1982

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THE FALLACY OF WEIGHTING ASSET VALUE AND EARNINGS VALUE IN THE APPRAISAL OF CORPORATE STOCK

ELMER J. SCHAEFER*

A minority shareholder who objects to a corporate merger will often be entitled to an appraisal of her shares, a procedure which, if successful, will lead to a cash award. A common characteristic of appraisals in Delaware and in other jurisdictions is the valuation of corporate shares by a weighted average of several values, typically net asset value, earnings value, and market value. The adequacy of the appraisal remedy has been the subject of much debate, but criticism usually has focused on matters of procedure and timing rather than on the validity of the

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The author wishes to thank Patrick Nooney of the William and Mary Class of 1978 for his assistance at an early stage in the preparation of this Article and Randolph Baker of the Class of 1981 and Randolph Frostick of the Class of 1982 for assistance at a later stage. Part of the work on the Article was done during a semester of research leave, funded by the College of William and Mary. Part of this Article was presented at the Fiftieth Annual Meeting of the Southern Economic Association in Washington, D.C. (November 6, 1980).


For appraisal decisions using the weighting method in other jurisdictions, see Flarsheim v. Twenty Five Thirty Two Broadway Corp., 432 S.W.2d 245 (Mo. 1968); In re Tudor City Fifth Unit, Inc., 17 A.D.2d 794, 232 N.Y.S.2d 758 (1962); Brown v. Hedahl's-Q B & R, Inc., 185 N.W.2d 249 (N.D. 1971); Fogelston v. Thumston Nat'l Life Ins. Co., 555 P.2d 606 (Okla. 1976); Santee Oil Co., Inc. v. Cox, 265 S.C. 270, 217 S.E.2d 798 (1975). Delaware law is of particular nationwide importance because of the large number of enterprises that are incorporated in Delaware.

For an explanation of asset value, earnings value, and market value, see infra note 29 and text accompanying notes 30-33.
weighting method of valuation. The explanations offered for the use of the weighting method are unclear; one is reminded of Dylan Thomas' children's book which told him “everything about the wasp, except why.”

Despite the lack of an expressed rationale, the weighting method is often assumed to result in accurate valuations of corporate stock. This assumption is incorrect. As this Article demonstrates, the weighting method systematically tends to undervalue corporate shares. The implications of this observation extend beyond the need to improve valuation techniques in appraisals. By their terms, appraisal statutes apply to all mergers, but, in practice, most appraisal cases which have been litigated through the appellate court level involve conflicts of interest; the outside shareholders have been frozen out on terms dictated by insiders. For this reason, there is a compelling need for a remedy which produces accurate valuations in appraisal proceedings.

I. THE ASSUMPTION THAT THE WEIGHTING METHOD LEADS TO ACCURATE VALUATIONS

This Article does not criticize the propriety of granting appraisal rights to dissenting shareholders. Instead, this Article criticizes the use of the weighting method to determine the value of dissenters' shares in appraisal proceedings. Courts and commentators have generally assumed that use of the weighting method leads to accurate estimations of corporate share value. As this Article demonstrates, however, the weighting method consistently underestimates the value of corporate shares,
and, therefore, deprives dissenting shareholders of the full benefit of their appraisal remedy.

General approval of the weighting method is evidenced by the fact that the validity of its use has seldom been discussed, even though extensive and severe criticisms have been directed at other aspects of the appraisal remedy. The assumption that the weighting method accurately measures share value underlies one commentator's recent assertion that "an appraisal based on full disclosure, in which a conscious attempt is made to err on the high side, produces a price that will adequately compensate remaining shareholders." 10

Misplaced confidence in the weighting method is also apparent in assertions that appraisal is an adequate remedy for shareholders who object to conflict-of-interest mergers. In Santa Fe Industries, Inc. v. Green, 11 the United States Supreme Court held that no relief was available under rule 10b-5 for a minority shareholder who claimed that he had been forced to surrender his shares at an unfair price in a freeze-out, but who did not allege any misrepresentation by the defendants.

8. See infra text accompanying notes 10-25. But see W. Cary & M. Eisenberg, Cases and Materials on Corporations 1457, 1459 (5th ed. 1980) (questioning whether a corporation should be valued at less than its liquidation value); Weiss, The Law of Take Out Mergers: A Historical Perspective, 56 N.Y.U.L. Rev. 624, 653-54, 672, 679-80 (1981) (arguing that weighting method ignores ability of insiders to make the most efficient use of a company's resources after a freezeout); Dyer, An Essay on Federalism in Private Actions Under Rule 10b-5, 1976 Utah L. Rev. 7, 22-23 (contending that because a freezeout is similar to an eminent domain proceeding, an appraisal award should be equal to the highest value of the corporation rather than a weighted average).

9. See, e.g., Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 Harv. L. Rev. 297, 305-07 (1974) (appraisal valuation, which depends on data from the past, unlikely to reflect an increase in earnings which insiders may anticipate); Manning, The Shareholder's Appraisal Remedy: An Essay for Frank Coker, 72 Yale L.J. 223, 222-33 (1962) (discussing litigation costs, technicality of procedure, taxability of award, unpredictability of the amount of the award). One commentator noted that

'The appraisal right presents many difficulties from the shareholder's perspective: It is always technical; it may be expensive, it is uncertain in result, and, in the case of a publicly held corporation, is unlikely to produce a better result than could have been obtained on the market; and the ultimate award is taxable. It is in short, a remedy of desperation—generally speaking, no shareholder in a publicly held corporation who is in his right mind will invoke the appraisal right unless he feels that the change from which he dissent is shockingly improvident and that the fair value of his shares before the change will far exceed the value of his shares after the change.

Eisenberg, The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking, 57 Calif. L. Rev. 1, 85 (1969).


12. "Freezeout" is one of several terms used to refer to a corporate transaction in which outside shareholders are forced to give up their stock for cash or nonparticipating senior securities.
Justice Stevens, in a brief opinion concurring in the denial of a federal remedy, stated that the plaintiff still had an opportunity to obtain the fair value of his shares through an appraisal action in the Delaware courts. The policy behind this approach was explained by S. Samuel Arsht, an eminent member of the Delaware corporate bar, in a speech delivered prior to the Green decision.

In a merger context . . . the appraisal remedy is available to insure that minority stockholders are not denied the fair value of their stock by the conduct of the majority . . . .

Absent a vested rights concept, and assuming full disclosure, the only reason for denying effect to an otherwise technically correct merger is that it operates unfairly with respect to minority shareholders. Such unfairness can only arise if the appraisal proceeding is incapable of arriving at the fair value of a minority shareholder's stock. 14 Arsht came close to an explicit endorsement of the weighting method, arguing that the Delaware appraisal process, because it considers factors other than market value, is "able to uncover elements of value temporarily hidden by artificially low stock prices." 15

In an economic analysis of corporate freezeouts, Professor Posner, now a judge in the Seventh Circuit, implicitly endorsed the weighting method of appraisal. He viewed the freezeout mechanism as providing the majority with a power of eminent domain over the minority shareholders when the company would be more valuable as a privately held company than it would be with publicly traded shares. 16 Without that power, minority shareholders could threaten to prevent the company from going private and could thus extract more than the fair value of their shares from the majority. Posner concluded: "The appraisal remedy . . . should assure that the 'condemnees' [i.e., the minority] received the 'fair market value' of their shares. The procedure would be


13. 430 U.S. at 481 (Stevens, J., concurring in part).
14. Arsht, Minority Stockholder Freezeouts Under Delaware Law, 52 BUS. LAW. 1495, 1499 (1977). The presentation of the paper on which the article was based antedated Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), which held that despite the availability of an appraisal remedy, equitable relief may be granted in Delaware unless the merger has a legitimate business purpose and is entirely fair. Id. at 976-80. A panelist commenting on Arsht's paper remarked that the effect of permitting a federal remedy for going private, where the merger had already been completed, would be "merely to substitute the federal District Court for the Delaware court in determining what is fair value." Arsht, supra, at 1500 (comment of Sidney Silberman).
15. Arsht, supra note 14, at 1500.
fraudulent in an economic sense only if the Delaware courts refused to take seriously their duty of appraisal; and there is no evidence of this before the court in *Green.*"^{17}

If the use of the weighting method in appraisals leads to fair evaluation, then it would be to the majority's advantage to offer initially a fair value to the minority and thereby avoid the cost of litigation. One commentator has contended that "availability of an appraisal proceeding provides some assurance that the management of [the parent] will not offer an unreasonably low price."^{18}

Tacit approval of the weighting method is inherent in legislative proposals to expand the scope of the appraisal remedy. The Committee on Corporate Laws of the Corporation, Banking and Business Law section of the American Bar Association recently amended the Model Business Corporation Act,^{19} expanding the role of dissenters' appraisal rights in resolving corporate disputes,^{20} but providing that those appraisal rights are exclusive except in cases of illegality or fraud.^{21} The Committee found no fault in the use of the weighting method and intended to leave "untouched the accumulated case law about market value, capitalized earnings value, and asset value."^{22} Approval of the weighting method was also reflected in the Committee's statement that dissenters' appraisal rights "in the majority of cases . . . lead to a satisfactory solution of conflicting interests."^{23} The Committee stated that "[s]ince dissenting shareholders can obtain the fair value of their shares, they are protected from pecuniary loss."^{24} It therefore recom-

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17. *Id.* at 306.

Appraisal rights . . . have . . . served as a countervailing power to force the insiders to tailor their plans to minimize the number of dissenters by getting the best deal possible. . . . [When such a] weapon is removed, the insiders lack the real self-interest to fashion a plan acceptable to a sufficient number of shareholders.

*Id.* at 1293.

21. The Committee pointed out that jurisdictions such as California, Massachusetts, New York, and Pennsylvania already consider dissenters' appraisal rights to be their exclusive remedy. *Id.* at 1863. Since the Committee's report was issued, Delaware has held that availability of the appraisal remedy does not bar other relief if the merger violates the fiduciary duty owed by majority stockholders to the minority. Singer v. Magnavox Co., 380 A.2d 969, 976-80 (Del. 1977). For an excellent treatment of the exclusivity of appraisal remedies, see Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 Harv. L. Rev. 1189 (1964).
23. *Id.* at 1856.
24. *Id.* at 1863.
mended that courts refrain from intervention in corporate disputes, even when persuaded that a corporate change is unwise or disadvantageous. 25

II. THE FALLACY OF THE WEIGHTING METHOD

Suppose that Subsidiary Company has one million shares of common stock, 80% of which are owned by Parent Corporation. Assume further that there is no market for the shares of Subsidiary and consequently no market value. 26 A freezeout merger is carried out between Parent and Subsidiary; Parent's shares in Subsidiary are cancelled, and the outside shareholders of Subsidiary receive $50.00 per share. Since the terms of the merger were set by Parent's management, 27 the minority shareholders might disagree with the merger price.

If the minority dissents, appraisal of the shares in Subsidiary is likely to be done by the weighting method. 28 Asset value and earnings value per share will be estimated, and the appraisal value will be a weighted average of the two figures. 29 This method is flawed, however, because the intrinsic value of the corporation should be the higher of

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25. Id. at 1856.
26. The treatment of market value in appraisal is disregarded in this Article, except for discussion infra at notes 29, 196, 213, 275, 315.
27. The price to the outside shareholders is in effect set by Parent, which controls the negotiations establishing the terms of the merger and has substantial, perhaps even decisive, power in any vote on the merger. See Brudney & Chirelstein, supra note 9, at 298.
29. In the example given in the text, it is assumed that there is no market value and therefore this measure would be omitted from the weighted average. In the more general case, where the weighted average of asset value and earnings value is also averaged with market value, the fallacy of the weighting method remains. If market value is to be considered, then weights should be assigned only to market value and to the higher of asset value and earnings value. This is because market value and the higher of asset value and earnings value may represent adequate, independent estimates of the true value of a corporation. The weights assigned would reflect the appraisers' relative confidence in each measure. See infra notes 196, 213. A complete analysis of the validity of market value as an estimate of the value of a share in a subsidiary involved in a conflict-of-interest merger is beyond the scope of this Article. See generally Brudney, Efficient Markets and Fair Shares in Parent Subsidiary Mergers, 4 J. Corp. L. 63, 63-74 (1978); Note, A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal, 74 Mich. L. Rev. 1023, 1036-44, 1048-54 (1976). There is good reason to believe that the market price will be depressed if the ownership of a large percentage of shares is concentrated in the hands of a controlling shareholder, making a freezeout possible. See Brudney & Chirelstein, supra note 9, at 306. The depressed market price of shares bearing a risk of freezeout results, in part, because the holder bears a further risk that, should an appraisal be necessary, the weighting method will undervalue the shares.
earnings value and asset value, rather than an average of the two. This is apparent from the definitions of the two estimates.

Asset value is the amount for which the assets of the corporation, such as its plant and equipment, inventory, and real estate, could be sold. The estimate ordinarily is based on the testimony of experts who rely on evidence such as the sale price of comparable assets. Assume that the factfinder estimates that the asset value of Subsidiary Corporation is $60 million, or $60.00 per share.

Earnings value measures the ability of the corporation to generate earnings. In theory, the pattern of future annual earnings of the corporation is predicted. The predicted future earnings are then reduced to their present value by use of a discount rate which reflects both the time period before the earnings will be realized and the uncertainty as to what the actual earnings will be. A short cut to this method is often used in appraisals: an average of earnings for recent years is multiplied by a ratio called a "multiplier," which reflects the relationship between market price and recent earnings for companies comparable to the corporation being appraised. The choice of the multiplier has a large impact on the estimate of earnings value. Since a wide range of multipliers is justifiable, a wide range of estimates of earnings value is pos-

30. Liquidation value is based on considerations such as the units in which the assets would be sold and the length of time over which the sales would be made. V. BRUDNEY & M. CHIRELSTEIN, CASES AND MATERIALS ON CORPORATE FINANCE 169-70 (2d ed. 1979). For a discussion of other considerations in measuring the asset value, see infra notes 47-53 and accompanying text.
32. See V. BRUDNEY & M. CHIRELSTEIN, supra note 30, at 35-44. The capital-asset pricing model, which is the basis of recent financial analysis, implies that the unsystematic portion of the riskiness of a corporation's predicted earnings—that which can be avoided by holding a diversified portfolio of securities—should be disregarded in selecting a discount rate. See J. VAN HORNEN, FINANCIAL MANAGEMENT AND POLICY 29-69 (4th ed. 1977).
33. See infra notes 56-61 and accompanying text.
34. "The multiplier is likely to represent the point of greatest disparity between the contending parties because of the absence of objective criteria by which to measure it and because a very small variation will result in a significant difference in the final appraised value." Note, supra note 28, at 1467. See Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216, 218 (Del. 1975) ("The choice of a multiplier is a most difficult task and one which is often the subject of parties' exceptions, since its use leads to an approximation of value for which creditable arguments can always be made for increase or decrease."); Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 471 (Del. Ch. 1975) ("The selection of a multiplier in an appraisal action is always difficult and imprecise, as is the entire procedure of appraisal."). As with the assignment of weights, there may be a tendency for a decisionmaker to use the multiplier to make catch-all adjustments without adequate explanation. See infra note 205 and accompanying text. In Gibbons, 339 A.2d at 468-71, the vice-chancellor removed the gain from the sale of a subsidiary from the appraiser's estimate of earnings per share, but for that reason increased the appraiser's multiplier. Increasing the multiplier because of the sale of a subsidiary is unjustified and arbitrary.
sible. Assume that the earnings value per share of Subsidiary is estimated to be $40.00.

Weights which total 100% are then assigned to asset value and earnings value. In many jurisdictions, precedent plays an important role in establishing the range of percentages from which the weights will be chosen.\footnote{See, \textit{e.g.}, \textit{Bell v. Kirby Lumber Corp.}, 413 A.2d 137, 142-46 (Del. 1980). For a table listing weights used in selected cases, see Note, \textit{supra} note 6, at 641. Delaware cases have been praised for the relative predictability of the weights used. Banks, \textit{supra} note 28, at 34. The predictability is a small benefit, however, given the paucity of explanation of how the weights are determined. \textit{Brudney, supra note 29, at 78.}} Courts typically justify the selection of a particular weight by a brief reference to the special circumstances of the corporation being appraised.\footnote{Summaries of the reasons offered by various courts in selecting weights are presented in Note, \textit{supra} note 28, at 1469-71; Note, \textit{supra} note 6, at 640-43. A case illustrating this reasoning is \textit{Levin v. Midland-Ross Corp.}, 41 Del. Ch. 276, 287-89, 194 A.2d 50, 57-58 (Del. Ch. 1963), in which the following weights were assigned by the vice-chancellor: Value per share Weight
\begin{tabular}{ll}
Earnings Value & $8.82 \\
Asset Value & 35.67 \\
Market Value & 18.69 \\
\end{tabular}

\textit{The resulting award was $24.71. The appraiser’s weight of 60% for asset value was reduced by the court to 50% because no previous Delaware case had assigned a weight greater than 50% to the asset value. A weight as high as 50% was justified by the court on the ground that excess liquid assets were valued at $16.70 per share and other unneeded productive assets were valued at over $6.00 per share. The court’s reasoning is deficient in a number of ways. If the asset value exceeded the earnings value, the award should have been equal to the asset value. See infra notes 47-64 and accompanying text. The estimate of the asset value in \textit{Levin} was based on book value, \textit{Levin v. Midland-Ross Corp.}, 41 Del. Ch. at 282-83, 194 A.2d at 54-55, and therefore was suspect. See infra notes 47-49 and accompanying text. Moreover, the court should have considered whether a value even higher than asset value or earnings value could have been obtained by adding earnings value to the value of surplus assets. See infra notes 126-34 and accompanying text.}} Assume that the court assigns a weight of 40% to asset value and 60% to earnings value. The appraised value under the conditions is represented in the following chart.

\begin{tabular}{|l|l|l|l|}
\hline
Value Factor & Value & Weight & Result \\
\hline
Asset Value & $60.00 & 40% & $24.00 \\
Earnings Value & $40.00 & 60% & $24.00 \\
\hline
Appraised Value per Share & & & $48.00 \\
\hline
\end{tabular}

The weighted average of asset value and earnings value results in an appraisal value somewhere between the two, closer to that value which receives the heavier weight.\footnote{Taking a weighted average of two values is equivalent to determining a point on a line} Here lies the fallacy. The value of
the corporation should be equal to the higher of the two values, since that higher value represents the more profitable use of the corporation's resources. This may be called the best-use value of the corporation.\textsuperscript{38} If the corporation's asset value is higher than its earnings value, the potential purchasers regard themselves as able to make a more profitable use of the assets than the corporation can, and the corporation should be liquidated.\textsuperscript{39} On the other hand, when the earnings value is greater than the asset value, the corporation's management should continue operations, and the asset value becomes irrelevant. The fact that less money could be realized by liquidating the corporation than by continuing its operations is no more relevant than the existence of other inferior courses of action. To take a weighted average between the value of the corporation when its assets are employed in their best use and its value if they were employed in a less profitable course of action results in an undervaluation of the corporation.\textsuperscript{40}

In estimating the intrinsic value of a corporation, it should be assumed that a corporation's assets will be liquidated if and only if liquidation is more profitable than continued operation.\textsuperscript{41} The power to decide whether all or part of a corporation's assets should be liquidated is an important management responsibility. For most corporations, in most circumstances, the decision against total liquidation is easy and tacit.\textsuperscript{42} At times, however, especially when predicted earnings are low, the possibility that liquidation is the more profitable course for the corporation must be seriously considered.

