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### Recommended Citation

Ryan W. Koppelman, *Including Non-Speculative Future Value in Delaware Appraisal Proceedings: Why the Chancery Court in Allenson Got It Wrong*, 2 DePaul Bus. & Com. L.J. 341 (2004)

Available at: <https://via.library.depaul.edu/bclj/vol2/iss2/4>

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# Including Non-Speculative Future Value in Delaware Appraisal Proceedings: Why the Chancery Court in *Allenson* Got It Wrong

Ryan W. Koppelman\*

## I. INTRODUCTION

When two corporations merge the majority shareholders often prefer to “cash-out” the minority shareholders in the transaction.<sup>1</sup> The minority shareholders receive cash in return for their shares and lose their stake in the company.<sup>2</sup> Majority shareholders often negotiate a merger through their control of management and easily vote to approve the merger to the detriment of the dissenting minority shareholder votes.<sup>3</sup> If the minority shareholders do not have the voting power to block the merger, they are vulnerable to the opportunistic acts of the majority shareholders.<sup>4</sup>

In the absence of any fraud, overreaching, or illegality, a cashed-out shareholder’s only remedy under Delaware law is judicial appraisal of that shareholder’s shares.<sup>5</sup> An appraisal action seeks to determine the fair price or fair value of the shares.<sup>6</sup> A controversial aspect of this process is the inclusion of the merged corporation’s future value. The controversy mainly stems from two Delaware Supreme Court decisions, *Weinberger v. UOP, Inc.*<sup>7</sup> and *Cede & Co. v. Technicolor, Inc.*<sup>8</sup>

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1. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 705-08 (Del. 1983) (involving the cash out of minority interest in a merger).

2. See *id.*

3. See *id.*

4. See *id.*

5. *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 248 (Del. 2001) (recognizing the Delaware rule).

6. See *id.*

7. *Weinberger*, 457 A.2d at 701 (Del. 1983).

8. 684 A.2d 289 (Del. Super. Ct. 1996). This case is often referred to as “*Cede IV*” because it was the fourth appeal. This article refers to it simply as “*Cede*” because it will not discuss the previous appeals. Only the fourth appeal and the lower court’s opinion that it overturned will be discussed. *Cede & Co. v. Technicolor, Inc.*, 1990 WL 161084 (Del. Ch. 1990).

These two cases expanded the ability of Delaware courts to include the future value of a merged firm in appraisals.<sup>9</sup>

In *Weinberger*, The Signal Companies, Inc. acquired 50.5% of UOP, Inc. via a tender offer.<sup>10</sup> A couple of years later, Signal and UOP negotiated a merger plan which cashed-out UOP's minority interest. The boards of directors of both companies and the majority shareholders of UOP approved the merger plan.<sup>11</sup> The cashed-out shareholders of UOP sued for appraisal of their shares. *Weinberger* repudiated use of the business judgment rule in determining the fairness of a cash-out merger and instead adopted the "entire fairness" test.<sup>12</sup> Also according to *Weinberger*, fair price is one inquiry in determining the entire fairness of a merger.<sup>13</sup> The court analyzed the role of future value in determining fair price.<sup>14</sup> It interpreted the statutory language of 8 Del. C. § 262(h), which states that the chancery court must determine, "fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation."<sup>15</sup> The court in *Weinberger* limited this exclusion to only the speculative elements of value arising from a merger.<sup>16</sup> It stated:

Only the speculative elements of value that may arise from the "accomplishment or expectation" of the merger are excluded. We take this to be a very narrow exception to the appraisal process, designed to eliminate use of *pro forma* data and projections of a speculative variety relating to the completion of a merger. But elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered.<sup>17</sup>

The *Weinberger* interpretation of Section 262(h) is the core of this article's argument.

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9. See *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1142-43 (Del. 1989) (acknowledging that *Weinberger* liberalized the standard for determining the "fair value" of the company's outstanding shares).

10. *Weinberger*, 457 A.2d at 704.

11. *Id.* at 705-06.

12. See *id.* at 712-13.

13. *Id.* at 711.

14. *Id.* at 713-14.

15. 8 Del. Ch. § 262(h). The Court of Chancery is a unique institution with a long history. It is a trial-level court that sits in equity and primarily handles corporate matters in Delaware, which it has unparalleled experience in doing. Its decisions are appealed directly to the Delaware Supreme Court. See generally William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792-1992*, in *Court of Chancery of the State of Delaware—1792-1992*, a publication of the Bicentennial Commemoration Committee of the Historical Society for the Court of Chancery of the State of Delaware, available at <http://courts.state.de.us/Courts/Court%20of%20Chancery/?history.htm>.

