Article is that shareholders, when they

115-28 and accompanying text, the court at one point defined fair price as "the highest value reasonably achievable" for an acquired corporation. *Id.* at 1143 (citing *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1993)). This formulation is nearly identical to the one proposed in this Article and in certain transactions may provide workable criteria for courts to reach the outcomes sought in this Article. For example, to restate this Article's principle in the fashion of the *Cinerama* articulation may be especially helpful to a court in a case such as *Cooper v. Pabst Brewing Co.*, No. Civ. A. 7244, 1993 WL 208763 (Del. Ch. June 8, 1993) (mem.), which is discussed at *supra* notes 89-96. *Cooper* involved a heated contest for Pabst in what appeared to be an efficient market for corporate control. Although fundamentally my articulation of this principle still expresses the essence of the fair value and fair price obligation, courts may feel more comfortable with the *Cinerama* articulation in such a case, because the "highest value reasonably attainable" may be apparent as a result of the bidding in the contest for control. In any event, the same outcome will be reached in such a factual setting under either the *Cinerama* articulation or my articulation.

In *Cinerama*, however, the court's articulation and use of its fair price formula is made less forceful by two facts. First, and less significantly, the particular articulation, "the highest value reasonably achievable," was only one of the multiple articulations of fair price from the court's decision. See *supra* note 122. So long as these various articulations are only different ways of saying the same thing, as they seem to have been in *Cinerama*, such articulations are not overly troublesome. Second, and more troublesome, is the fact that the outcome reached by the court in *Cinerama* seems inconsistent with the court's own, otherwise attractive formula for fair price. See *supra* notes 124-29 and accompanying text.

purchase stock in a corporation, consent to a measure of payment in the event of acquisition that impounds assumptions of sound management and full disclosure. It is impossible, without stretching the notion beyond acceptable limits, to find that shareholders consent to different levels of payment, depending upon the path plaintiffs are able to access during any ex post settlement that might occur. Disparate measures of fair value and fair price based on some ex ante consent are, therefore, unsupportable under the analysis offered by this Article.

Although presently cases generally seem to distinguish between the measure of fair value and the measure of fair price, society already may be moving in the direction of eliminating such differences. This Article, for example, describes cases in which outcomes in fair value cases and fair price cases seem to be nearly identical.¹⁷⁸ Thus in *Cooper*, a fair value case, and in *Cinerama*, a fair price case, the two courts reached nearly identical outcomes, essentially requiring a sharing of a significant part of the synergy generated by the transactions.¹⁷⁹ Recently proposed changes in the Revised Model Business Corporations Act also may be consistent with limiting disparate outcomes.¹⁸⁰

Finally, the principle also is meant to provide the underpinnings for sensible and intelligible fair value and fair price criteria that are amenable to modern finance theory. Investment bankers, special negotiating committees, shareholders, and ultimately courts involved in disputes over fair value and fair price are required to establish a present value for the company involved in the particular acquisition. Only by comparing the consideration offered for the acquired corporation with some measure of the present value of the acquired corporation are those parties able to determine whether the consideration amounts to fair value or fair price.

Fundamentally, under modern finance theory, the present value for any company (or any portion of a company) is determined by discounting the expected cash flows to be derived from the company in the future.¹⁸¹ This Article's principle provides meaningful guidance

178. See *supra* notes 89–96, 115–28 and accompanying text.

179. See *Cinerama*, 663 A.2d at 1176–77; *Cooper*, 1993 WL 208763, at *7–12.

180. See MODEL BUS. CORP. ACT § 13.01(4) & official cmt. 2 (Proposed Changes 1998), *supra* note 27, at 254–57.

181. Brealey and Myers state the matter succinctly: “Value . . . always equals future cash flow discounted . . .” BREALEY & MYERS, *supra* note 11, at 73. The authors provide an extensive discussion of present value calculations as applied to corporations, shares in corporations, particular investments, etc. Always, the foundation of such discussion is reducing future cash flows through discounting to a present value. See *id.* at

for defining the cash flows appropriately considered in arriving at the present value of the acquired corporation and for defining the discount rates appropriately applied to those cash flows. Stated broadly, the principle presented in this Article defines the cash flows as all cash flows reasonably anticipated, assuming good management and full disclosure of material information about the company,¹⁸² and defines the appropriate discount rate as the rate the efficient market applies to the cash flows of companies similar in risk to the acquired corporation.¹⁸³

11-84.

182. To elaborate, return one final time to the parsing of Part II, *see supra* notes 41-44, and indulge the following assumptions about the cash flows of Acquired Corporation. Assume that the present cash flow of Acquired Corporation is \$1,000,000 annually, or \$1 per share, and that amount represents the reasonably foreseeable cash flows if Acquired Corporation continues on as it is and without the disclosure of information concerning the jet fighter parts contract. As each of the Additives materializes, however, assume that the cash flow of Acquired Corporation increases by \$100,000, or \$0.10 per share. Thus, for example, disclosure of the jet parts contract (the Information Additive) will increase the reasonably foreseeable cash flow of Acquired Corporation by \$100,000, or \$0.10 per share, aggressively pursuing the remedy for past mismanagement (the Discrete Mismanagement Additive) will result in a similar increase in Acquired Corporation's cash flows, and so forth. Under those facts, the principle presented in this Article identifies the cash flow to be discounted in fair value and fair price calculations as \$1.7 million, or \$1.70 per share. *See supra* notes 155-76 and accompanying text.

183. For a simplified explanation of the discount rate, *see* BREALEY & MYERS, *supra* note 11, at 12-14 (calculating present value in a simple example by discounting cash flows "by the rate of return offered by comparable investment alternatives"). In the first nine chapters in their book, Brealey and Myers provide a lucid and sophisticated discussion of modern present value theory, including a thorough discussion of the theoretical underpinnings and calculation methodologies for discount rates. *See id.* at 1-235.