\textsuperscript{38} In calculating asset value in Delaware, the concept of "highest and best use," familiar from the law of eminent domain, is followed. Appraiser's Report at 5, Bell v. Kirby Lumber Corp., 413 A.2d 137 (Del. 1980). The applicability of this concept to valuation of the corporation has been neglected.

\textsuperscript{39} There is an exception to the statement in the text. Management might be delaying liquidation because it anticipates an increase in the asset value. See infra note 62 and accompanying text.

\textsuperscript{40} For example, a corporation would probably be less profitable if its factories were shut down during the summer, but no one would think it sensible to evaluate the corporation by striking an average between its earnings value with the factories operating normally and its earnings value with the factories closed in the summer.

\textsuperscript{41} See infra notes 219-24 and accompanying text.

\textsuperscript{42} A dividend can be viewed as a partial liquidation of the corporation. Cf. infra note 126 and accompanying text (payment of dividends should depend on whether the corporation can make better use of the funds than its shareholders can).
This is a fundamental principle of the law of bankruptcy reorganization. The comparison of the liquidation value and earnings value remains important under the Bankruptcy Reform Act of 1978. A plan for the reorganization and continued operation of a corporation cannot be confirmed over the objection of a claimant or interest holder who would receive less value under the plan than she would receive if the corporation were liquidated.

The weighting method always undervalues corporate stock. The particular inadequacies of the method, however, are best examined by looking to the three possible fact patterns in which the method would be applied. In the first two, asset value is respectively higher or lower than earnings value. In the third, slightly more complicated situation, the best use of the corporation's resources calls for a partial liquidation of the assets. The most obvious example of this situation occurs when the corporation has assets which are not being used in its operations. This is often true of a corporation in an appraisal proceeding because corporations with surplus assets are more likely than other corporations to end up in takeovers, which in turn are often followed by freezeouts. When a partial liquidation is called for, the best-use value of the corporation is the sum of the amounts which can be realized from the sale of the assets that are the most valuable when liquidated and the amount which will be realized from continued operations with the remainder of the assets. In short, the value of surplus assets is added to the earnings value from continuing operations.

45. Id. § 1129(a)(7)(A).
46. E. Aranow & H. Einhorn, Tender Offers for Corporate Control 5 (1973). In one study for the years 1956 to 1967, 71.5% of the target companies had current ratios (current assets divided by current liabilities) higher than 2.25, which was considered to be the dividing line between normal and high liquidity. D. Austin & J. Fishman, Corporations in Conflict—The Tender Offer 14-16 (1970), cited in E. Aranow & H. Einhorn, supra, at 5-6. Another study concluded that the average quick ratio (cash plus cash equivalent items plus receivables, divided by the current liabilities) of target companies was significantly higher than that of a comparable control group of companies. Hayes & Tausig, Tactics of Cash Takeover Bids, 45 Harv. Bus. Rev. 135-42 (1967). For an appraisal case acknowledging that surplus assets make a company an attractive target for a takeover, see Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 465-66 & n.1 (Del. Ch. 1975). In Gibbons, however, Vice-Chancellor Marvel did not recognize the significance of surplus assets to corporate appraisal. See infra notes 120-59 and accompanying text. In an earlier case, Vice-Chancellor Marvel also failed to recognize that when a company is regarded as an attractive target, the market price is normally less than the true value of a share. David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30, 34 (Del. Ch. 1971). The Greene decision was limited by Singer v. Magnavox Co., 380 A.2d 969, 979 (Del. 1977), to cases in which the elimination of the minority stockholders was not the sole purpose of the "cash-out merger."
A. FACT PATTERN ONE: ASSET VALUE ESTIMATED TO BE GREATER THAN EARNINGS VALUE

This section describes the fallacy inherent in applying the weighting method in situations where asset value exceeds earnings value. The section also analyzes some recent cases in which asset value exceeded earnings value, yet the weighting method was applied.

1. The Fallacy of Using the Weighting Method in Fact Pattern One

In the example above, earnings value for Subsidiary was estimated at $40 million and the asset value was estimated at $60 million. The two estimates imply that Subsidiary's operations should be terminated and its physical assets sold. Therefore, the appraisal value of $48 million that resulted from the weighting method is much too low.

There are two possibilities when asset value is estimated to be greater than earnings value. Either the value estimates are in error or the company should at some time be liquidated. In either situation, valuation by weighting the estimates of asset value and earnings value will produce an incorrect result.

a. Erroneous valuations: The failure to liquidate may be due to an overestimate of asset value or an underestimate of earnings value. When an inconsistency appears, both estimates should be checked. In our example, a factfinder, after review, might correct the estimate of asset value for Subsidiary to, say, $35 million. The earnings value would then exceed the asset value, the company should not be liquidated, and the best-use value would be the earnings value of $40 million.

A possible source of error in the estimation of asset value is the use of a standard such as book value or reproduction cost rather than the price the assets would command on the open market. The book value of an asset has little to do with its economic value. Nevertheless, appraisers in the past have used book value as the starting point for an estimate and then made various adjustments. Book values often un-
derstate the asset values in a period of inflation, but during a time of deflation, use of book value to measure asset value may cause estimates of asset value to exceed estimates of earnings value. 49

A few Delaware cases in which the estimate of asset value exceeded the estimate of earnings value50 may be explained by the fact that asset value was measured by reproduction cost less depreciation, a standard which has since been rejected in favor of theoretical liquidation value.51 The reproduction cost of assets can never be less than their market value, but may be greater.52 When reproduction cost exceeds market value, it seems unreasonable that anyone would produce more assets of that kind, because to do so would be unprofitable.53

The apparent inconsistency may also arise from an underestimate of earnings value. Such an error is significant because it implies that the best-use value of the corporation is even higher than the best-use value indicated by the original estimates of asset value and earnings value.54 Thus, if the factfinder concludes that the estimate of Subsidi-

Use of book value in estimating asset value may be sound if each component of book value is considered and adjusted where necessary to reflect the market value of that asset. This approach was apparently followed in Brown v. Hedahl's—Q B & R, Inc., 185 N.W.2d 249, 256 (N.D. 1971).

49. D. Herwitz, Business Planning 24-25 (1966). For a postdepression example, see Levin v. Midland-Ross Corp., 41 Del. Ch. 276, 278-79, 282, 287-88, 194 A.2d 50, 52, 54, 57 (Del. Ch. 1963) (productive assets, in a declining industry marked by closing of plants, had little value in liquidation, yet asset value per share was estimated at the book value of $35.67, of which $16.70 was liquid; earnings value was estimated to be at $8.82). See infra note 36 (discussing Levin in more detail).

50. E.g., Felder v. Anderson, Clayton & Co., 39 Del. Ch. 76, 83-84, 89, 159 A.2d 278, 281-84, 286 (Del. Ch. 1960) (asset value per share estimated at $700.05; earnings value estimated at $365.23); Heller v. Munsingwear, Inc., 33 Del. Ch. 593, 598, 98 A.2d 774, 777 (Del. Ch. 1953) (asset value per share estimated at $46.57; earnings value estimated at $11.97). With respect to the standard for asset value, these cases no longer express the current law. Poole v. N.V. Deli Maatschappij, 243 A.2d 67, 70-72 (Del. 1968). See infra note 51.

51. Poole v. N.V. Deli Maatschappij, 243 A.2d 67, 72 (Del. 1968). In this suit for fraudulent misrepresentation in inducing the sale of stock, the court applied the weighting method, citing texts on valuation and emphasizing that the fair market value standard for assets is clearly defined, whereas "going-concern asset value [roughly equivalent to depreciated reproduction cost] is comparatively an ethereal concept." Id.

52. Market value cannot exceed reproduction cost because a buyer would choose to reproduce the asset rather than pay a higher market price. (This statement assumes that reproduction cost includes the cost of delay while reproduction is taking place.)

53. But see D. Herwitz, supra note 49, at 14; Note, supra note 28, at 1458-59 (discussing the asset value of rental property).

54. In one fraudulent misrepresentation case, a positive weight was assigned to an earnings value of $4.20 per share, although the asset value was $22.40 per share. Poole v. N.V. Deli Maatschappij, 243 A.2d 67, 73 (Del. 1968). In an offering letter the corporation had pointed out that its assets, land used to grow wrapper tobacco for cigars, had appreciated in value, but stated that the corporation did not necessarily believe that the land should be sold. It explained: "Whether such action would be desirable will depend among other things upon the future course of events in the
ary's earnings value should be revised to $70 million, then the company should be kept operating and its best-use value is $70 million or $70.00 per share. If management is properly continuing to operate the corporation, its business judgment must be that the best-use value of the corporation exceeds current asset value, or asset value is expected to increase.\textsuperscript{55}

Errors readily occur in estimations of earnings value, which in principle require the prediction of future earnings and the translation of that prediction into a present value, whether through use of a multiplier or otherwise. In appraisal proceedings in Delaware, estimates of annual earnings are based on average reported earnings for the previous five years rather than on a prediction of future earnings.\textsuperscript{56} If earnings are expected to increase over their recent past average, the Delaware formula can lead to an underestimation of earnings value.\textsuperscript{57} An anticipated increase in earnings can be reflected in the multiplier, but only to the extent that the companies chosen as comparable have opportunities for earnings growth similar to those of the company being valued.\textsuperscript{58} This would be true if the possible increase in earnings

\textsuperscript{55} The point is often missed when a party argues that a given corporation should be valued at liquidation value. A court is likely to dismiss the argument on the ground that the corporation is a going concern. \textit{See}, e.g., \textit{Seaboard World Airlines, Inc. v. Tiger Int'l, Inc.}, 600 F.2d 355, 362, 364-65 (2d Cir. 1979). Yet continued operation of such a company only makes sense if the best-use value is thought to be even higher than liquidation value. This point was missed in \textit{Seaboard World Airlines} despite the recognition that the liquidation value represented a "fallback" position if the operations planned by the acquiring corporation were unsuccessful. \textit{Id.} at 364-65, 367. \textit{See infra} notes 274-304 and accompanying text. As to the possibility that asset value may increase, see \textit{infra} note 62 and accompanying text.

\textsuperscript{56} \textit{See}, e.g., \textit{Universal City Studios, Inc. v. Francis I. duPont & Co.}, 334 A.2d 216, 218 (Del. 1975). Accounting earnings differ from the economic concept of earnings relevant to valuation. \textit{See} J. Lor\textit{ie} & M. Hamilton, \textit{The Stock Market—Theories and Evidence} 143-44 (1973). \textit{See generally} Blum & Katz, \textit{Depreciation and Enterprise Valuation}, 32 U. Chi. L. Rev. 236 (1965) (application of conventional depreciation formulas to assets which will be replaced in future years ignores the fact that replacement expenditures will be in future dollars, which are less valuable). Because of the discretion permitted by generally accepted accounting principles, identical companies could have widely different reported earnings. J. Lor\textit{ie} & M. Hamilton, \textit{supra}, at 144-50.

\textsuperscript{57} \textit{But cf.} J. Lor\textit{ie} & M. Hamilton, \textit{supra} note 56, at 137-38, 142-67 (five year average may "normalize" earnings, especially for industries where earnings vary cyclically; predicting departures of corporate earnings from historical levels is difficult).

\textsuperscript{58} An ad hoc adjustment of the multiplier might be made to reflect the possibility of growth. \textit{Cf.} e.g., \textit{Universal City Studios, Inc. v. Francis I. duPont & Co.}, 334 A.2d 216, 218-22 (Del. 1975) (use of the average price-earnings ratio of nine other companies justified in part by the upward trend in corporation's earnings and by guaranteed increases in revenues from existing contracts).
stems from factors common to the industry, but not if the possibility of greater earnings is peculiar to the merging company. A freezeout of minority shareholders may well occur at a time when management expects earnings to increase, perhaps on the basis of intuitive assessments that are difficult to articulate. With an appraisal technique based on past earnings, freezeouts at such a time will be more profitable for insiders, and therefore more likely to occur than they would be with an appraisal technique based on future earnings. When earnings value has been erroneously estimated to be below asset value, the factfinder should correct the error and, if the revised estimate exceeds asset value, adopt the earnings value as the best-use value.

b. Liquidation: If a review of the calculations confirms that the original estimates of asset value and earnings value are correct, then the value of the corporation can be maximized through liquidation. Management may have refrained from liquidating the company because it anticipates that the market price of assets will increase sufficiently to justify delaying the sale. For example, the management of Subsidiary may think that the asset value of the corporation is likely to increase from $60 million to $65 million. If an increase in the asset value is expected, however, then the best-use value of Subsidiary is

59. See V. Brudney & M. Chirelstein, supra note 30, at 73-75.

60. A company similar with respect to riskiness and growth of earnings is unlikely, however, to have a surplus asset position similar to that of the corporation being valued. Thus, surplus assets will not be reflected in an earnings value generated by the use of a multiplier. The per share value of surplus assets should instead be added to the earnings value of each share. See infra notes 126-34 and accompanying text.

61. See Brudney & Chirelstein, supra note 9, at 305-06. A case in which this may have occurred is Berkowitz v. Power/Mate Corp., 135 N.J. Super. 36, 40, 342 A.2d 566, 568-69 (Super. Ct. Ch. Div. 1975), in which a dramatic increase in earnings would have been reported for the six-month period just before the proposed merger, if the insiders had not paid themselves large bonuses. The court issued a preliminary injunction against the merger, remarking that "[T]he timing of the merger suggests that the insiders have chosen a most opportune time—in relation to Power/Mate's earnings record since it went public—to buy out the minority at an unreasonably low price." Id. at 48, 342 A.2d at 573. Cf. infra note 87 (dramatic increase in asset value after a freezeout).

62. If the market for a type of asset is efficient, however, the price will follow a random walk and will be as likely to go up as to go down. See Treynor, The Trouble with Earnings, FIN. ANALYSTS J., Sept.-Oct. 1972, at 42, reprinted in MODERN DEVELOPMENTS IN INVESTMENT MANAGEMENT 612, 614 (J. Lorie & R. Brealey eds. 1978). The management of a corporation is likely to have expert knowledge about the industry, but it may not possess more expertise than other potential buyers and sellers of that type of asset. But cf. infra notes 84-92 and accompanying text (asset value at time of going-private tender offer found to exceed earnings value; company liquidated six years later for an amount greatly exceeding the earlier estimate of asset value).
even greater than $60 million.

Another possibility is that immediate liquidation is the best course of action for the corporation, and that management, hoping to profit at the expense of the outside shareholders, has failed to take this course of action. For example, assume that the best course for Subsidiary is liquidation, which would yield a best-use value of $60 million or $60.00 per share. Instead, management has frozen out the outside shareholders and dictated a payment of $50.00 per share. Once the outsiders are eliminated, management can then liquidate the company for its entire $60 million value. An appraisal process which arrived at the best-use value per share would eliminate this incentive to freezeout the minority. Because the weighting method consistently underestimates the value of the corporation, however, it tends to encourage the delay in liquidation.

2. Recent Cases Illustrating Fact Pattern One

In Bell v. Kirby Lumber Corp., two Delaware courts affirmed the appraiser's finding that asset value was $456.00 per share, and that earnings value was $120.00 per share. A weight of 40% was assigned to asset value and a weight of 60% was assigned to earnings value, so that only $254.40 per share was awarded as the fair value of the shares. Given the estimates of asset value and earnings value, the award should have been $456.00 per share, 79% higher than the court's award.

63. See infra notes 127, 219-24 and accompanying text. When failure to liquidate has been followed by a freezeout, the conflict of interest inherent in the freezeout places management in a position of having to prove that its behavior was fair to the outsiders. Even under a business judgment standard, an unexplained, significant disparity between asset value and earnings value could result in liability for policies that could not reasonably be considered in the best interests of the corporation. See Arzt, The Business Judgment Rule Revisited, 34 Bus. L. Rev. 93, 97, 109-10, 112, 121-26 (1979) (citing Gimbel v. Signal Companies, Inc., 316 A.2d 599 (Del. Ch. 1974), aff'd, 316 A.2d 619 (Del. 1974); Thomas v. Kempner, No. 4138 (Del. Ch. Mar. 22, 1973)). But cf. Weiss, Disclosure and Corporate Accountability, 34 Bus. L. Rev. 575, 587-88 (1979) ("Directors' duty of due care has almost been interpreted out of existence") (discussing Kamin v. American Express Co., 86 Misc. 2d 809, 383 N.Y.S.2d 807 (N.Y. Sup. Ct. 1976)). If management argued that its failure to liquidate was reasonable because earnings value was greater than asset value or because asset value was expected to increase, that argument would, of course, provide evidence that best-use value was greater than present asset value. See supra notes 54-55, 62 and accompanying text.

64. Cf. infra note 224 and accompanying text (undervaluation by the weighting method creates an incentive for management temporarily to delay using the corporation's resources to the best advantage), note 248 and accompanying text (undervaluation by the weighting method may create an artificial and inefficient stimulus to tender offers).