16. *Weinberger*, 457 A.2d at 713. .

17. *Id.*

In *Cede*, MacAndrews & Forbes Group, Inc. (“MAF”), a company controlled by Ron Perelman, acquired Technicolor, Inc. via a “two-step merger,” i.e. a planned merger utilizing an initial tender offer followed by a short-form merger.<sup>18</sup> After MAF took control of Technicolor via the tender offer, but before it initiated a short-form merger, Ron Perelman initiated his plan to break up Technicolor by selling it off in pieces.<sup>19</sup> The chancery court held that the Perelman plan could be considered during appraisal, because the steps required to implement the plan changed the “nature of the enterprise” and became the “operative reality” of the organization.<sup>20</sup> The Delaware Supreme Court in *Cede* overruled the chancery court decision<sup>21</sup> and applied the *Weinberger* interpretation of Section 262(h) to the actions of the majority acquiror in the interim between the first and second steps of the merger.<sup>22</sup>

Since the Delaware Supreme Court decision in *Cede*, the chancery court has issued three opinions dealing with the issue of future value. *Grimes v. Vitalink, Inc.*<sup>23</sup> involved a two-step merger between two technology companies.<sup>24</sup> In *ONTI, Inc. v. Integra Bank, Inc.*<sup>25</sup> a majority acquiror cashed out a 40% interest in several cancer treatment centers as the first part of a sequence of mergers.<sup>26</sup> *Allenson v. Midway Airlines, Inc.*<sup>27</sup> pertained to a one-step merger that was negotiated in lieu of a bankruptcy.<sup>28</sup>

The chancery court in *Allenson* held that *Cede* did not apply to a one-step merger.<sup>29</sup> The court reached its conclusion because it was more persuaded by its own conception of economic fairness than the law as set forth in *Weinberger*.<sup>30</sup> This article argues that *Allenson* was not properly decided in light of *Weinberger* and *Cede*.<sup>31</sup> The non-speculative future value of a merged firm should be included in the appraisal regardless of whether the merger utilized a one or two-step

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18. *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 291-93 (Del. Super. Ct. 1996).

19. *Id.* at 293.

20. *Id.*

21. *See Cede & Co. v. Technicolor, Inc.*, 1990 WL 161084 (Del. Ch. 1990).

22. *Cede*, 684 A.2d at 298-99.

23. 1997 WL 538676 (Del. Ch. 1997), *aff'd*, 708 A.2d 630 (Del. 1998) (commenting merely that the chancery court’s opinion was well reasoned).

24. *Id.* at \*1.

25. 751 A.2d 904 (Del. Ch. 1999).

26. *Id.* at 907.

27. 789 A.2d 572 (Del. Ch. 2001).

28. *Id.* at 577-78.

29. *See id.* at 584-86.

30. *Id.* at 585-86.

31. *See infra* notes 103-120 and accompanying text.

process. In support, this article first briefly discusses the *Grimes* and *ONTI* decisions.<sup>32</sup> An examination of the chancery court's reasoning in *Cede* and the Delaware Supreme Court's rejection of it follows.<sup>33</sup> Finally, *Allenson* is analyzed and critiqued.<sup>34</sup>

## II. *Grimes v. Vitalink*

In *Grimes*, NSC, Inc. acquired Vitalink, Inc. via a tender offer and short-form merger.<sup>35</sup> Vitalink was in the business of making "wide-area bridges," which network computers together.<sup>36</sup> It sought to modernize its business by selling routers, a new and more-advanced technology that was competing with bridges.<sup>37</sup> In furtherance of this goal, Vitalink had been pursuing two strategies.<sup>38</sup> First, it had been trying to internally develop its own routers.<sup>39</sup> Second, it had been trying to secure an OEM contract with another manufacturer to sell that company's routers under the strong Vitalink brand name.<sup>40</sup> At the time of the merger, however, Vitalink had not yet developed a viable router nor had it secured an OEM contract.<sup>41</sup>

Before the merger, Vitalink made several sales forecasts for the sale of routers.<sup>42</sup> It wanted to include those forecasts in the appraisal value of the company.<sup>43</sup> It argued that this maneuver was acceptable under *Cede*.<sup>44</sup> The chancery court disagreed and held that the sales forecasts were too speculative to be included.<sup>45</sup> It distinguished *Cede* because in *Cede* the company owned the assets that Perelman was trying to sell, but here Vitalink had yet to gain access to the products it was trying to sell, rendering any future sales speculative.<sup>46</sup>

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32. See *infra* notes 37-68 and accompanying text.

33. See *infra* notes 69-81 and accompanying text.

34. See *infra* notes 82-115 and accompanying text.

35. *Grimes v. Vitalink, Inc.*, 1997 WL 538676, at \*1 (Del. Ch. 1997).

36. See *id.* at \*3.

37. *Id.* at \*4.

38. *Id.*

39. *Id.*

40. *Id.* at \*4.

41. *Grimes v. Vitalink*, 1997 WL 538676 (Del. Ch. 1997).

42. *Id.* at \*5.

43. *Id.*

44. *Id.* at \*6.

45. *Id.*

46. *Id.*

III. *ONTI v. Integra Bank*

The cashed-out shareholders in *ONTI* originally owned a 40% interest in OTI, Inc.<sup>47</sup> Douglas Colkitt owned the other 60%.<sup>48</sup> On August 30, 1995, OTI performed a cash-out merger with “The Eight Treatment Centers”<sup>49</sup> that it owned, extinguishing the plaintiff’s 40% interest.<sup>50</sup> Two entities survived the merger, *ONTI, Inc.* and “The New Treatment Companies.”<sup>51</sup> The cashed-out shareholders sought appraisal on the basis of this merger.<sup>52</sup>

Immediately after the first merger, The New Treatment Companies merged with COG, Inc., a company entirely owned by Colkitt.<sup>53</sup> Then, on September 6, 1995, just seven days after the first merger, COG announced a merger with EquiVision, a public company of which Colkitt owned 30%.<sup>54</sup> That merger was completed on February 5, 1996.<sup>55</sup> Colkitt was planning the execution of both of these two subsequent mergers well before the first merger between OTI and The Eight Treatment Centers.<sup>56</sup>

In order to calculate the fair price of their shares, the cashed-out shareholders’ valuation expert considered the subsequent mergers. In his calculation he used the EquiVision market stock price. The day after the COG merger announcement, the stock price was \$14.25 per share, and the day the merger was completed it was \$15.50 per share.<sup>57</sup> The expert used the more conservative value, \$14.25, and multiplied it by the number of shares of the merged firm that COG shareholders received in the EquiVision merger.<sup>58</sup> He multiplied that product by 31.7%, The Eight Treatment Centers’ worth in relationship to COG, its former parent company.<sup>59</sup> The expert multiplied that product by 40%, the cashed-out shareholders stake in The Eight Treatment Cen-

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47. *ONTI, Inc. v. Integra Bankr.*, 751 A.2d 904, 907 (Del. Ch. 1999).

48. *Id.* at 906.

49. The court used the terms “The Eight Treatment Centers” and “The New Treatment Companies” as shorthand references for two groups of companies, which, for practical purposes, it treated as singular companies.

50. *ONTI*, 751 A.2d at 907.

51. *Id.*

52. *Id.* at 907.

53. *Id.*

54. *Id.* at 907-08.

55. *Id.* at 908.

56. *ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 910 (Del. Ch. 1999).

57. *Id.* at 908.

58. *Id.*

59. *Id.*

ters.<sup>60</sup> The result was an estimated appraisal value of \$93 million for their shares versus the \$6 million that they were originally allotted.<sup>61</sup>

The court allowed this valuation method to be considered, holding that the Equivision merger could be used in determining the fair price in light of *Cede*.<sup>62</sup> The court found that the Delaware Supreme Court's statement in *Cavalier Oil* that, "[A corporation must be valued] as an operating entity by application of traditional value factors, weighted as required, but without regard to post-merger events or other possible business combinations,"<sup>63</sup> must be considered in light of *Cede*, which requires "consideration of 'all elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation.'"<sup>64</sup> Since the EquiVision merger was effectively in place at the time of the merger, the court found it was not a product of speculation.<sup>65</sup> Therefore, *Cede* requires allowance of the valuation method chosen by the cashed-out shareholders' valuation expert.<sup>66</sup>

#### IV. *Cede* Chancery Court Opinion

In *Cede* the chancery court held that the Perelman plan should not be included in the fair price.<sup>67</sup> It based its decision on the "majority acquiror principle,"<sup>68</sup> which holds that dissenting shareholders are only entitled to the value of the going concern "unaffected by the plans or strategies of the acquiror."<sup>69</sup> To be consistent with this principle, the court proposed that the *Weinberger* holding be read with the insertion of an assumed phrase.<sup>70</sup> The revised holding would read: "But elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered [unless, but for the merger, such elements of future value would not exist]."<sup>71</sup> The

60. *Id.* at 908.