66. 395 A.2d at 736-37, 739-40; 413 A.2d at 147-48.
67. 413 A.2d at 146.
One of the reasons offered in *Bell* for using the weighting method was the assertion that management does not have the duty to maximize the value of the corporation.68 This proposed justification is discussed and rejected in a later section of this Article.69 An investment banker, testifying as an expert for the defendant corporation, proposed a further justification: minority stockholders could use their award to buy into other corporations whose shares had depressed market prices. This argument was treated sympathetically by the appraiser, who said that the witness testified "accurately, I believe," and added:

That seems fair enough, but there are unknown tax and transaction costs to be considered and there is also the recognition that the corporation may have obtained a bargain at the expense of its stockholders. . . . Fortunately, I need not go extensively into this area because the present weighting of assets takes care of whatever disparity may exist [between market price and asset value].70 Thus, the appraiser was apparently led by this argument to choose weights which resulted in a smaller award. The Delaware Supreme Court quoted the relevant passage of the appraiser's report, identifying it as partially explaining the selection of weights.71 The argument should have been rejected. Economic theory and empirical evidence refutes the proposition that bargains can be found in the securities market.72 Furthermore, the argument pushes to an extreme the principle that a plaintiff must minimize damages73 by assuming that the plaintiff must seek out bargain investments. It is also, as the appraiser noted, invalid to the extent that taxes and transactions costs would diminish the ability of outside shareholders to replace the common stock in Kirby Lumber Corporation with other investments.74 Another drawback is that a dissenter who purchased stock at a depressed price in another corporation would run the risk of similar mistreatment. This is most likely to happen if the other corporation is already controlled by a parent corporation that is able to freezeout minority shareholders. If, instead, the dissenter seeks a bargain in the shares of an independent corporation whose market price is below asset value, the risks are similar. The company may be mismanaged, in which case the chance of

68. See id. at 140.
69. See infra notes 225-33 and accompanying text.
71. 413 A.2d at 145.
72. See, e.g., Cohen, *The Suitability Rule and Economic Theory*, 80 Yale L.J. 1604, 1614-17 (1971). Bargains may develop after a security has been purchased, but a buyer cannot predict, at the time of purchase, which securities will become bargains. Id. See infra note 75.
74. Appraiser's Report at 38, Bell v. Kirby Lumber Corp., 413 A.2d at 142.
receiving an adequate return from a purchase at the market price would depend upon an improvement in management. One prospect for management improvement lies in the possibility that the corporation will become the target of a tender offer. A tender-offer price equal to the best-use value of the corporation is not likely, however, because such a price would not fully compensate the bidder for the costs and the risks of the offer. Thus, even assuming that bargains are available in the securities markets, a freezeout at a price below best-use value or a tender offer followed by a freezeout at a price below best-use value will likely await a dissenter seeking a bargain in another corporation with a depressed market price. The risk of such an occurrence is in part created by an appraisal remedy which awards less than the true value of a share.

The outsiders in Bell argued that because a natural resource company presents special valuation problems, their shares should be appraised at the price which would be paid by an unrelated corporation in an arms-length merger, rather than be appraised by the weighting method. The refusal of the appraiser to adopt the suggested standard was affirmed on the ground that there was no precedent for departing from the general appraisal rules because of the nature of the corporation. The court added:

[An arm's-length merger presupposes an acquisition value based upon the very fact that the company will not continue in business on the same basis that existed immediately prior to the merger. It introduces another element, namely, the value another would place upon it as a price for merger as opposed to the corporation's independent value as a going concern.

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75. The suggestion that outsiders could find bargain investments elsewhere to make up for a loss incurred in the freezeout is inconsistent with the semistrong form of the efficient market hypothesis, which holds that market prices fully reflect public knowledge about the prospective returns from holding a stock. See J. Lorie & M. Hamilton, supra note 56, at 71. For a summary of evidence supporting the semistrong form of the efficient market hypothesis, see id. at 83-87.

76. A takeover bidder would hope either to realize the asset value through liquidation or to achieve an earnings value which is even higher than asset value. See infra notes 236-41 and accompanying text.

77. See infra notes 242-45 and accompanying text.

78. 395 A.2d at 735-36.

79. Id. at 735; 413 A.2d at 142. One commentator favors the outsiders' contention that an exception should be made for appraisals of natural resource companies, giving asset value a higher weight. Comment, Bell v. Kirby Lumber Corp.: Ascertaining "Fair Value" Under the Delaware Appraisal Statute, 81 Colum. L. Rev. 426, 438-40, 439 n.95 (1981). The commentator does not recognize that persistent refusal to liquidate a corporation with a high asset value makes sense only when the going-concern value is even greater than asset value. Instead, the investor is regarded by the commentator as seeking either asset value or earnings value. See id. at 429-30, 438-39, 439 n.95. A rational investor seeks the larger value, whatever it is.

80. 395 A.2d at 736 (emphasis in original).
The court's remarks are paradoxical; the court does not explain how the corporation's value can be less than the "third-party price," the price a willing buyer would pay for it. If the controlling shareholders are not selling the corporation at the third-party price, they must be placing an even higher value on it. 81

In Lynch v. Vickers Energy Corp., 82 a recent case dealing with the application of the weighting method to a corporation whose asset value exceeded its earnings value, the Delaware Supreme Court criticized the result but failed to identify the fallacy in the weighting method. In an earlier opinion in that case, 83 the court had held that a parent corporation had breached its fiduciary duty to outside shareholders of its subsidiary by making a tender offer at $12.00 per share without disclosing two material facts. 84 On the first remand, the chancellor valued the shares of the subsidiary in order to determine the appropriate remedy for the breach of fiduciary duty. 85 He adopted the weighting method, analogizing the proceeding to an appraisal hearing after a merger. 86 Although he concluded that net asset value per share was $17.50, he combined this with a market value of $9.48, and an earnings value of $5.25, to obtain a weighted average of $11.85 per share at the date of the tender offer. Accordingly, the chancellor concluded that the outside shareholders had not been injured by the failure to disclose the material facts, since the tender offer had been $12.00 per share. 87

81. But see Chazen, Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?, 36 BUS. LAW 1439, 1467-72 (1981) (arguing that the price paid in a negotiated transaction by controlling shareholders, where the outsiders are represented by a committee of outside directors or other negotiators, might properly be less than the third-party price, which may be regarded as payment for both control and non-control shares). Chazen's argument relies in part on the proposition that a company might be worth more to a third party than to a controlling shareholder, who can nevertheless block a sale of the whole company by refusing to sell his shares. The proposition is unsound, however, because a controlling shareholder's refusal to sell at the third-party price provides strong evidence that the company is worth even more to him than to the third-party.

83. 363 A.2d 278 (Del. 1977).
84. Id. at 281-82.
86. Id. at 11-12.
87. Id. at 12. The tender offer was made in September 1974. In June 1980, potentially enormous discoveries of gas were made in an area where the subsidiary owned considerable property. Wall St. J., Aug. 27, 1980, at 2, col. 2. In August 1980, after having obtained bids from several large corporations, the ultimate parent entered into a tax-free transaction whereby it received $60.00 for each share of the subsidiary, plus 10% of the profits from the new discoveries of gas, after the deduction of certain startup costs. In addition, the subsidiary's debt to the ultimate parent of approximately $25 million was to be paid. Id. The president and chief executive officer of the parent explained that the transaction resulted from an evaluation by management of the
The Delaware Supreme Court reversed, holding that damages should have been based on the value of the subsidiary at the date of trial rather than at the date of the tender offer.\textsuperscript{88} Although the opinion is ambiguous,\textsuperscript{89} the court apparently did not object to the use of the weighting method.\textsuperscript{90} In addition to holding that the chancellor's valuation of the corporation was too low,\textsuperscript{91} the court did suggest, however, that the weight assigned to asset value had been too low in comparison to the weight assigned to market value:

\begin{quote}
[T]he value which the Chancellor fixed was influenced significantly by the percentage which he assigned to assets in the formula he used. It seems to us that assigning the same factor (40\%) to both asset value and market value was highly questionable. We say this because oil was (and is) a limited and much needed energy source which significantly affected its value as a corporate asset; in contrast, [the parent's] dominance of [the subsidiary] and its announced plan to acquire all of [the subsidiary's] stock undoubtedly had an influence on the value assigned by the market to the shares traded.\textsuperscript{92}
\end{quote}

Although the court was fully justified in distrusting the assignment of

\footnotesize
\begin{itemize}
\item [88] See supra note 87.
\item [89] The court stated that, "reversal is required because the chancellor erroneously relied on the Poole case and on an appraisal formula (which has been developed in our case law under the [appraisal] Statute, 8 Del. C. § 262)," 429 A.2d at 500. The court's recognition of error in relying on Poole, however, may have been only in reference to the date at which damages were to be measured. See supra note 88 and accompanying text.
\item [90] See infra notes 92-94 and accompanying text.
\item [91] The court held that the stock should be valued at least at $15.00, which is the price that the parent had been willing to pay to third parties on the open market, on the ground that the parent should have been at least as generous to outside shareholders, to whom a fiduciary duty was owed, as it was to strangers. Id. at 505.
\item [92] Id.
\end{itemize}
weights in *Lynch*, it did not correctly analyze the chancellor's errors. The court was probably right in concluding that the parent's control of the subsidiary and the announcement of its plans influenced the market price. In particular, the market price was probably below the true value of a share.\textsuperscript{93} It is unsound, however, to assign any weight to a measure of value which is thought to underestimate the true value, unless an attempt is made to correct the underestimation.\textsuperscript{94} The court also erred in asserting that the relative weighting of the asset value was too low because "oil was (and is) a limited and much needed energy source . . . ." An asset worth $100.00 consisting of a valuable energy source is no more valuable—and no more worthy of a greater weight—than an asset consisting of $100 worth of recyclable wastepaper, just as one hundred pounds of lead weighs no more than one hundred pounds of feathers. The relative weighting of asset value was too low only because a positive weight was assigned to earnings value. The earnings value was smaller than asset value and was therefore irrelevant. Thus the disquiet of the court produced by the use of the weighting method in *Lynch* was not translated into any useful insight about the fallacious-ness of the method itself.\textsuperscript{95}

\textbf{B. FACT PATTERN TWO: EARNINGS VALUE ESTIMATED TO BE GREATER THAN ASSET VALUE AND THERE ARE NO SURPLUS ASSETS}

This section describes the fallacy inherent in applying the weighting method in situations where earnings value exceeds asset value and there are no surplus assets. The section also analyzes a recent case in which earnings value exceeded asset value, there were no surplus assets, and the weighting method was applied.

1. \textit{The Fallacy of Using the Weighting Method in Fact Pattern Two}

Assume that in the previous hypothetical, Subsidiary's earnings value is estimated to be $70 million and that its asset value is found to be $40 million. Earnings value then exceeds asset value. This is the expected

\textsuperscript{93} See supra note 29.

\textsuperscript{94} \textit{Cf.} Morris, \textit{Combining Expert Judgments: A Bayesian Approach}, 23 Mgmt. Sci. 679, 682-83 (1977) ("calibration" of expert's prediction in light of the types of errors in her previous predictions). Here, market value as an estimator of true value should be "calibrated" in accord with theoretical and empirical considerations which suggest that it tends to underestimate true value.

\textsuperscript{95} \textit{Cf. infra} notes 322-23 and accompanying text (importance of identifying the fallacy in assigning a positive weight to the lower of asset value and earnings value, rather than simply increasing the relative weight of best-use value).
relationship for a corporation whose operations are ongoing. Asset value represents what others could realize from the separate physical assets of the corporation. It excludes from consideration most of the characteristics that make the ongoing corporation a significant entity: the synergism of operating the physical assets together; the human capital of a skilled labor force and an established organization; and such intangible assets as ideas, reputation, and the image created by advertising.

If the weighting method is applied with the same weights as were used before, the appraisal value is as follows:

<table>
<thead>
<tr>
<th>Value Factor</th>
<th>Value</th>
<th>Weight</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Value</td>
<td>$40.00</td>
<td>40%</td>
<td>$10.00</td>
</tr>
<tr>
<td>Earnings Value</td>
<td>$70.00</td>
<td>60%</td>
<td>$42.00</td>
</tr>
</tbody>
</table>

The best-use value of the corporation, however, is $70.00 per share. Assigning a weight to asset value reduces the appraised value below the best-use value. The amount of the reduction depends on the amount of synergism, skill, and intangible assets present, i.e., on the value generated by the cooperative effort of all the assets of the corporation.

It might be argued that assigning a weight to asset value accounts for the possibility that the corporation's earnings will be disappointingly low and that liquidation at the lower asset value will occur. Earnings value, however, should already reflect the possibility of untoward circumstances; the estimate of future annual earnings

96. "[To] confine the appraisal to the strictly asset basis [leaves] out of account all the elements which contribute to value as incidental to a going enterprise." Chicago Corp. v. Munds, 20 Del. Ch. 142, 150, 172 A. 452, 455 (Del Ch. 1934).


99. For discussion of a similar argument, see infra notes 206-16 and accompanying text.
should be a weighted average of both good and bad possibilities, and the discount rate should include a risk premium reflecting the risk that the corporation will do badly. An estimate of earnings value which inadequately reflects the probability that earnings will be poor should obviously be corrected. Only through an extreme coincidence would any needed correction in the earnings value correspond to the reduction in the appraisal value which results from assigning a weight to asset value.

Indeed, asset value in some circumstances may serve as a fallback position or "abandonment value" which sets a floor on the extent to which a possible decline in earnings can affect the best-use value of the corporation. It can be anticipated that the worst possible financial outcome will be avoided by liquidating the corporation as soon as it appears that disastrously low earnings are likely to persist. If the estimate of earnings value reflects the fact that the worst case possibilities for earnings will never be experienced, the estimate of earnings value will be increased and so also will the estimate of best-use value. Thus, the presence of assets which could be sold can increase best-use value in some circumstances, but never diminish it. The weighting method ignores this principle and instead reduces appraised value in proportion to the extent that asset value falls short of earnings value.

Consider, for example, a corporation with a novel marketing strategy, whose success is uncertain. Suppose for simplicity that the operating results of a new management will be known within one year to be very bad, satisfactory, or very good, and that those results will persist forever. Suppose, again for simplicity, that all other uncertainty about the corporation's earnings can be ignored. Specifically, let the corporation's probability distribution of earnings be:

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101. See J. VAN HORNE, supra note 32, at 144-49. For recognition that the liquidation value of assets provides a fallback if planned operations are unsuccessful, see Seaboard World Airlines, Inc. v. Tiger Int'l, Inc., 600 F.2d 355, 364-65, 367 (2d Cir. 1979).

102. The prediction of future earnings on which an estimate of earnings value is based may always be revised in light of the company's experience. Earnings below the predicted value in one year may be due simply to bad luck, but they also may cast some doubt on the prediction. Cf. M. Schaefer & E. Schaefer, A Bayesian Approach to Bankruptcy Reorganization 5-6, (unpublished paper) (presented at the Joint Meeting of The Institute for Management Science and the Operations Research Society of America in New York City, May 3, 1978) (copy on file with Southern California Law Review).
Because in this example all the uncertainty will disappear after one year, a virtually risk-free discount rate would be appropriate in valuing the company after that time. Assume that the discount rate is 8½%. The probability distribution of the corporation's value one year from now is:

<table>
<thead>
<tr>
<th>Earnings Value One Year From Now</th>
<th>Probability</th>
<th>Weighted Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$300,000 per year forever, discounted at 8½%</td>
<td>½</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>$600,000 per year forever, discounted at 8½%</td>
<td>½</td>
<td>$2,400,000</td>
</tr>
<tr>
<td>$900,000 per year forever, discounted at 8½%</td>
<td>½</td>
<td>$3,600,000</td>
</tr>
<tr>
<td>Expected value of Corporation in 1 year:</td>
<td></td>
<td>$7,200,000</td>
</tr>
</tbody>
</table>

Thus, the expected earnings value of the corporation one year from now is $7,200,000. To obtain the present value of the corporation, this figure is discounted for the waiting period of one year and for the high uncertainty presently surrounding the corporation's prospects: there is a one-third chance that the earnings value one year from now will be well below $7,200,000. If a discount rate of 15% were used to reflect this risk, the corporation's present value would be roughly $6,260,000.103

Suppose, however, that the physical assets of the company can always be sold for $4,500,000, even if the company's marketing strategy is a total failure.104 The corporation will choose to realize this "abandonment value" if the earnings value of the corporation falls below $4,500,000. If the new marketing strategy is unsuccessful, and

103. The value of $1.00 to be received in one year, discounted at 15% is $1 + 1.15, or roughly $0.87. V. BRUDNEY & M. CHIRELSTEIN, supra note 30, at 38. The present value of $7,200,000 is thus $7,200,000 / (1 + 0.15), or $6,260,000.

104. The floor on best-use value provided by asset value may be a moving floor if the disappointing earnings are the result of an industry-wide depression which reduces the value of the assets. For example, if the earnings value fell to $3,600,000 because of reduced demand for the goods produced by the firm's assets, the asset value would probably be lower than $4,500,000. This possibility would complicate, but not fundamentally alter, the analysis.
the earnings value of the corporation is only $3,600,000, management
will instead choose to sell the physical assets for $4,500,000. With this
option, the probability distribution of the value of the corporation is
more favorable than before:

<table>
<thead>
<tr>
<th>Value One Year from Now</th>
<th>Probability Weighted Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$4,500,000 from sale of assets</td>
<td>½</td>
</tr>
<tr>
<td>$600,000 per year forever, discounted at 8½% = $7,200,000</td>
<td>½</td>
</tr>
<tr>
<td>$900,000 per year forever, discounted at 8½% = $10,800,000</td>
<td>½</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Because the higher asset value can be realized when earnings value is
disastrously low, the expected value of the corporation one year from
now is higher, i.e., $7,500,000. Moreover, the riskiness of holding the
corporation's stock for one year has been reduced, since the worst
possible outcome is $4,500,000 rather than $3,600,000. Therefore, a
lower risk premium is appropriate. With a discount rate of 13%, the
present value of the corporation would be roughly $6,640,000. 105 Thus,
the presence of physical assets which can be sold if the corporation's
earnings are too low diminishes the riskiness and increases the best-use
value of the corporation. 106 These factors, however, are fully reflected
in a proper estimation of the earnings value and no correction through
a weighted asset value is necessary.

2. A Recent Case Illustrating Fact Pattern Two

Until recently, estimates of asset value have exceeded earnings value in
most appraisal cases. 107 Application of the weighting method in these
cases without consideration of the implications of the relative magni­
tudes of asset value and earnings value made it likely that courts would
also apply the method when asset value was less than earnings value. 108
A Delaware court has now done so. In Universal City Studios v. Francis
I. duPont & Co., 109 the estimated earnings value of $92.89 was assigned

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105. The present value of $1.00 to be received one year from now, discounted at a rate of 13%,
is $1 + 1.13. V. BRUDNEY & M. CHERELSTEIN, supra note 30, at 37. The present value, therefore,
can be found by dividing $7,500,000 by 1.13.

106. When abandonment value is taken into account, best-use value resembles a hybrid of
earnings value and asset value, and recognizes that the higher of those two options can always be
chosen.

107. See infra note 197 and accompanying text.

108. Id.

a weight of 87.5%, and the estimated asset value of $91.72 was assigned a weight of 12.5%, yielding an appraised value of $92.75 per share. If the two estimates were correct, then the best-use value of the corporation was its earnings value of $92.89. Assigning a weight of less than 100% to earnings value resulted in an appraised value that was $0.14 less than the best-use value. The difference in this case was relatively small because asset value was almost as great as earnings value and because a weight of only 12.5% was assigned to asset value. Nevertheless, application of the weighting method when earnings value is greater than asset value has the potential for significant underestimation of the value of the corporation. The conventional range of weights for asset value is well above 12.5%, and an operating company's asset value is often well below its earnings value.

Universal City Studios also illustrates how drawing a fine distinction between asset value and earnings value further ensures that appraisal value will be less than best-use value. The dissenting shareholders argued that the corporation's right to obtain revenues from theatrical showings of its fully amortized films represented an asset which should be valued on the basis of predicted future earnings, by the capitalization of the revenue generated by the films in the previous year. The court rejected this contention on the basis of Delaware precedent requiring that the earning power of individual assets be taken into account only through the weight assigned to earnings value. The films were assigned an asset value on the basis of the only evidence of their market value in the record, a figure much less than their earnings would apparently have justified.

Conceptually, the court's holding has some merit: if one is valuing assets and earnings separately and then averaging those values, the separate categories become confused if earnings predictions are permitted

110. 312 A.2d at 352.
111. See infra note 212.
112. 312 A.2d at 351. Cf. Piemonte v. New Boston Garden Corp., 377 Mass. 719, 732, 387 N.E.2d 1145, 1152 (1979) ("The fact that earnings from concessions were included in the computation of earnings value, one component in the formula, does not mean that the value of the concessions should have been excluded from the computation of net asset value, another such component."); In re Watt & Shand, 452 Pa. 287, 292 n.7, 304 A.2d 694, 698 n.7 (1973) (defining net asset value to include "good will and the corporation's value as a going concern").
113. 312 A.2d at 351, aff'd, 334 A.2d at 222. Inconsistently, the court allowed future television revenues to be considered in determining asset value. 312 A.2d at 350. See infra text accompanying note 116.
114. The court found that the films were worth $0.65 per share. The dissenters contended that the present value of future theatrical revenue from the films was $32.17 per share. 312 A.2d at 350-51.
to influence both asset value and earnings value. As a practical matter, however, this reasoning has two drawbacks. First, the market value of assets cannot be neatly separated from their earning power. Evidence of the earnings the films could generate was evidence upon which to base an opinion about market value. Indeed, the market value of the films could not plausibly be estimated to be less than their earnings value. Moreover, since films are not fungible, the evidence of market value accepted by the court was probably based indirectly on evidence about earnings. For example, if the evidence of market value was based on sale prices of comparable films, it is highly likely that in judging them to be comparable, consideration was given to relative earning power. The court implicitly recognized the role of earnings in valuing assets when it accepted the agreement of both parties that the present value of future estimated television revenues should be included in asset value.

Second, use of earnings power to value assets can correct, in a clumsy way, some of the underestimation of corporate value which would otherwise result from applying the weighting method when earnings value exceeds asset value. If asset value more closely approximates earnings value, when earnings value is the best-use value for a corporation, the error created by striking an average between the two values is reduced. Capitalizing earnings from a portion of the corporation’s business, such as the sale of television rights to old movies, and treating those rights as an asset may seem artificial, but might lead to a weighted average closer to best-use value. Moreover, the description of a valuable right of the corporation as an asset is consistent with familiar conceptions of an asset. Piecemeal valuation of individual assets whose earning power can be isolated is of course a poor way to try to capture the earnings value of an entire corporation, which entails an estimation of the effect of combining all of a corporation’s assets with its labor force and administrative organization. So long as the weighting method is applied, however, using the earning power of each asset in calculating the value of that asset tends to result in a truer estimate of actual value than would otherwise be obtained, although the result would remain inferior to that obtainable by best-use

115. See, e.g., D. Dobbs, supra note 73, at 146-47, 391.
116. 312 A.2d at 350-51.
117. See, e.g., W. Sharpe, Investments 3 (1978) (“Every investment can be conceived as an asset held by someone: the prospect of future returns.”).
118. See supra notes 96-98 and accompanying text.
valuation.\textsuperscript{119}

The correct result will be achieved if courts would recognize that asset value should sometimes be disregarded in determining intrinsic value, i.e., when it is less than earnings value and there are no surplus assets. In \textit{Gibbons v. Schenley Industries, Inc.},\textsuperscript{120} the court assigned a zero weight to asset value,\textsuperscript{121} but this was inappropriate. Vice-Chancellor Marvel relied on a leading work on securities analysis for the proposition that the market price of a share depends chiefly on the earnings power of a corporation, and that asset value is largely irrelevant.\textsuperscript{122} This proposition was inapplicable in \textit{Gibbons} for two reasons: the estimate of asset value exceeded the estimate of earnings value, and the value of surplus assets was significant.\textsuperscript{123}

Whether the \textit{Gibbons} suggestion that asset value should usually be ignored will eventually lead to a correct analysis of the relationship between asset value and earnings value is uncertain. So far, its influence has not been promising; \textit{Gibbons} was treated in \textit{Bell v. Kirby Lumber Corp.}\textsuperscript{124} as precedent for reducing the weight assigned to asset value, even though in \textit{Bell} asset value greatly exceeded earnings value.\textsuperscript{125}

\textbf{C. FACT PATTERN THREE: EARNINGS VALUE ESTIMATED TO BE GREATER THAN ASSET VALUE BUT THERE ARE SURPLUS ASSETS}

This section discusses the fallacy inherent in applying the weighting method when earnings value exceeds asset value but there are surplus assets. The section concludes with an analysis of recent cases in which

\textsuperscript{119} Like the manipulation of weights, the ad hoc device described in the text risks confusion and may delay abandonment of the weighting method. See infra note 323 and accompanying text.

\textsuperscript{120} 339 A.2d 460 (Del. Ch. 1975).

\textsuperscript{121} \textit{Id.} at 472-73.


\textsuperscript{123} See infra notes 137-59 and accompanying text.

\textsuperscript{124} 413 A.2d 137, 142-46 (Del. 1980).

\textsuperscript{125} See supra notes 65-67 and accompanying text. \textit{Gibbons} was quoted with approval in \textit{In re Valuation of Common Stock of Libby, McNeil & Libby}, 406 A.2d 54, 66 (Me. 1979), which held that the appraiser's weight of 20\% for asset value was "if anything, on the high side." \textit{Id.} at 67. The court pointed out that the appraiser's estimate of asset value was based on book value, which "would be equal or even close to ... actual current value only by sheer coincidence." \textit{Id.} The unreliable estimate of asset value, however, greatly exceeded that of the earnings value. \textit{Id.} at 59. The court did not discuss the possibility that a correct measure of asset value would also have exceeded earnings value.
earnings value exceeded asset value, surplus assets were present, and the weighting method was applied.

1. The Fallacy of Using the Weighting Method in Fact Pattern Three

Even if the corporation's earnings value exceeds the value of all its assets so that its operations should be continued, it may still have some assets whose value in contributing to earnings is less than their value if they were sold or distributed to the shareholders. Easiest to identify are assets which make no contribution at all to earnings. Suppose that Subsidiary is found to have an earnings value of $70 million and an asset value of $40 million. Best-use value is then at least $70 million, or $70.00 per share. Assume further, however, that Subsidiary has $5 million in cash above the amount which is needed for working capital in continuing operations. That cash could be distributed to the shareholders with no diminution in the earnings value of the corporation. Thus, the best-use value of the corporation should be estimated to be $75 million, or $75.00 per share. This amount, which may be termed surplus-asset-plus-earnings-value, is greater than either asset value or earnings value, and will always be greater than any weighted average of the two. Surplus-asset-plus-earnings-value assumes that all of a corporation's assets should be put to their best use: surplus assets should be liquidated; those which are more valuable in continuing operations should be used to generate earnings.

Surplus assets usually indicate an incorrect investment policy. Assets which are earning a smaller return for the corporation than the shareholders could obtain for themselves should be distributed in some form to the shareholders. Management and controlling shareholders should invest the assets of the corporation productively and pay dividends when no such investments can be found.

A challenge by shareholders to unproductive policies of a continuing corporation would typically come in the form of an allegation of

126. See Brudney, Dividends, Discretion, and Disclosure, 66 Va. L. Rev. 85, 86-87 (1980). One branch of the financial theory of dividends holds that dividends sometimes enhance the market value of shares even when the corporation could make more productive use of the funds than could its shareholders. See id. at 87-99. For a persuasive recent argument to this effect, see Bhattacharya, Imperfect information, dividend policy and "the bird in the hand" fallacy, 10 Bell. J. Econ. 259 (1979). If this aspect of the theory of dividends is accepted, the statement in the text follows a fortiori.

127. See Brudney, supra note 126, at 100-03. Directors and officers owe the corporation a duty of due care in the management of its affairs, H. HENN, supra note 1, at 453-55, which must include due care to use its resources productively. Cf. supra note 63 (potential liability when failure to liquidate corporation violates duty of due care).
underpayment of dividends. Such an attack is difficult to mount. The information needed to assess investment policy is in the control of management and is difficult to discover because it involves judgments about future earnings possibilities. If an attack is mounted, it is not likely to succeed. Controlling shareholders of a continuing corporation are regarded as having no conflict of interest as long as all shareholders are treated alike, and the controlling shareholders bear a pro rata share of any sacrifice in earnings occasioned by an unproductive investment policy. Relying on the business judgment rule, a court is unlikely to find that the failure to reinvest promptly assets which yield little benefit to the corporation is an abuse of the discretion granted to management.

It should be easier to challenge investment policies in an appraisal following a freezeout than in a suit seeking payment of dividends. Although it may be difficult to obtain sufficient evidence of the inner workings of the firm through discovery, a dissenter will often receive valuable information from the disclosures made by management as it executes a freezeout. Moreover, the corporation's past policies will no longer be tested by the business judgment rule. In freezeout mergers, a conflict of interest exists because the inside shareholders are treated differently from the outside shareholders. If corporations were valued on the basis of suboptimal previous policies, insiders would have an incentive to increase their profit by failing to make the maximum use of resources and therefore temporarily depressing corporate earnings. Management, therefore, should have the burden of proving in an appraisal proceeding that there are no gains to be realized from better use of the corporation's assets.

128. See Brudney, supra note 126, at 116-17.
129. See id. at 100 n.46, 104. Brudney argues that courts will avoid finding a conflict of interest, perhaps because of the difficulty of determining the correctness of a dividend policy. Id. at 104-05, 126-27 n.122.
130. See H. HinN, supra note 1, at 665-69. Judicial reluctance to find a violation may stem from the difficulty of the factual judgments involved and the uncertainty of the standards which should govern the payment of dividends. See Brudney, supra note 126, at 104-05.
131. See Brudney, supra note 29, at 75-76.
132. For an illustration of this situation, see infra notes 139-54 and accompanying text.
133. Continuing to operate a corporation when asset value exceeds earnings value is a special case of failure to maximize the value of a corporation. See supra notes 63-64 and accompanying text; infra note 219 and accompanying text. The market price of the shares of a corporation that should liquidate but is continuing to operate will probably be substantially less than the asset value. Market prices have been known to double or triple when companies have announced intentions to liquidate. Sloan, Beware the Sugar Bubble, FORBES, April 28, 1980, at 73.
134. Cf. Francis I. duPont & Co. v. Universal City Studios, Inc., 312 A.2d 344, 351 (Del. Ch. 1973), aff'd, 334 A.2d 216 (Del. 1973) (because of fiduciary duty, parent corporation had burden in
2. Recent Cases Illustrating Fact Pattern Three

A brief analysis of recent cases in which there were surplus assets illustrates how the use of the weighting method undervalues corporate stock under these conditions. As discussed above, in *Gibbons v. Schenley Industries, Inc.*, the court assigned a weight of zero to asset value. The assignment was incorrect for two reasons. First, the court's estimate of earnings value per share was less than the appraiser's estimate of asset value per share. A court should not accept an estimate of earnings value which is less than that of the asset value without determining whether the earnings value estimate is too low, whether the asset value estimate is too high, or whether the corporation should be liquidated.

Second, Schenley Industries, the company whose stock was being appraised in *Gibbons*, had surplus assets. A correct analysis would have added the value of the surplus assets to the earnings value of the corporation and compared that sum, the surplus-asset-plus-earnings-value, with the asset value of the company. Schenley's ownership of a large amount of surplus cash was judicially acknowledged nearly three years after *Gibbons* in *Cole v. Schenley Industries, Inc.*, a case that involved alleged violations of federal securities law during the freezeout.

In *Cole*, the minority shareholders alleged that the proxy statement for the merger failed to disclose adequately the amount of liquid assets unnecessary for Schenley's operations and the amounts of cash which Schenley would transfer to its parent, Glen Alden, after the merger of Schenley with a wholly-owned subsidiary of Glen Alden. The proxy statement reported that, about five months before the appraisal to prove that fee paid to it by the subsidiary was fair); Bell v. Kirby Lumber Corp., 413 A.2d 137, 143 (Del. 1980) (appraisal is to yield fair price within the context of the fiduciary duty of entire fairness owed by majority to minority).

135. *See supra* notes 120-22 and accompanying text.


137. The appraiser's estimate of earnings value per share, $52.78, exceeded his estimate of asset value, $49.33. *Id.* at 467. This is the relationship to be expected for an ongoing corporation. The *Gibbons* court lowered the earnings figure to $39.79, which was below the appraiser's estimate of asset value. *Id.* at 468-73. Nevertheless, the court did not address the question of whether the appraiser's estimate of asset value was too high or otherwise attempt to reconcile the inconsistency created.

138. *See supra* notes 47-64 and accompanying text.


140. 563 F.2d 35, 41-43 (2d Cir. 1977).
merger, Schenley had liquid assets of $162 million, or $20.25 per share,\textsuperscript{141} in cash, certificates of deposit, and marketable securities. By the time of the merger, Schenley had sold a wine company for $14 million in cash and marketable securities, and held an additional $16 million in not readily marketable debentures issued by its parent.\textsuperscript{142} At the time of the merger, Schenley apparently had over $190 million, or over $23.75 per share, in cash and securities, and most of those securities were highly liquid.

Some of those liquid assets were required to maintain adequate working capital.\textsuperscript{143} Information on Schenley's need for working capital is not available in any of the reported decisions concerning the merger, but it is reasonable to infer that the liquid assets obtained from disposing of entire businesses were unlikely to be needed in the remaining operations. The $14 million in liquid assets received for the wine company would fall into this category, as would the $90 to $95 million in liquid assets remaining from Schenley's sale of its Buckingham subsidiary just before the merger.\textsuperscript{144} Moreover, for the three years preceding the merger, Schenley's parent had been reducing Schenley's excessive inventories of unpopular brands of whiskey.\textsuperscript{145} Although the amount of cash thus realized cannot be determined from the opinions, that amount probably represented surplus liquid assets.

Another indicator of surplus liquid assets is the amount of cash Schenley transferred to its parent after Schenley merged into a wholly-owned subsidiary of the parent. The second paragraph of the proxy statement said in bold print that “in connection with the reorganization Schenley will transfer to [its parent] a substantial part of the proceeds received by Schenley from the recent sale of [Schenley's] subsidiary, The Buckingham Corporation.”\textsuperscript{146} The Cole court found that a shareholder could reasonably have concluded from the proxy statement that the parent's management intended to transfer to the parent between

\begin{itemize}
\item \textsuperscript{141} Id. at 40.
\item \textsuperscript{142} Id. at 40-41. Management contended that a registration statement had to be filed before the debentures could be sold, pursuant to § 5 of the Securities Act of 1933, 15 U.S.C. § 77e (1976). 563 F.2d at 41 n.11.
\item \textsuperscript{143} There is no discussion in Gibbons of any debt which had to be offset against earnings value or asset value, so it is assumed in the text that there was no significant debt against which surplus assets had to be applied. But cf. Cole, 563 F.2d at 41 (proxy statement for merger said that $10.5 million of the proceeds of the sale of Buckingham were to be used “to prepay some of Schenley's outstanding debts to insurance companies.”). If the assumption in the text is incorrect, appropriate adjustments in the calculations are necessary.
\item \textsuperscript{144} Cole, 563 F.2d at 40-41.
\item \textsuperscript{145} Gibbons, 359 A.2d at 466.
\item \textsuperscript{146} Cole, 563 F.2d at 41.
\end{itemize}
$47 million and $102 million from funds which were not needed for Schenley's operations.\textsuperscript{147} By the time of the \textit{Cole} trial in October 1975, five months after the \textit{Gibbons} decision, $75 million had been transferred from Schenley to its parent.\textsuperscript{148} Funds transferred from Schenley to its parent undoubtedly reflected surplus assets which should have been added to the earnings value of the ongoing corporation.

Whatever the correct figure for Schenley's surplus assets, it was a substantial amount per share. The lowest estimate of surplus asset value is $47 million, the amount which, according to the \textit{Cole} court, the proxy statement implied was Schenley's unneeded liquid assets. To translate this value into a per common share figure on a fully diluted basis, the total should be divided by the number of common shares, eight million.\textsuperscript{149} This represented over $5.88 per share that should have been added to a factfinder's estimate of earnings value per share from continuing operations.

A higher estimate of surplus assets per share might well have been correct. A second possible estimate is $12.75 per share, based on the finding in \textit{Cole} that the proxy statement implied that a transfer would be made to the parent of up to $102 million from funds not needed for Schenley's continuing operations. A third estimate can be derived from Schenley's possession of over $190 million in cash and securities at the time of the merger. Depending upon the requirements for working capital, surplus liquid assets might have exceeded $23.75 per share. Failure to take explicit account of surplus assets in valuing a corporation can obviously result in a serious underestimation of the true value.

The surplus-asset-plus-earnings value must be compared to asset value; best-use value is the higher of the two. If Schenley's earnings from continuing operations is taken to be the $39.79 per share estimate

\textsuperscript{147} \textit{Id.} at 42. The court found that a shareholder could have drawn this conclusion by comparing the proxy statement with the Plan and Agreement of Reorganization, which was an exhibit in the proxy statement. \textit{Id.} To ask the shareholder to follow this pattern of inference seems inconsistent with the holding of \textit{Mills} v. Electric Autolite Co., 403 F.2d 429, 432-35 (7th Cir. 1968), aff'd \textit{in part}, rev'd \textit{in part on other grounds}, 396 U.S. 375 (1970) (proxy statement which made assertions later qualified by statements in smaller print was deficient).

\textsuperscript{148} 563 F.2d at 43. \textit{Gibbons} was submitted to the Court of Chancery in January 1975 and was decided in May 1975. Presumably the amount of cash transferred by those dates was less than the figure given in text.

\textsuperscript{149} Outside shareholders seeking to enjoin the merger as unfair argued that the gross revenue of $120 million received from Schenley's sale of its Buckingham Corporation had a value per share of $15.00. This amount results from dividing the gross revenue by 8 million shares. David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30, 32 (Del. Ch. 1971). If some other divisor is appropriate to reflect the value per share of the surplus assets on a fully diluted basis, the figures in the text should be modified.
of earnings value in Gibbons, then addition of the minimum estimate of $5.88 per share in surplus liquid assets leads to a surplus-asset-plus-earnings value of $45.67 per share. This is less than the asset value of $49.33 per share, so best-use value would be $49.33.\textsuperscript{150} The second estimate of $12.75 per share, however, yields a surplus-asset-plus-earnings value of $52.54, which would than be the best-use value.\textsuperscript{151} The third and largest estimate of $23.75 in liquid assets produces a surplus-asset-plus-earnings value of $63.54, which represents a best-use value 88% higher than the appraisal value found by the court through the weighting method.\textsuperscript{152}

These estimates for best-use value are only tentative. A deduction for double counting must be made in each estimate, but additional information is needed to determine the proper amount of the deduction. The Gibbons court based its estimate of earnings value on Schenley's average earnings for the previous five years, which included the earnings from Buckingham and from the wine subsidiary,\textsuperscript{153} rather than on a prediction of Schenley's earnings from its continuing operations. To add an estimate of surplus liquid assets, which in part stemmed from the sale of Buckingham, to an estimate of earnings value which included Buckingham's earnings would be double counting. If historical earnings, rather than a direct prediction of future earnings,\textsuperscript{154} is to be used to estimate earnings value, then the portion of the historical earnings attributable to Buckingham and the wine subsidiary should be estimated and deducted from previous earnings. The general conclusion

\textsuperscript{150} Similarly, in Piemonte v. New Boston Corp., 377 Mass. 719, 734, 387 N.E.2d 1145, 1153 (1979), the surplus-asset-plus-earnings value was less than asset value. The subsidiary corporation being appraised had $5 million in excess liquid assets. Diluted over 224,892 shares, 377 Mass. at 729 n.10, 387 N.E.2d at 1151 n.10, this amounts to $22.22 per share. If $22.22 is added to the earnings value per share of $52.60, 377 Mass. at 726, 387 N.E.2d at 1149, the total is $74.82, less than the net asset value of $103.16. 377 Mass. at 722 n.3, 387 N.E.2d at 1148 n.3. The trial court used the existence of excess liquid assets as a justification for assigning a 50% weight to net asset value. If the estimate of asset value was correct, however, that should have been the value of the corporation; use of the weighting method, with only a 50% weight assigned to asset value, underestimates the value per share.

\textsuperscript{151} This estimate is close to the $53.33 per share received by Scheuley's founder, who held 18% of Schenley's common stock in March 1968. See Cole, 563 F.2d at 37.

\textsuperscript{152} This estimate should be compared to the price in the August 1968 tender offer by Glen Alden of $58.66 per share. See id. at 37-38. There is reason to expect that the true value will be at least as great as the price in a tender offer because of the cost involved in making a tender offer. See infra notes 242-45 and accompanying text. But cf. David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30, 34 (Del. Ch. 1971) (arguing that the intrinsic value was less than Glen Alden's tender offer price because the latter had been "distorted" by competition with a rival tender-offeror).

\textsuperscript{153} 339 A.2d at 468.

\textsuperscript{154} See supra notes 56-61 and accompanying text.
is unaltered, however: the best-use value of Schenley could not be determined reliably without an analysis of surplus-asset-plus-earnings value.

Corporations which must be appraised are more likely than corporations as a whole to have surplus assets. Companies which maintain liquid assets substantially above the amount needed for their operations are regarded as attractive targets for takeover attempts. A successful tender offer may be followed by a freezeout and an appraisal. A freezeout merger by the original management may also be precipitated if a corporation has significant surplus assets, whether liquid or not, or if its assets are otherwise failing to generate the earnings which could be obtained if they were used more productively.

Although the preceding discussion has drawn on the later Cole opinion, the facts discussed in Gibbons demonstrate that an appraiser or an outside shareholder will often be aware that surplus assets are present. The merger followed a tender offer for Schenley, perhaps motivated by the presence of the target company's surplus assets. In fact, the Gibbons court acknowledged that the opportunity to turn Schenley's surplus assets into cash had been the reason for a tender offer battle between Glen Alden and another large company. The court also recognized that during its three years of controlling Schenley, Glen Alden had been realizing cash by disposing of Schenley's inventories and collecting its receivables. Thus, the evidence in the record put both the appraiser and the court on notice that a correct valuation of the corporation would entail an analysis of the surplus assets.

A version of the correct analysis of the surplus assets case was advanced by the dissenting shareholders in Levin v. Midland-Ross Corp., but was rejected by the vice-chancellor. The management of the company had been liquidating plants, selling unneeded assets, including excess inventory, and preparing to sell other unused facilities and land during the period before the merger. The court found that earnings from continuing operations were $1.00 per share and that an appropriate multiplier was seven, resulting in an earnings value of

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155. See supra note 46 and accompanying text.
156. See supra note 133 and accompanying text.
157. See supra note 46 and accompanying text.
159. Id. at 466.
160. 194 A.2d 50 (Del. Ch. 1963).
161. Id. at 57.
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$7.00 per share.\textsuperscript{162} Excess liquid assets amounted to $16.70 per share.\textsuperscript{163} Other unneeded assets such as unused land and machinery, amounted to over $6.00 per share.\textsuperscript{164} Adding the unneeded asset value per share of at least $22.70 to the earnings value from continuing operations of $7.00 per share yields $29.70 per share.\textsuperscript{165} The court, however, using the weighting method, awarded only $24.71 per share.\textsuperscript{166} The dissenters in \textit{Levin} asked the court to determine the value of the corporation by adding the capitalized value of its manufacturing operations to the value of its unneeded assets.\textsuperscript{167} The court rejected this contention, relying solely on precedent. It cited \textit{In re General Realty \\& Utilities Corp.},\textsuperscript{168} an opinion in Vice-Chancellor Seitz refused to accept the proposition that appraisal value should never be less than asset value.\textsuperscript{169}

One recent decision, although grounded in the case's special circumstances, has applied the correct method of valuation for surplus assets. This occurred in the unreported Delaware appraisal opinion, \textit{In re Creole Petroleum Corp.},\textsuperscript{170} which did not discuss the earlier rejection of the correct approach in \textit{Levin}. The assets of a subsidiary, which had been used to produce and refine crude oil in Venezuela, were to be nationalized, but other assets not described by the court were to continue to be used in operations. The parent corporation, which had acquired 95.4\% of the common stock in 1961, executed a freezeout merger and dissenting shareholders obtained an appraisal. The vice-chancel-

\textsuperscript{162.} \textit{Id.} \\
\textsuperscript{163.} \textit{Id.} \\
\textsuperscript{164.} \textit{Id.} at 56-58. The court remarked that "there is no showing that [failure to invest the idle assets] was improper," although it acknowledged that the failure depressed earnings. \textit{Id.} at 56. It also remarked that "a non-productive dollar asset is worth less than a full dollar." \textit{Id.} at 58. The court erred in thus permitting insiders, through a lower appraisal award, to profit from failure either to invest the corporation's assets productively or distribute them to shareholders. See \textit{infra} text accompanying note 133; \textit{infra} notes 220-24 and accompanying text.

\textsuperscript{165.} 194 A.2d at 58. The court's estimate of asset value, $35.67, was even higher. \textit{Id.} at 57. If this estimate was valid, then total, rather than partial, liquidation was the best use of the corporation's assets, and the best-use value was $35.67. The court, however, affirmed the use of book value as the estimate of asset value, and there was evidence that book value exceeded liquidation value. \textit{Id.} at 54. Thus, the surplus-assets analysis may well have been correct.

\textsuperscript{166.} \textit{Id.} at 58. The court incorrectly attempted to take account of the presence of $22.70 per share of unneeded assets by reducing the weight for the low earnings value, pointing out that if earnings value were given a "maximum" weight of 50\%, the appraisal value would be only $17.30 per share. \textit{Id.} \\
\textsuperscript{167.} \textit{Id.} at 55-56. \\
\textsuperscript{168.} 29 Del. Ch. 480, 52 A.2d 6 (Del. Ch. 1947). \\
\textsuperscript{169.} \textit{Id.} at 498-99, 52 A.2d at 15. For criticism of that case, see \textit{infra} notes 269-301 and accompanying text.

lor affirmed the valuation of the appraiser, who had obtained the appraisal value by adding the value per share of the consideration to be received for the nationalized assets to the value per share of future earnings from continuing operations. The vice-chancellor's opinion, however, did not explain the reasons why this method of valuation was used. In fact, the vice-chancellor described the process as assigning a weight of 100% to asset value and 100% to future earnings value, even though what occurred was the addition of the values rather than the taking of a weighted average. He compounded this confusion by asserting that the process departed from Delaware precedent by assigning a weight of 100% to asset value when a maximum weight of 50% was preferred. The Delaware Supreme Court has cited Creole Petroleum as precedent for assigning a weight of 100% to asset value. Because of this confusion, Creole Petroleum is not likely to lead to an adoption of the correct appraisal method in Delaware.

III. PURPORTED JUSTIFICATIONS FOR THE WEIGHTING METHOD

As discussed above, the weighting method has been subjected to little criticism. Nevertheless, an apologist for the weighting method might offer several justifications for its use. In this section, six possible justifications for the weighting method are considered. First, the weighting method may be regarded as a compromise among several competing measures of the value of a security. The appeal of this justification lies in the tacit assumption that the weighting method achieves benefits similar to those of compromise in other decisionmaking contexts. This assumption is false, however, because the weighting method does not strike a legitimate compromise between independent estimates of the value of a security. Second, it can be argued that the weights represent the probabilities corresponding to each of the ways in which shareholders might have received the value generated by the corporation, had no merger taken place. The weights assigned in an appraisal case

171. Market value was found unreliable and therefore was given no weight. 3 Del. J. Corp. L. 606, 611 (1978).
172. Id. at 610-14.
173. Id. at 614. To further confuse the analysis, the vice-chancellor characterized the value of future earnings as an asset. Id. Historical earnings were assigned a weight of zero on the ground that nationalization would change the nature of the company's business. Id. at 611-12.
174. Former cases were distinguished on the ground that they did not apply to companies whose assets were being nationalized. Id. at 614.
175. Bell v. Kirby Lumber Corp., 413 A.2d 137, 142 (Del. 1980).
176. See infra notes 182-205 and accompanying text.
for a typical corporation, however, are poorly correlated with reasonable estimates of the probabilities of a shareholder receiving benefits through liquidation, sale of his shares on the market, or receipt of dividends. More significantly, this justification assumes that insiders should be able to dictate the terms on which outsiders will receive value for their shares, even where, as a result of the terms, the outsiders realize less than they would under a different course of action. The assumption that insiders should be able to dictate the terms in which outsiders will receive value for their shares is sometimes offered as a third independent justification for the weighting method. This assumption is inconsistent, however, with the fiduciary duty owed by controlling shareholders and management to the minority shareholders of a corporation. Fourth, it might be argued that the undervaluation of outsiders' shares which results from the use of the weighting method has the desirable effect of encouraging the takeover of badly managed corporations. Even if this argument justified a deliberate policy of awarding less than the fair value of the outsiders' shares, however, it would not support the use of the weighting method as a remedy which is supposed to yield fair values for corporate shares. Nor does the argument justify application of the weighting method of appraisal to a conflict-of-interest merger when there has not been an ouster of incumbent management through a takeover bid. Moreover, the argument goes too far: the undervaluation produced by the weighting method could create perverse incentives for unjustified takeover bids on corporations which have been well managed. Fifth, it may be argued that the freezeout benefits the outsiders, and that an appraisal remedy when the freezeout price exceeds the market price, which accurately values stock will discourage such freezeouts. An inadequate appraisal remedy, however, creates an opportunity for management to profit from the temporary misuse of resources when it would otherwise be in its interest to use those resources efficiently. If a remedy is needed for outside shareholders, a better one can be devised than freezeout at an unfair price. Finally, the weighting method is frequently justified by an appeal to judicial precedent. The cases which led to the development of the weighting method in Delaware, however, did not adequately consider whether the valuations which they produced were accurate. Moreover, the development of the weighting method de-

177. See infra notes 206-16 and accompanying text.
178. See infra notes 217-33 and accompanying text.
179. See infra notes 234-48 and accompanying text.
180. See infra notes 249-57 and accompanying text.
pended on language used in earlier cases without giving careful attention to the economic context in which the language was used. Because there is ample ground to conclude that Delaware appraisals are intended to produce accurate valuations, it would not violate principles of stare decisis for Delaware courts to abandon the use of the weighting method. 181

A. Purported Justification: The Weighting Method as Compromise

The weighting method appears to be a compromise among several different ways of measuring the value of a corporation. Both courts and commentators have invoked this intuitively appealing characteristic as a justification for weighting. Adopting the weighting method in a case of first impression, one court reasoned that "[h]aving determined the value of a share . . . by each method, the problem becomes one of weighing the various factors to reach a final result that properly takes into consideration all of the elements and factors involved in determining the fair value of a share . . . ." 182 In Bell v. Kirby Lumber Corp., 183 the Delaware Supreme Court stated that "[w]e feel as the Vice-Chancellor that the 40% weight assigned to asset value . . . and the 60% weight assigned to earnings value . . . fairly capture the situation . . . ." 184 A commentator in a survey of appraisal cases over ten years ago was more explicit:

Consideration of at least the three factors discussed [asset value, market value, and earnings value] helps to minimize the effect of defects in any one and to assure that no single computation will be determinant. Even if perfectly accurate values could be derived for assets, market, and earnings, the three figures will seldom be identical. Although each is a suitable measure of stock for certain purposes, each requires the appraiser to make different assumptions as to stockholder objectives.

Once the various elements have been computed, they must be balanced in order to arrive at a figure that will represent fair consideration for the dissenter's stock. The relative weights will necessarily vary according to the type of business involved and the special circumstances surrounding the particular company. Less weight should

181. See infra notes 258-334 and accompanying text.
183. 413 A.2d 137 (Del. 1980).
184. Id. at 146.
be given a particular element when the estimate of its value is unreliable . . . .

Another commentator characterized the weighting method as "able to uncover elements of value temporarily hidden by artificially low stock prices." 186

There are many kinds of compromise, with differing purposes and justifications. 187 At issue here is the validity of adopting a figure between what purport to be differing measures of the value of the corporation. 188 Michael O. Finkelstein has raised the general objection that a factfinder confronted with differing conclusions from competing statistical models should never strike a balance between the two. Instead, he should decide which model is correct and accept the conclusion of that model. 189

The choice of a value which lies between the estimates of two different models, though it might appear to a layman's rough sense of compromise to be supported by the results of each, is in reality consistent with the assumptions of neither, so that the compromise would lack any evidentiary support . . . . [Use of a compromise between the results of two or more models] suggests that personal judgment, rather than hard evidence, is the basis for [the] decision. 190

Finkelstein does not explain why it would be unreasonable for a factfinder to have doubts about the assumptions of different models, and yet average the results to reach a compromise. It would seem that a determination by the factfinder that approximates the result of a

185. Note, supra note 28, at 1468. The commentator, however, praised the requirement in Delaware that explicit weights be assigned "[to guard] against the possibility that the figures will be merely a compromise between the contentions of the parties or an intuitive judgment." Id. at 1469.

186. Arsht, supra note 14, at 1500.


189. Finkelstein, Regression Models in Administrative Proceedings, 86 HARV. L. REV. 1442, 1467-71 (1973). Finkelstein's argument is addressed to the problem faced by a decisionmaker who is presented with evidence which includes the results of two or more conflicting econometric studies. His objections seem applicable as well to a factfinder confronted with conflicting measures of the value of a corporation that are based on different methods of estimating value.

190. Id. at 1470 (emphasis added). In support of his argument, Finkelstein cites only a conversation with Herbert Robbins, Professor of Statistics at Columbia University. Id. at 1470 n.122. For a similar argument, see supra note 185.
model is consistent with that result and receives evidentiary support from that model. Moreover, a decision that is close to the results of several models might well be considered a judgment appropriate to the factfinder's role, rather than mere personal judgment.191

The propriety of striking a compromise in appropriate circumstances is supported by the statistical decision theory developed to solve the panel-of-experts problem, in which a decisionmaker is confronted by differing expert opinions about a numerical value on which a decision depends.192 One of the standard solutions to the panel-of-experts problem is to take a weighted average of the experts' opinions.193 The appraisal problem could be regarded as a panel-of-experts problem if it were valid to assume that the measures typically used—asset value, earnings value, and market value—are equivalent to expert opinions on the value of the corporation. If a method of measurement is theoretically valid and if no error can be found in the calculations,194 then it is reasonable to regard the figure resulting from the application of that method as providing valuable information about the disputed value and therefore to assign a positive weight to that figure.195

The problem with the weighting method as applied to appraisals is not that it is erroneous to strike a compromise among differing measures of the value of a corporation. The problem is that it is fallacious to assume that asset value and earnings value can measure simultaneously the true value of a corporation. When asset value and earnings value are unequal, only the higher of the two should be regarded as a meas-


192. See H. RAFFA, DECISION ANALYSIS 228-33 (1968) (discussing the more general problem where experts differ both as to which outcomes are more desirable and as to probabilities); Morris, supra note 94, at 293 (applying Bayesian statistical theory to measure the “joint information represented by the probability assessments of a panel of experts”).

193. H. RAFFA, supra note 192, at 230-33; Morris, supra note 94, at 679. For example, the International Time Bureau in Paris collects readings from various atomic clocks in government laboratories around the world. Official international time is an average of those readings, with some weighting in favor of the steadiest clocks. N. CALDER, EINSTEIN'S UNIVERSE 30 (1979).

194. Although Finkelstein's general theoretical objection is incorrect, it suggests a useful procedure. Before averaging differing estimates, or combining them in some other way, a decisionmaker should attempt to find out why the estimates differ and whether any errors have been made. Cf. supra notes 47-61 and accompanying text (estimation error as a possible explanation for calculations which find asset value to be greater than earnings value). Errors should be corrected individually, because it is unsound to assume that they will cancel out. See infra notes 197-205 and accompanying text.

195. A variation of the weighting method has been proposed, in which the decisionmaker would adjust the opinion of each expert in accordance with that expert's previous tendency to underestimate or overestimate. Morris, supra note 94, at 684.
ure of the corporation's value; the lower value is incorrect for the very reason that it is lower. This is because asset value and earnings value describe the results of alternative courses of conduct: liquidation or continuation of the corporation. Only one course of conduct will be taken, and it is the more valuable of these courses of conduct which is the true value of the corporation. A compromise between the values is clearly invalid and prejudicial to dissenting shareholders. Compromise by factfinders occurs frequently and often may be justified, but the weighting method does not produce a true compromise between independent measures of a corporation's value.196

A variant of the compromise justification is the belief that giving weight to one measure of value can correct an error in another measure of value. In 1966, Professor Herwitz pointed out that it seems that in every case where an asset value factor was included it exceeded the figure derived by capitalizing earnings and therefore resulted in increasing the final value figure. Thus inclusion of an asset value factor has had the effect, if not the purpose, of countering the possibility that too conservative a multiplier was used in capitalizing earnings.

On the other hand, in some circumstances the asset value factor could play the opposite role and offset an overly optimistic capitalization of earnings.197

Flaws in the argument that weighting will correct unspecified errors are illustrated by Chancellor Seitz's opinion in Felder v. Anderson, Clayton & Co.198 In that case, the dissenting shareholders objected to the appraiser's estimate of annual earnings which was the average of the company's earnings over the previous five years, a period that included a very large loss resulting from one year of drought. Because

196. It would be reasonable to take a weighted average of best-use value and market value if market value could be regarded as an unbiased estimate of the value of the firm. The weights would reflect the factfinder's relative confidence in best-use value and market value as estimates of the true value of the corporation being appraised. See supra notes 191-95 and accompanying text. There is good reason, however, to believe that the market price will be depressed in conflict-of-interest mergers. See supra note 29. If concentration of ownership has caused the threat of a freezeout to depress the market price, giving weight to that market price without correcting for bias would fulfill the market's prophecy that insiders can benefit at the expense of outsiders. See supra note 29 and accompanying text; infra notes 220-24 and accompanying text.

197. D. HERWITZ, supra note 49, at 25. See also Comment, supra note 79, at 430 ("[A]ssets ... provide a necessary counterweight to the other factors in the appraisal process."). Since Herwitz wrote in 1966, a nonzero weight has been assigned to an asset value which was below earnings value. See Francis I. duPont & Co. v. Universal City Studios, Inc., 312 A.2d 344 (Del. Ch. 1973), aff'd, 334 A.2d 216 (Del. 1975); supra text accompanying notes 109-19.

that was the only loss for the company during the previous ten years, the dissenters urged that the appraiser use a ten-year average, which would have lessened the impact of the one bad year. The chancellor acknowledged that "reasonable men might differ in the first instance as to what period should be employed to obtain average earnings," but affirmed the appraiser's use of a five-year period as within the range of reason.\footnote{39 Del. Ch. at 87, 159 A.2d at 284.} He added that, "[a]ny unfairness arising from the use of the [earnings from the bad year] can be offset in arriving at the ultimate weight given this factor."\footnote{Id.}

The appraiser had rejected depreciated reproduction cost as a measure of asset value because a capitalization of the income which could be earned from the assets indicated that their reproduction would be unprofitable. Nevertheless, the chancellor adopted depreciated reproduction cost as a standard for valuation. He admitted that "it may be that actual [asset] value is somewhat less," but argued that "that negative factor . . . can be taken care of by reducing the weight which would otherwise be given asset value in arriving at appraised value."\footnote{39 Del. Ch. at 84, 159 A.2d at 283. For similar language, see 39 Del. Ch. at 86, 159 A.2d at 284 ("In determining the ultimate weight given asset value the appraiser can 'discount' depreciated reproduction cost evidence and thus offset one of the dangers of its use."). The use of depreciated reproduction cost to measure asset value is an error which has been corrected in Delaware. \textit{See supra} notes 50-53 and accompanying text.}

Thus, the chancellor argued that an appropriate adjustment of the relative weights for asset value and earnings value would correct two different possible errors. On the one hand, the estimate of earnings value would be too low if the five-year period used in calculating annual earnings did not represent the typical earnings pattern of the firm. Correction of this error called for the assignment of a higher weight to the estimate of asset value, which exceeded the estimate of earnings value,\footnote{If asset value is below earnings value, it does not appear possible to correct an initial underestimation of earnings value by adjusting the relative weights of asset value and earnings value.} than was otherwise justified. On the other hand, the chancellor conceded that asset value might be overestimated. Correction of this error required the assignment of a lower weight to asset value and a correspondingly higher weight to earnings value than would otherwise be appropriate. To correct the first error, the relative weight for asset value should have been raised; to correct the second error, it should have been lowered. To make these adjustments accurately the magnitude of each error would have had to been considered. If the

\begin{itemize}
\item 199. 39 Del. Ch. at 87, 159 A.2d at 284.
\item 200. Id.
\item 201. 39 Del. Ch. at 84, 159 A.2d at 283. For similar language, see 39 Del. Ch. at 86, 159 A.2d at 284 ("In determining the ultimate weight given asset value the appraiser can 'discount' depreciated reproduction cost evidence and thus offset one of the dangers of its use."). The use of depreciated reproduction cost to measure asset value is an error which has been corrected in Delaware. \textit{See supra} notes 50-53 and accompanying text.
\item 202. If asset value is below earnings value, it does not appear possible to correct an initial underestimation of earnings value by adjusting the relative weights of asset value and earnings value.
\end{itemize}
adjustments require that the magnitude of each error be considered, the estimates should simply be corrected, rather than taking the additional step of adjusting weights.

The potential for confusion created in *Felder* by the court's attempt to correct indirectly errors with unspecified magnitudes through undisclosed alterations of weights was compounded by the chancellor's unwillingness to take a position on whether there were errors in the estimates. His statements on the issue were ambiguous: "It may be that actual [asset] value is somewhat less" and "any unfairness [in earnings value] can be offset." Such ambiguity creates the impression that the weighting method is a catch-all designed to assure the reader, and indeed the author, of an opinion that errors will cancel out, thereby making a careful examination of the valuation issue unnecessary. There is no justification, however, for assuming that errors will cancel out without an examination of their magnitude and direction. Once the magnitude and direction of the errors is calculated, the proper course of action is to adjust the estimated values directly, not to compensate by adjusting the weights.

**B. PURPORTED JUSTIFICATION: WEIGHTING REFLECTS THE PROBABILITIES OF LIQUIDATION OR CONTINUATION OF THE CORPORATION**

It might be argued that the weight attached to a value factor corresponds to the probability that the shareholder would have received that value had no merger taken place. That is, the weight assigned to market value might correspond to the probability that the shareholder would have sold her stock; the weight for earnings value to the probability that she would have retained her shares for a considerable period of time; and the weight for asset value to the probability of corporate liquidation.  

203. 39 Del. Ch. at 84, 159 A.2d at 283.
204. *Id.* at 87, 159 A.2d at 284.
205. An appraiser side-stepped resolution of the problems created when the estimated asset value greatly exceeds the estimated earnings value, writing: "Fortunately, I need not go extensively into this area because the present weighting of assets takes care of whatever disparity may exist between market price and asset value." Appraiser's Report at 38, Bell v. Kirby Lumber Corp., 413 A.2d 137, 145 (Del. 1980). The Delaware Supreme Court quoted this passage with approval. 413 A.2d at 145. See supra note 70-77 and accompanying text.
206. *Cf.* Note, supra note 28, at 1468-69 ("Although each [factor] is a suitable measure of stock for certain purposes, each requires the appraiser to make different assumptions as to stockholder objectives.")
This scenario would justify the use of weighting as an attempt to award the dissenting shareholder the expected value of the returns from owning the stock in the absence of a merger.\(^{207}\) This analysis is consistent with the language in some appraisal cases. For example, in determining the appropriate weight to be given to asset value, courts have questioned whether management had any plans to liquidate.\(^{208}\) In In re Delaware Racing Association,\(^ {209}\) the court assigned a relatively large weight to market value on the ground that the dissenting shareholder would probably have realized her returns from ownership by selling her stock if the merger had not taken place.\(^ {210}\)

In general, however, this justification is not consistent with the weights assigned in appraisal cases. For example, it is unlikely that the probability of liquidation for a continuing corporation whose earnings value exceeds its asset value is as high as the 12.5% assigned to asset value in Francis I. duPont & Co. v. Universal City Studios, Inc.,\(^ {211}\) and 12.5% is one of the lowest weights ever assigned to asset value in Delaware appraisal cases.\(^ {212}\)

A more significant weakness of this justification is that the probability should be zero that a properly managed corporation, when faced with the choice of liquidation or continued operation, will follow the less rewarding course of action.\(^ {213}\) Accordingly, an asset value which is below earnings value can only play a role if earnings value subsequently declines below the level of asset value,\(^ {214}\) and the earn-

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\(^{207}\) Expected value is the weighted sum of possible outcomes multiplied by the probability that each outcome will occur. The expected value is an important way to summarize a prediction of future earnings. See V. BRUDNEY & M. CHRELSTEIN, supra note 30, at 65.


\(^{209}\) 42 Del. Ch. 175, 206 A.2d 664 (Del. Ch.), aff'd, 42 Del. Ch. 406, 213 A.2d 203 (Del. 1965).

\(^{210}\) 42 Del. Ch. at 186, 206 A.2d at 670.

\(^{211}\) 334 A.2d 216, 218 (Del. 1975).

\(^{212}\) In assigning a zero weight to asset value in Gibbons v. Scheane Indus., Inc., 339 A.2d 460, 473 (Del. Ch. 1975) the court cited the weight of 12.5% assigned in Universal City Studios, 312 A.2d at 352. In that case, however, the parties agreed that the weight assigned to earnings value should be seven times that assigned to asset value. 312 A.2d at 352. For criticism of the assignment of zero weight to asset value in Gibbons see supra notes 137-59 and accompanying text. A survey of appraisal cases lists no case besides Gibbons and Universal City Studios with an asset value weight below 20%. Note, supra note 6, at 641-42.

\(^{213}\) Striking a weighted average of earnings value and asset value is thus incorrect. Taking a weighted average of best-use value and market value, with the weights reflecting the relative probability that a shareholder would choose to realize the market value by selling her stock rather than holding it, might be defensible if market price were untainted by the presence of a conflict of interest. The market price is tainted, however. See supra notes 29, 196.

\(^{214}\) The estimate of best-use value should reflect protection against disaster provided by an
ings value estimate should already reflect the possibility of that occurring.215 A corporation whose properly measured asset value exceeds properly measured earnings value should be liquidated. For such a corporation, the probability of realizing asset value should be 100%,216 on the assumption that management will act to realize the highest value of the corporation.

C. PURPORTED JUSTIFICATION: OUTSIDE SHAREHOLDERS HAVE NO RIGHTS TO HAVE THE ASSETS LIQUIDATED EVEN IF LIQUIDATION WOULD BE ADVANTAGEOUS TO THE CORPORATION

A more extreme version of the notion that the weight for asset value should depend on whether management had plans to liquidate the corporation is built on the contention that even if asset value exceeds earnings value, outside shareholders have no power to compel liquidation. For example, in In re Behrens,217 where asset value exceeded earnings value, the following argument was advanced as an alternative basis for the decision:

Assuming, as the Court does on the basis of the record, that the company could be liquidated to produce the valuations for the preferred and common stocks attributed to them by the appraisers, the fact remains that this company was not to be liquidated; that petitioners had no expectation or right to have it liquidated or considered on a liquidating basis. The company was engaged in an operating business, with its assets employed at the risks of the business, with the hope, of course, that the operations would make the investment profitable, although it had not been altogether profitable in the past.218

As a general rule management has a fiduciary duty of due care to

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215. See supra notes 99-100 and accompanying text.
216. Yet 60% has been the highest weight for asset value in Delaware even where asset value exceeded earnings value. See Note, supra note 6, at 641-42. Indeed, in Levin v. Midland-Ross Corp., 41 Del. Ch. 276, 289, 194 A.2d 50, 58 (Del. Ch. 1963), the appraiser's weight for asset value was reduced from 60% to 50% because no previous Delaware case had assigned a weight greater than 50%. In Bell v. Kirby Lumber Corp., 413 A.2d 137, 143 (Del. 1980), the court asserted that asset value had been assigned a weight of 100% in In re Creole Petroleum Corp., C.A. No. 4860 (Del. Ch. Jan. 11, 1978), reprinted in 3 Del. J. Corp. L. 606 (1978). This assertion is incorrect. The vice-chancellor in Creole spoke of giving a 100% weight to nonoperating assets and a 100% weight to the present value of future earnings from operating assets, 3 Del. J. Corp. L. at 612-14, but the two figures were simply added. See supra notes 170-75 and accompanying text.
218. 61 N.Y.S.2d at 183.
the corporation. In the normal course of corporate conduct, however, the business judgment rule shields management from lawsuits alleging a breach of this fiduciary duty. A complaint alleging that management has failed to pursue the course of conduct which is most advantageous to the corporation will be dismissed unless there is a showing of fraud, conflict of interest or gross abuse of discretion. The business judgment rule, however, has no proper place in appraisal proceedings because the vast majority of appraisals involve a conflict of interest, i.e., a freezeout. In other words, whether or not the business judgment rule shields management from liability when the failure to liquidate harms all shareholders equally, a freezeout is a fundamentally different case: management has isolated an identifiable minority for disparate treatment. The consequence must be that management is obliged to treat the minority fairly, including paying the asset value for their shares if corporate liquidation is objectively the most profitable alternative.

Also, the business judgment rule has been justified on the grounds that it will prevent overcrowding of courts, and that courts are not competent to review the questions involved in corporate decisions. Such justifications are inapplicable to appraisal proceedings, however, because in these proceedings the dispute is already before the court and the court has the obligation to determine the corporation's value. Management's conflict of interest in a freezeout is readily apparent; they retain the option of switching the resources of the corporation into their most profitable use after the appraisal has been completed. Judicial tolerance of such self-dealing, implicit in the weighting method, permits management to take advantage of a failure to use the resources of a corporation to best advantage and creates an incentive to operate


221. See supra note 6 and accompanying text.


223. Cf. supra note 87 (liquidation of subsidiary six years after going-private tender offer at large premium over tender price).
the company inefficiently before a freezeout takes place, thus violating the fiduciary duty of due care.

The attempted justification discussed in this section concedes that a corporation's assets would be more valuable if liquidated, but asserts nonetheless that it is proper for the majority to force the outsiders to accept less than asset value. Outrageous as the argument is, a variant was recently advanced by the defendant corporation in Bell v. Kirby Lumber Corp. The argument succeeded at each level of decision in reducing the appraised value of the corporation's common stock. In the proceedings before the appraiser, the corporation drew on the testimony of a prominent investment banker to argue that without a sale, liquidation, or merger, the minority was "locked in" and would have been restricted to earnings and dividends until such an event took place. The appraiser found a per share asset value of $456, which greatly exceeded the per share earnings value of $120. He also concluded that the assets "could have been fairly quickly liquidated had the management wished to do so." In effect the corporation was arguing that the outside shareholders were restricted to the receipts generated by the course of action chosen by management, even though the evidence indicated that this course of action was disadvantageous.

The appraiser implied that his choice of weights for asset value and earnings value was influenced by the corporation's argument. After summarizing the appraiser's discussion of the "locked-in" argument, the vice-chancellor expressed no disagreement: "I find myself in a position wherein I can find no solid justification for deviating from the weightings assigned by the Appraiser." At the second stage of review, the Delaware Supreme Court apparently adopted the proposition that the assets of the corporation should be valued on the basis of the use to which management was currently putting them rather than the use to which they should be put:

Santa Fe, as the holder of 95% of Kirby's outstanding stock had the power to do with Kirby whatever it chose. Based upon the [most optimistic] appraisal of assets [rejected by the appraiser] it could have

225. 413 A.2d 137 (Del. 1980).
227. Id. at 39.
228. Id. at 37.
229. Id.
230. Bell v. Kirby Lumber Corp., 395 A.2d 730, 740 (Del. Ch. 1978), aff'd, 413 A.2d 137 (Del. 1980). The court may have been paraphrasing the outsiders' arguments in this passage, however, rather than taking a position of its own.
liquidated Kirby and realized approximately $670 per share for each stockholder. It could have negotiated a merger with an unrelated corporation; or it could have permitted the minority to continue in the corporation for better or for worse. Instead Santa Fe chose to cash out the minority because the price of the minority stock was as low as Santa Fe management could anticipate under existing market conditions. 231

The supreme court then concurred with the vice-chancellor’s affirmation of the appraiser’s conclusions as to weights. 232 The court disregarded the inconsistency between this conclusion and its earlier declaration that an appraisal proceeding must be conducted within the context of the fiduciary duty of entire fairness owed by the majority shareholders to the minority. 233

D. PURPORTED JUSTIFICATION: ENCOURAGEMENT OF TENDER OFFERS FOR POORLY MANAGED COMPANIES

Economists Grossman and Hart have argued that after a successful tender offer for control of a corporation, a freezeout of the outsiders for a price less than the best-use value of their shares should be permitted. 234 Analogously, it may be argued that the award in an appraisal following a tender offer and freezeout should also be below the true value. 235 This argument presupposes that the management of a corporation may fail to make the best use of its resources resulting in a waste of society’s resources. 236 In such a situation, the shareholders who have an interest in correcting the inefficiency have few effective remedies. Proxy fights have so many limitations that they are seldom

231. 413 A.2d at 140.
232. Id. at 146. In his concurring opinion, Justice Quillen expressed doubts about the measurement of the earnings value, but agreed that “the Appraiser’s weighting of earning value and asset value, carefully reviewed by the vice-chancellor, was within the permissible realm of reasonable judgment.” Id. at 151 (Quillen, J., concurring).
233. Id. at 140.
236. A statistical analysis of cash tender offers from January 1956 to June 1974 found that the shares in firms which had resisted the tender offer had experienced returns significantly below what would otherwise have been expected in the period from 24 months to four months before the offer. Kummer & Hoffmeister, Valuation Consequences of Cash Tender Offers, 33 FIN., 505, 506-07, 511 (1978).
237. Economists have generally focused their attention on allocative efficiency—the proper distribution of resources among firms—rather than on what Professor Leibenstein has called “X-efficiency”: the proper use of resources within a firm. The waste described in text would be an example of X-inefficiency. Leibenstein argues that X-inefficiency may be a more important source of waste than allocative inefficiency. See H. LEIBENSTEIN, BEYOND ECONOMIC MAN 29-47 (1976).
undertaken. The business judgment rule effectively prevents most shareholder suits. If dissatisfied shareholders simply sell the stock of a mismanaged corporation, the market price will reflect the current inefficient use of the corporation's resources, and pressure on management to improve its performance is reduced. Thus, it is argued, a takeover bid is a valuable device through which inefficient management can be replaced by a management which is prepared to use the corporation's resources more effectively. The mere possibility of a successful takeover bid will generate pressure on management to increase efficiency.

This control on inefficient management is imperfect, however, because a takeover attempt is costly and risky. A hostile tender offer for control will be made only when a raider believes that the profit it can obtain from improving the performance of the target company will justify the costs and risk involved. Grossman and Hart argue that if outside shareholders are able at the second step of a two-step takeover, such as a freezeout, a merger after a tender offer, to obtain more than the original tender price, a "free-rider" effect will result, with the nontendering outsiders capturing part of the benefits of the takeover without bearing any of its costs. Some takeovers, which would otherwise be worthwhile, will not be undertaken if some of the gains which result can be captured by free riders. Other attempted takeovers may fail if enough minority shareholders attempt to free ride, wrongly guess that the raiders will succeed, and therefore refuse to tender.

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239. See supra note 220 and accompanying text.


242. See R. WINTERS, *GOVERNMENT AND THE CORPORATION* 21-24 (1978); Smiley, *Tender Offers, Transactions Costs and the Theory of the Firm*, 58 REV. ECON. & STATISTICS 22, 22-23, 29-31 (1976) (evidence that the threat of takeover tends to assure only that a firm is operated at about 86% of the value it would have if its resources were used optimally); Smiley, *The Effect of the Williams Amendment and Other Factors on Transactions Costs in Tender Offers*, 3 INDUS. ORGANIZATION REV. 138, 138-45 (1975).


An appraisal remedy which permits dissenters from the second step of a two-step takeover to obtain the true value of their shares would encourage free riders because the true value will exceed the tender prices unless the raider has miscalculated the true value. The Grossman-Hart argument thus applies to any appraisal remedy which awards true value of a share. This argument might justify an explicit change in the law to deny an appraisal remedy at the second step of a two-step takeover so that tender offers would not be chilled. For example, the Brudney-Chirelstein proposal might be adopted, under which outsiders may be lawfully frozen out at the second step of a two-step takeover if the freezeout price is at least equal to the original tender offer price. At present, however, a dissenter from a merger is entitled, through an appraisal, to the true value of her shares whether or not the merger is the second step of a two-step takeover. The Grossman-Hart argument, in any event, does not justify avoiding the free rider effect through the use of the weighting method. Even if it were decided that in a two-step merger dissenting shareholders should receive less than the true value of their shares, there would be little justification for use of the weighting method. The weighting method undervalues shares by an arbitrary amount, unrelated to the amount by which, that under the Grossman-Hart argument, the award to shareholders should fall short of the true value. Moreover, at the second step of a two-step merger, use of the weighting method, or of any rule that might permit a freezeout at a lower price than the tender price, creates at least the possibility that excessive encouragement will be given to takeovers. The takeover of a well-managed company might be profitable at a tender price above the true value of the shares, if a freezeout could later be accomplished at a price sufficiently below true value.

246. Development of a mechanism other than tender offers by which outside common shareholders could force insiders to maximize the value of the corporation might make it unnecessary to improve the tender offer mechanism. Cf. supra notes 128-30 and accompanying text (possibilities and limitations of derivative suit to compel dividend payments as such a mechanism).

247. Brudney & Chirelstein, supra note 11, at 1359-62; Brudney & Chirelstein, supra note 9, at 336-40.

248. Cf. supra text accompanying note 64 (underestimation of true value by use of the weighting method implies failure to deter a breach of fiduciary duty in a conflict-of-interest merger). Grossman and Hart point out that as "dilution," the permissible gap between the permissible freezeout price and the true value of a share, increases, the benefit to shareholders from encouraging takeovers when management is inefficient must be balanced against the cost of receiving a lower price in a successful tender. They argue that there is an optimal amount of dilution, which maximizes the value of a share. Grossman & Hart, supra note 234, at 44-54, 59-60.
E. **Purported Justification: Encouragement of Freezeouts of “Locked-In” Outsiders**

Some commentators have argued that a freezeout can be advantageous to outsiders if there is little opportunity for them otherwise to sell their shares, especially if the freezeout price is above the market price. An appraisal remedy that properly values outsiders’ shares would tend to discourage freezeouts, and thus arguably would deprive “locked-in” outsiders of opportunities to escape from ownership of their shares.

The immediate answer to this argument is that appraisals are not intended to encourage insiders to buy out “locked-in” outsiders at a bargain price; they are intended to award dissenters the fair value of their shares. The argument faces other difficulties as well. First, even if prevention of freezeouts at a price less than best-use value brings a putative disadvantage to outsiders, it also brings significant advantages: forced exchanges to which outsiders would object are discouraged, and a perverse incentive toward temporary mismanagement is removed. Second, outsiders may fare better if they are “locked-in” than if freezeouts at bargain prices occur. A derivative suit, the threat of a derivative suit, or the development of another remedy might correct defects in management. For example, a third party might make a satisfactory tender offer or the legitimate synergistic advantages of a freezeout might lead insiders to propose one on fair terms. Third,


250. Hetherington, supra note 10, at 240, 251-52. Cf. *Cash Tender Offers*, supra note 238, at 241-43 (a tender offer for less than liquidation value but more than market price might be advantageous to outsiders).

251. Sportswriter Red Smith told a story about the “Deacon,” a boxing manager celebrated for his righteousness and shrewdness. The Deacon, conversing with a reporter in a hotel lobby late one night, was consulted by the house detective. “Sir, I just rolled a drunk for everything he had in his wallet, and now I’m wondering whether I did right.” “How much money,” the Deacon asked, “did he have?” “Two hundred dollars,” said the detective. “Put one hundred back in his wallet, and when he soberes up, he’ll think that he spent the rest,” was the Deacon’s advice. The detective expressed his thanks and rushed off to follow this advice. The Deacon turned to the reporter and said with a sigh, “In this wicked world, one does what one can.”

Like the drunk who got half his money back, the outsider might be better off with an unfair freezeout than she would be if she continued to be locked in a minority position. Half a loaf is better than none.

252. See supra note 224 and accompanying text.

253. Brudney & Chirelstein, supra note 11, at 1369.

254. See supra notes 127-30 and accompanying text.

255. See supra note 246.

256. Cf. Brudney, *Standards of Fairness and the Limits of Preferred Stock Modifications*, 26 Rutgers L. Rev. 445, 472, 475-76 (1973) (although additional protection of preferred shareholders might discourage some recapitalizations proposed by the common shareholders which would
the appropriate redress for "locked-in" outsiders is not a valuation formula which encourages unfair freezeouts but a remedy which permits outsiders to escape ownership on fair terms. If outsiders are willing to sell their locked-in shares at less than the best-use value of the corporation, they may bargain with insiders to do so, but the law should not impose such a bargain upon them.

F. PURPORTED JUSTIFICATION: PRECEDENT

The case law on valuation under the Delaware appraisal statute began with *Chicago Corp. v. Munds*. There, dissenting holders of convertible preferred stock objected to the appraisers' valuation, which was based solely on market value. The chancellor held that market price would not be adopted as the exclusive measure of value under the appraisal statute, because market price is not always an accurate indicator of true worth. Approving the view that "appraisers, having made a full examination of the status of the company and its prospects, are in a better position to gauge the fair value of the stock than the outside public," the chancellor emphasized that his holding was limited to the rejection of market value as the sole determinant of share value: "The instant case calls for an answer to the narrow question—is 'value' to be measured exclusively by market quotations when the same are available? The conclusion of the court is that it is not."

In response to the contention of the dissenters that their stock should be appraised on the basis of asset value, the chancellor remarked that to adopt this as a general rule would "[leave] out of account all the elements which contribute to value as incidental to a going enterprise." This objection to the use of asset value as a determinant for appraisal implicitly assumes that asset value is less than earnings value. Later cases ignored this assumption and cited *Munds* for the proposition that the value of a corporation can never be equal to

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257. Cf. Hetherington & Dooley, Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem, 63 Va. L. Rev. 1, 52-59 (1977) (statute proposed under which an outside shareholder in a solvent corporation whose stock is not listed or regularly quoted over-the-counter could require the corporation to buy her shares). The proposed statute should be modified to prohibit use of the weighting method. *Contra id.* at 57.
258. 20 Del. Ch. 142, 172 A. 452 (1934).
259. *Id.* at 151-55, 172 A. at 455-57.
260. *Id.* at 153, 172 A. at 456.
261. *Id.* at 154, 172 A. at 457.
262. *Id.* at 150, 172 A. at 455.
its asset value. This later misuse of the chancellor's opinion disregarded his carefully drawn limitation on the scope of his remarks: "Market value undoubtedly is a pertinent consideration. So is net asset value. Neither, however, deserves necessarily to be accepted as exclusive." 264

Judicial misuse of the Munds holding began with the appraisal of preferred stock in Root v. York Corp., 265 in which a different chancellor relied solely on Munds for the proposition that in an appraisal, "[n]either the net asset value nor any other single factor could be the controlling element." 266 With seeming approval, the Root opinion summarized expert testimony offered by the corporation to the effect that there is little correlation between intrinsic value and asset value of stock, including an expert's assertion that:

[In my opinion, assets are not of any great importance in determining the value of the stock . . . because after all the purposes of assets is to have earning power and if the Company does not have earning power it does not have earning power however great its assets may be. 267

This statement would have been incorrect if it had been addressed to the valuation of a corporation, because asset value is the best-use value of a corporation which has no earnings value. Indeed, asset value is unimportant to value only if earnings value is greater. 268 There is some truth to the statement, however, with respect to the valuation of preferred stock, and all of the corporation's experts emphasized that they were limiting their testimony to the value of the stock as opposed to the value of the corporation. 269 Preferred shareholders are not assured of receiving at least the asset value of their stock; common shareholders may block a liquidation that would maximize the value of the corporation, in order to avoid the liquidation preference of the preferred stock until the preferred shareholders have agreed to give up part of their claim. 270 Even if earnings value of the corporation exceeded asset

263. See infra note 275 and accompanying text; infra text accompanying note 304. The court in Munds asserted that there may be some corporations which should not be valued at their asset values. See infra text accompanying note 264. The transformation to the proposition that no corporation should be valued at its asset value is an elementary error in logic. See L. COPI, SYMBOLOGIC LOGIC 67-69 (1973).
264. 20 Del. Ch. at 55, 172 A. at 457 (emphasis added).
265. 29 Del. Ch. 351, 50 A.2d 52 (1946).
266. Id. at 359, 50 A.2d at 56.
267. Id. at 361, 50 A.2d at 57 (emphasis added).
268. See supra notes 96-106 and accompanying text.
269. 29 Del. Ch. at 361-62, 50 A.2d at 57.
270. See, e.g., Barrett v. Denver Tramway Corp., 53 F. Supp. 198, 204-05 (D. Del.), aff'd, 146
value, the preferred shareholders might receive less than their claim on asset value through delay of the common shareholders in paying off arrearages. The value of the future receipts of the preferred shareholders is dependent on the rate at which the common shareholders are expected to be able and willing to use earnings of the corporation to pay off arrearages on the preferred. Because the issue before the court was the value of preferred shares with substantial arrearages, the court's remarks do not constitute a holding that the value of a corporation may be lower than its asset value. Indeed, the proposition that the value of a corporation must be at least as high as its asset value was apparently not advanced by its dissenters.

The only Delaware case which has considered that proposition is In re General Realty & Utilities Corp. There, the appraiser had found market value per preferred share to be $90; asset value per share to be $129.61; and earnings value per share to be $83. The appraiser decided on a per share value of $120, without explaining the precise derivation of this result. As part of his conclusion, the appraiser reasoned:

"It certainly cannot be said that the intrinsic value of any shareholder's interest in a going Corporation at a given time is less than he could realize for it upon a liquidation of the Corporation's assets at that time. If that be the situation in any Corporation, surely its time for liquidation has arrived.

Even in a struggle between preferred and common shareholders, the expert's claim that "assets are not of any great importance in determining the value of the stock" is still inaccurate because asset value would be a subject of the bargaining between common and preferred.

271. The investment value standard; developed to test the fairness of recapitalizations and required under the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (1976), would measure the value of preferred stock by the present value of the dividends expected to be paid under the strong assumption that arrearages will be paid back with future earnings as quickly as possible. See In re Eastern Gas & Fuel Assoc., 30 S.E.C. 834, 910, 913, 919 (1950). Arrearages might well be paid at a rate slower than assumed. The investment value standard has been proposed as a test of the fairness of voluntary recapitalizations affecting preferred stock. See authorities cited in Brudney, supra note 256, at 468 n.55. Professor Brudney advocates the liquidation preference as a measure of the claims of preferred shareholders once a voluntary recapitalization is proposed. Id. passim.

In any event, the effect on the value of preferred shares of the inability of preferred shareholders to force payment of arrearages, or of dividends as they come due, cannot be measured by taking a weighted average of earnings value and asset value.

272. 29 Del. Ch. 480, 52 A.2d 6 (Del. Ch. 1947).

273. Id. at 497, 52 A.2d at 14 (emphasis in original). This language should perhaps be quali-
This cogent statement of a general principle of valuation was rejected by Chancellor Seitz, who relied solely on precedent:

[T]he Appraiser indicated that the "intrinsic value" of a stockholder's shares in a going concern should always be more than their . . . liquidating value, and if the situation is otherwise, he suggests that the Corporation is a proper subject for liquidation. I cannot believe the Appraiser intended to convey the thought that the appraised value of shares under our statute should never be less than their hypothetical liquidating value because such is not the law. As the New York court recently said in Application of Behrens . . . :

"Net asset value is entitled to weight, but it must be remembered that an appraisal is not a liquidation, and that the stock must be appraised on a going concern basis (Matter of Fulton) with the possibility in different cases that the value of the stock may be substantially above or below net asset or break-up value. National Bank of Commerce v. City of New Bedford; Lebold v. Inland S. S. Co."

Such a result is implicit in the language of the court in Chicago Corporation v. Munds. See also Jones v. Healy.\(^{274}\)

Although this passage implied that the law was settled, only one directly supporting authority\(^{275}\) was cited, In re Behrens,\(^{276}\) a New York trial court decision. The significance of the material quoted from Behrens was limited by the fact that preferred shares were being appraised.\(^{277}\) In declining to award the full amount of net asset value,\(^{278}\)
the *Behrens* court noted that the preferred shareholders were subject to delays, risks, and limitations on potential payments if the corporation was not liquidated. Furthermore, the dividend rate on the preferred shares was below the current market rate for other preferred stock which had a greater probability of paying dividends. In addition, the stock in *Behrens* was callable at a price which set a ceiling on the possible return from holding the shares.\footnote{279}

The language from *Behrens* relied solely on precedent, without any discussion of the principles of financial analysis, and furthermore, the precedent was misused by the court. A New York case, *In re Fulton*,\footnote{280} was the only authority cited for the assertion that "an appraisal is not a liquidation, and . . . the stock must be appraised on a going-concern basis."\footnote{281} The court in *In re Fulton*, however, did not say that stock must be appraised on a going-concern basis when a higher value could be realized by the sale of the corporation's assets. The case merely held that a New York appraisal of a corporation that had been dissolved was not governed by a formula adopted by the United States Supreme Court for valuing preferred shares.\footnote{282} The rejected formula treated preferred and common shares as equivalent by dividing the sun of the capital stock and the surplus by the total number of shares, both common and preferred.\footnote{283} Thus, *In re Fulton* addressed the standard by which the claims of a preferred shareholder, as compared to those of a common shareholder, should be measured in an appraisal. As to the valuation of the corporation, *In re Fulton* merely said that appraisers should consider those economic factors which are relevant in the circumstances, giving each factor "such consideration as to them seems proper . . . ."\footnote{284} The misuse of *In re Fulton* in *Behrens* is made apparent by the statement in *In re Fulton* that the per share value of the applicable assets was "the only factor to

\[\text{whether the merger price is likely to represent a fair valuation. See supra note 27 and accompanying text.} \]

In fact, there was a conflict of interest: the corporation whose shareholders dissented in *Behrens* was a subsidiary of its merger partner. *Moody's Manual of Investments, Industrial Securities* 1595 (1945).

\footnote{278. The court conceded, however, that, "In some cases the appraisal may come out at or close to market value, and in others at or close to net asset value." 61 N.Y.S.2d at 183.}

\footnote{279. Id. at 154. This argument is sufficient to support the result of *Behrens*. See supra notes 270-71 and accompanying text; infra text accompanying notes 299-301.}

\footnote{280. 257 N.Y. 487, 178 N.E. 766 (1931).}

\footnote{281. 61 N.Y.S.2d at 183.}

\footnote{282. Continental Ins. Co. v. United States, 259 U.S. 156 (1922).}

\footnote{283. 257 N.Y. at 490-96, 178 N.E. at 767-69.}

\footnote{284. Id. at 495, 178 N.E. at 769.}
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consider under the facts in this case—virtually a direct contradiction of the proposition for which it was cited in Behrens.

The court in Behrens cited two other authorities for the proposition that there is a "possibility in different cases that the value of the stock may be substantially above or below net asset or break-up value." The first part of the proposition is obviously correct: the intrinsic value of stock may be substantially above net asset value. No explanation other than the authority of the two cases was offered for the second part of the proposition, however, and in fact, no explanation is possible: stock can never be less valuable than its asset value. The first case, National Bank of Commerce v. City of New Bedford, held that assessment of the state corporate franchise tax should be based on market value of the shares if a corporation's operations were being continued, even if the liquidation value per share was higher. The decision was based on statutory interpretation. An alternative ground was available, but it was not discussed by the court. The history of Massachusetts taxing statutes provided good reason to regard the statute in question as contemplating assessment of the franchise tax on the basis of market value of the corporation's shares.

285. Id. at 494, 178 N.E. at 769. The statement is dictum, however, because the court valued the preferred stock at par, basing its conclusion on an examination of the capital stock account of the corporation. Id. at 495, 178 N.E. at 769.

286. 61 N.Y.S.2d at 183.

287. The second part of the proposition may of course be true for preferred stock, for reasons that the Behrens court advanced in another part of the opinion. See supra notes 277-79 and accompanying text; infra text accompanying notes 299-301.


289. Id. at 314-15, 29 N.E. at 533. Holmes did say that if the corporation was to continue in business, market value was "the full amount of cash that could be got or ought to be got for a share," Id. at 315, 29 N.E. at 533. Holmes was addressing, in a dispute between a corporation and the taxing authorities, the question of whether market value should be used as a standard under a particular statute even though it was less than asset value. His remarks could not constitute approval of an assertion by management that the true value of a corporation is less than the amount realizable by liquidation. From the facts given in the opinion, it is impossible even to determine whether earnings value, and thus best-use value, exceeded asset value.

290. Id. at 314-15, 29 N.E. at 533. Holmes did say that if the corporation was to continue in business, market value was "the full amount of cash that could be got or ought to be got for a share," Id. at 315, 29 N.E. at 533. Holmes was addressing, in a dispute between a corporation and the taxing authorities, the question of whether market value should be used as a standard under a particular statute even though it was less than asset value. His remarks could not constitute approval of an assertion by management that the true value of a corporation is less than the amount realizable by liquidation. From the facts given in the opinion, it is impossible even to determine whether earnings value, and thus best-use value, exceeded asset value.

291. The statute construed in National Bank of Commerce required that a corporation be assessed on the basis of the "fair cash value" of its shares. 155 Mass. at 314, 29 N.E. at 532. Similar Massachusetts statutes providing for taxation of corporations on the basis of "fair cash valuation" of its shares had already been definitively interpreted as calling for assessment based on market value of the shares. For a discussion of the history of the statutes, see Commissioner of Corps. & Taxation v. Boston Edison Co., 310 Mass. 674, 679-94, 39 N.E.2d 584, 588-95 (1942). The Massachusetts corporate tax under both the state and federal constitutions had been held to be valid only if based on market value of the corporation's shares, rather than on its property. Commonwealth v. Hamilton Mfg. Co., 94 Mass. (1 Allen) 298, 301-04, 306-07 (1866), aff'd, 73 U.S. 632 (1867).
The second case cited in Behrens, Lebold v. Inland Steel, merely held that the true value of a corporation may be less than or greater than its book value. This, of course, is correct because book value is usually the result of accounting conventions and bears little relation to the intrinsic value of a corporation. Moreover, the Lebold court held it was error for the lower court to refuse to consider the high earnings value of the corporation, which was "a going prosperous concern." The Lebold opinion thus correctly analyzed a situation in which earnings value exceeded asset value, so that the true value also exceeded asset value. Citing that opinion for the proposition that the true value of a corporation may be less than asset value, as Behrens did, was highly misleading.

Thus, both General Realty and the case on which it heavily relied, Behrens, were based on a misreading of precedent. Both cases ignored or misconstrued language consistent with the proposition of selecting asset value as the value of the corporation when asset value is higher than earnings value. Cases with narrow holdings, involving statutory construction or compromise between asset value and market value of a closed-end investment company were erroneously given broad readings.

Moreover, in both Behrens and General Realty a special circumstance existed: the stock appraised at less than asset value was preferred stock. Unlike common stock, the limited nature of the rights of the preferred shareholders to immediate payment may justify a valuation which is less than asset value. The weighting method is not,
however, a rational way to evaluate the preferred stock limitations.301

In Tri-Continental Corp. v. Battye,302 the Delaware Supreme Court’s first opinion on valuation under the Delaware appraisal statute, the court expressed its approval for the idea that the value of a corporation may be less than its asset value. The court claimed to be adopting principles first formulated in Munds and followed in Root and General Realty:

The basic concept of value under the appraisal statute is that the stockholder is to be paid for that which has been taken from him, viz., his proportional share in a going concern. . . . In determining what figure represents . . . true or intrinsic value, the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. . . .

. . . [S]ince intrinsic or true value is to be ascertained, the problem will not be settled by acceptance as the sole measure of only one element entering into value without considering other elements. For example, as was specifically held in Chicago Corp. v. Munds . . . market value may not be taken as the sole measure of the value of the stock. So, also, since value is to be fixed on a going-concern basis, the liquidating value of the stock may not be accepted as the sole measure.303

The concluding sentence repeated the distortion of Munds which originated in Root v. York.304

The word “consideration” was used ambiguously in this passage. Consideration of all factors may mean that asset value, earnings value, and all other evidence of value are assessed and compared in valuing the corporation, even though one or more of those factors may finally be deemed to play little or no role in determining the corporation’s value.305 This interpretation of consideration is consistent with ordinary use of language306 and also with generally accepted security anal-

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301. See supra note 271.
302. 31 Del. Ch. 523, 74 A.2d 71 (Del. 1950).
303. Id. at 526, 74 A.2d at 72.
304. See supra notes 263-66 and accompanying text.
305. An analogy to the law of evidence exists: “consideration” of a factor is like admission of evidence; the importance, if any, to be given to the evidence is to be determined by the factfinder. Cf. Endicott Johnson Corp. v. Bade, 37 N.Y.2d 585, 338 N.E.2d 614, 376 N.Y.S.2d 103 (1975): [A]ll three elements do not have to influence the result in every valuation proceeding. It suffices if they are all considered. Compelling the consideration of all of them, including those which may turn out to be unreliable in a particular case, has the salutary effect of assuring more complete justification by the appraiser of the conclusion he reaches. It also provides a more concrete basis for court review.
306. One definition of “consider” is “to think carefully about, esp. in order to make a deci-
ysis. Best-use value can only be determined by consideration of both asset value and earnings value. In *Tri-Continental*, however, a special, narrow meaning seems to have been assigned: consideration is given to a factor only if the factor increases or decreases the valuation.207 Subsequently, this use of the word was translated into the proposition that giving consideration to a factor requires that the factor receive a nonnegative weight.208

The quoted passage was also ambiguous in stating that “value is to be fixed on a going-concern basis.” If the best course of action is to continue a corporation as a going concern, it would of course be incorrect to use liquidating value as the sole measure of value or even to include liquidating value in the calculation of value, except as a floor on the potential decline in earnings value. The ambiguous reference to valuation “on a going-concern basis” suggests that liquidation value cannot be used as the value of the corporation, even when that is the best-use value, if management has failed to liquidate the corporation. The ambiguity lies in the use of the term “going concern.” A corporation which has not been liquidated may be described as a “going concern,” but earnings value is also often referred to as “going-concern” value. Consolidation of the two concepts allows courts to avoid an inquiry into whether the corporation’s maximum value is actually achieved as a going concern.209

The misleading language should have been limited by the facts of *Tri-Continental*, because in that case a closed-end investment company was the subject of appraisal. The appraisal affirmed by the court was based on an average of the month-end values of the assets in the investment company’s portfolio.310 A deduction from this average was made to reflect the fact that shares in closed-end investment companies, for a variety of reasons,311 sell in the market at a discount from their net asset value. Inability to sell shares at a market price which corresponds to the underlying net asset value is a disadvantage which is presumably accepted by all shareholders in closed-end investment companies. It is

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207. 31 Del. Ch. at 530, 74 A.2d at 74.
209. Cf. supra notes 50-51 and accompanying text (rejection in Delaware of “going-concern asset value” as “comparatively an ethereal concept.”)
310. 31 Del. Ch. 523, 531, 74 A.2d 71, 75 (Del. 1950).
arguable whether the discount which would apply in a hypothetical market sale should be disregarded when insiders\(^{312}\) are themselves obtaining the net assets free of the closed-end format which generates the discount.\(^{313}\) However, the discount at which shares in a closed-end investment company sell provides a sufficient explanation for the valuation of the shares in Tri-Continental\(^{314}\) at less than asset value.\(^{315}\)

IV. RECONCILING DELAWARE CASE LAW WITH SOUND PRINCIPLES OF VALUATION

The initial failure to adopt best-use value in Delaware appraisals was the result of misreading earlier cases, but a weighted average of earnings value and asset value continues to be employed in subsequent Delaware opinions.\(^{316}\) However, as Justice Quillen of the Delaware Supreme Court remarked, "[T]his Court should not foster an unnecessary damages forum because of any judicial limitation placed on the statutory appraisal procedure. Rather, we should encourage this legislatively established valuation process to be open to generally accepted techniques of valuation used in other areas of business and law."\(^{317}\) Thus, the adoption of best-use valuation in Delaware would improve the substantive-law of valuation and would not violate the principle of stare decisis.

\(^{312}\) The closed-end investment company was being merged with its parent. Tri-Continental Corp. v. Battye, 31 Del. Ch. 101, 102, 66 A.2d 910, 911 (Del. Ch. 1949), rev'd, 31 Del. Ch. 523, 74 A.2d 71 (Del. 1950).

\(^{313}\) In E.I. duPont de Nemours & Co. v. Collins, 432 U.S. 46, 54-58 (1977), the Securities and Exchange Commission's adherence to net asset value as a standard of fairness under Section 17 of the Investment Company Act of 1940, 15 U.S.C. § 80a-17 (1976), was affirmed by the Supreme Court as an appropriate application of a standard developed by an expert administrative agency. Insiders had merged DuPont with an undesired closed-end investment company which had been used to hold 28.3% of DuPont's common stock. The holding company's DuPont stock was exchanged at a 2.5% discount for DuPont stock issued directly to the shareholders in the investment company. The contention that the exchange ratio should have reflected more of the 23% discount from net asset value at which holding company stock had been selling was rejected by the Commission, which stated, "[a]n investment company ... can normally be presumed to be worth its 'net asset value.'" 432 U.S. at 51.

\(^{314}\) 31 Del. Ch. at 528-31, 74 A.2d at 74-77 (Del. 1950).

\(^{315}\) If market value is less than asset value, but is untainted by a parent-subsidiary relationship, a weighted average of asset value and market value, regarded as independent estimates of value, may be acceptable. See supra notes 196, 213. No satisfactory justification exists for taking a weighted average of the asset value and the earnings value, however.

\(^{316}\) For a summary of important cases using the weighting method, see Note, supra note 6, at 641-42. A weight of zero was assigned to asset value in Gibbons v. Schenley Indus., Inc., 339 A.2d 460 (Del. Ch. 1975), but this did not result in a correct calculation of best-use value. See supra notes 135-58 and accompanying text.

\(^{317}\) Roland Int'l Corp. v. Najjar, 407 A.2d 1032, 1040 n.12 (Del. 1979) (Quillen, J., dissenting).
In *Bell v. Kirby Lumber Corp.* 318 Justice Quillen repeated his call for the use of generally accepted techniques of evaluation in appraisals. He adverted to the possibility that "in the past the process has been burdened by too strict an adherence to precedent from different factual contexts than a case at hand" 319 and warned that "it can be a mistake to read past appellate decisions on evaluation as a bar to future creativity and fresh approaches." 320

Justice Quillen suggested that Delaware appraisal precedents could be reconciled with accepted techniques of valuation through the "wide flexibility" permitted in the selection of weights, observing that an increase in the relative weight for asset value in *Bell* would have brought the appraised value closer to the corporation's high liquidation value. 321 This suggestion is unsound. Correct valuation usually requires that the lower of asset value and earnings value be disregarded. 322 Although disregarding a value is equivalent to assigning a weight of zero to the factor, the manipulation of weights to achieve that result would not enhance the clarity of valuation procedure and might perpetuate confusion. 323

A more promising avenue for adoption of best-use valuation is found in Justice Quillen's statements that the treatment of a factor in an earlier case need not be replicated in a case with different facts and that what is appropriate in some circumstances may be impermissible

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318. 413 A.2d 137, 150-51 (Del. 1980).
319. *Id.* at 151 (Quillen, J., concurring).
320. *Id.* at 150 (Quillen, J., concurring).
321. *Id.* at 151 (Quillen, J., concurring). In Metromont Materials Corp. v. Pennell, 270 S.C. 9, 24, 239 S.E.2d 753, 761 (1977), the court assigned a weight of 95% to net asset value of $785.01 and a weight of 5% to an earnings value of 0, to yield an appraisal award of $745.76 per share. The seemingly high weight for asset value was not high enough. Since asset value exceeded earnings value for the company (a closely held family corporation for holding real estate), assigning a 5% weight to earnings value reduced the award to 5% below best-use value. Moreover, the corporation had conceded that asset value should receive a high weight. It had proposed a weight of 90%, while the outsiders argued for a weight of 100%.

In *King v. Southwestern Cotton Oil Co.*, 585 P.2d 385 (Okl. Ct. App. 1978), the appellate court affirmed the trial court's assignment of a weight of 100% to net asset value, based on testimony by a professor of finance who emphasized that the company's major asset, a portfolio of securities, was oriented toward the production of capital gains. *Id.* at 390-92. However, the company was also operating a machine shop and planned to continue to do so. *Id.* at 387-88. Thus, its best-use value was probably the sum of the earnings value of the machine shop and the value of the surplus assets. See *supra* notes 126-34 and accompanying text.
322. *See supra* notes 58-64, 96-106, 126-34 and accompanying text.
323. *Cf. supra* notes 88-95, 124-25, 170-75 and accompanying text (confusion resulting from failure to analyze correctly the error introduced by application of the weighting method).
in others. For example, asset value should be disregarded when it is less than earnings value, but not when it exceeds earnings value. A reexamination of the Delaware precedent in the light of generally accepted principles of valuation, as suggested by Justice Quillen, should lead to judicial recognition of the principle that corporation valuations should proceed from the premise that the best use will be made of the corporation's resources.

Judicial correction of the fallacy inherent in the weighting method would be proper because continued use of an inaccurate valuation method is inconsistent with the fabric of Delaware corporation law. First, the purpose of the appraisal remedy is to give outside shareholders the economic value of their shares, rather than some lesser amount. If appraisals do not comply with sound principles of financial analysis, courts will be pressured to develop other remedies. Second, the power of an appraiser to consult the books and records of a corporation in determining "the value of the shares upon such investigation as to him seems proper," granted under the earlier versions of the statute, calls for general principles of analysis rather than any specific mechanism for calculating that value. Third, the current use of the weighting method is based on the mistaken belief that it yields sound valuations. The weighting method is said to be justified because precedent has established it as a means of determining "the actual value of

324. 413 A.2d at 150-51. Justice Quillen's exposition is impaired, however, by retention of the weighting method.
325. This is the premise of the authorities cited supra in notes 10-24 and accompanying text.
326. See supra text accompanying note 317. Cf. supra notes 13-16 and accompanying text (arguments that an additional remedy is needed for a shareholder objecting to a freezeout only if appraisal is insufficient). The holding in Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977), that a Delaware merger must have a purpose besides freezing out minority stockholders and must also be entirely fair to the minority, was accompanied by a declaration that "defendants cannot meet their fiduciary obligations to plaintiffs simply by relegating them to a statutory appraisal proceeding." Id. at 977.
327. DEL. CODE ANN. tit. 8, § 262(e) (1974). The current version grants the court discretion to permit discovery or other pretrial proceedings. DEL. CODE ANN. tit. 8, § 262(f) (Supp. 1978). There is no indication that the revision was intended to diminish the freedom of the factfinder to analyze issues of value. In his concurring opinion in Bell v. Kirby Lumber Corp., 413 A.2d 157 (Del. 1980), Justice Quillen argued that the analytical freedom of the factfinder has been increased by the revision:

[T]he statutory change should generally foster improvement in the proceeding by assigning to chancery judges (with their judicial and equitable feel for flexibility and its relation to fairness) the trial function. It should be anticipated that if, in the past, the process has been burdened by too strict an adherence to precedent from different factual contexts than a case at hand, relief has been supplied by a change of the original forum.

Id. at 151.
Fourth, Delaware courts are willing to follow standard works on corporate valuation. For example, in *Gibbons v. Schenley Industries, Inc.*, a lower court adopted the reasoning of a standard work on security analysis to the effect that asset value is unimportant as compared to earnings value for an operating company. Largely based on this authority, the court went beyond previous cases and assigned a weight of zero to asset value, even though the lowest weight for asset value which the court could find in a prior Delaware decision was $12\%$. Fifth, in appraisal cases Delaware courts often engage in economic analysis of the financial evidence. Sixth, Delaware courts have declined to follow precedent which is economically unrealistic. The Delaware Supreme Court has, for example, corrected a line of appraisal cases because their treatment of asset value had wandered away from the principles of financial analysis. Thus, the use of weights should not be permitted to continue as an artificial method of valuation.

328. Poole v. N.Y. Deli Maatschappij, 43 Del. Ch. 283, 286, 224 A.2d 260, 262 (Del. 1966) (nonappraisal case in which the weighting method was adopted in assessing damages).


330. See supra note 212.


The validity of the economic analyses used by the courts varies, of course, from case to case.
tion, supported only by earlier judicial error. Adoption of generally accepted principles of valuation, through the application of best-use analysis, would better serve the purposes of Delaware appraisal law.

Other jurisdictions would no doubt follow Delaware's lead in adopting best-use valuation. Alternatively, other jurisdictions should independently recognize the flaw in the weighting method, and replace it with best-use valuation.

CONCLUSION

The purpose of the appraisal process is to determine the true or intrinsic value of corporate shares. This Article has demonstrated that under all circumstances the weighting method systematically undervalues corporate shares, and that the true value of a corporation is properly its best-use value. The best-use value of a corporation is simply the value derived when the corporation pursues its most profitable course, whether that course be continued operations or liquidation. Dissident shareholders forced to accept less than the best-use value have been denied the true or intrinsic value of their shares. To give full effect to the appraisal remedy, therefore, courts should recognize the basic fal-

334. But cf. In re Delaware Racing Ass'n, 42 Del. Ch. 406, 413-15, 213 A.2d 203, 208-09 (Del. 1965), where the court rejected the contention that dissenters frozen out for cash in a short-form merger should receive liquidation value upon appraisal, rather than the weighted value previously used in appraisals following a long-form merger. The court argued that, in enacting the short-form merger statute, the legislature must be presumed to have acted with knowledge that courts use the weighting method in appraisals following long-form mergers.

The argument of the stockholders that the fact that they are being forced out of a going concern and being paid off in cash should lead to a measure of value which would give them that which they would have received in the event of dissolution, while perhaps superficially appealing, is more properly addressed to the General Assembly which enacted the law as we have found it.

Id. at 415, 213 A.2d at 208.

A similar argument could be made that a legislature which adopts the revisions of the appraisal sections of the Model Business Corporation Act tacitly "codifies" the judicially created weighting method, especially in view of the revisers' comment that the revision "leaves to the parties and ultimately to the courts the means by which fair value of the shares shall be determined, thereby leaving untouched the accumulated case law about market value, capitalized earnings value, and asset value." REPORT OF THE COMMITTEE, supra note 1, at 1874. Such arguments, however, are unsatisfactory. There is no reason to infer from revisions unrelated to valuation issues that a legislature intended to put an end to judicial development of valuation law. See H. HART & A. SACKS, THE LEGAL PROCESS 1401-05 (temp. ed. 1958). The argument that the weighting method is flawed has seldom been discussed and has not been presented to any legislature. A legislature should not, therefore, be regarded as having made a decision on this point any more than a court should be regarded as having ruled on an argument that was not presented to it.

335. Professor Hetherington has claimed: "Empirical evidence of actual disadvantages to shareholders [from going private transactions] is wholly lacking." Hetherington, supra note 10, at 247-48. The fallacy of the weighting method described in this Article refutes this claim.
lacy inherent in the weighting method and adopt the best-use method of valuation.
SOUTHERN CALIFORNIA LAW REVIEW

VOLUME 55 JULY 1982 NUMBER 5

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SOUTHERN CALIFORNIA LAW REVIEW

Published Six Times Annually by the Students of the Gould School of Law
Law Center
University of Southern California
University Park
Los Angeles, California 90007