61. *Id.* at 907-08.

62. *ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 911 (Del. Ch. 1999).

63. *Id.* at 909-10 (citing *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989)).

64. *Id.*, 751 A.2d at 910 (citing *Cede & Co. v. Technicolor*, 684 A.2d 289, 300 (Del. Super. Ct. 1996)).

65. *ONTI*, 751 A.2d at 910.

66. *Id.* at 910.

67. *Cede & Co. v. Technicolor, Inc.*, 1990 WL 161084 at \*20 (Del. Ch. 1990).

68. *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 295-96 (Del. Super. Ct. 1996) (referring to the Chancery Court's principle as the "majority acquiror principle").

69. *Cede*, 1990 WL 161084 at \*20.

70. *Id.* at \*19.

71. *Cede*, 684 A.2d at 295-96 (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)); *Cede*, 1990 WL 161084 (Del. Ch. 1990)).

Delaware Supreme Court referred to this inserted phrase as the “proximate cause exception.”<sup>72</sup>

In *Cede* the Delaware Supreme Court rejected the lower court’s reasoning, but it qualified the rejection with the phrase “for two-step mergers.”<sup>73</sup> It stated: “[t]he majority acquiror principle and correlative proximate cause exception *for two-step mergers*, upon which the Court of Chancery premised its holding, are inconsistent with this Court’s interpretation of the appraisal statute in *Weinberger*.”<sup>74</sup> This qualification was also present in the opinion where the court stated its main holding: “In a *two-step merger*, to the extent that value has been added following a change in majority control before cash-out, it is still value attributable to the going concern . . . on the date of the merger.”<sup>75</sup> Even though this qualification limits the *Cede* holding to two-step mergers, it does not mean that the court in *Cede* was attempting to limit the *Weinberger* holding to only two-step mergers situations. If this were the court’s intent, such a limitation would support the outcome in *Allenson*, in which non-speculative future value resulting from a one-step merger was not included in the appraisal value because it was a one-step merger. The proper interpretation of the “two-step merger” qualification in *Cede* is important to the thesis of this article.

The *Cede* court did not limit the *Weinberger* holding to two-step mergers for at least two reasons. First, it is a stretch to say that the acquiror in *Weinberger* used a true two-step merger. While *Weinberger* involved a tender offer and a subsequent cash-out merger, the merger agreement was negotiated after the tender offer.<sup>76</sup> The tender offer was not part of the merger agreement.<sup>77</sup> The original tender offer was in 1975, and the second round of negotiations leading to the cash-out did not begin until 1977.<sup>78</sup> Thus, since *Weinberger* did not involve a two-step merger, the *Weinberger* language did not contain a two-step merger limitation and it would therefore be illogical for the court in *Cede* to insert such a limitation in *Weinberger*.

Second, and most importantly, the proximate cause exception advocated by the chancery court in *Cede* is logically inconsistent with the *Weinberger* language. When the Delaware Supreme Court included the qualification “for two-step mergers” in its rejection of the proxi-

72. *Cede*, 684 A.2d. at 296.

73. *Id.*

74. *Id.* (emphasis added).

75. *Id.* at 298 (emphasis added).

76. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 704 (Del. 1983).

77. *Id.* at 704-05.

78. *Id.*

mate cause exception, it could not have been reserving the applicability of the exception to one-step mergers because of this inherent inconsistency. It is evident by inserting the proximate cause exception into the *Weinberger* opinion two sentences before the place the chancery court in *Cede* inserted it. Doing so renders *Weinberger* as saying: "Only the speculative elements of value that may arise from the 'accomplishment or expectation' of the merger are excluded [unless, but for the merger, such elements of future value would not exist.]"<sup>79</sup> The phrases "arising from the accomplishment of the merger" and "but for the merger" both apparently refer to the merger causing the value. The original *Weinberger* language says that *non-speculative* elements caused by the merger should be included; whereas the proximate cause exception says that *all* elements of value caused by the merger should be excluded. These statements are inconsistent. Therefore, the Supreme Court could not have been reserving the applicability of the proximate cause exception for one-step mergers. The proximate cause exception is fundamentally inconsistent with *Weinberger* for both one and two-step mergers alike.

#### V. *Allenson v. Midway Airlines*

In *Allenson*, Midway Airlines, Inc. was having severe financial difficulty and needed an infusion of new capital to avoid filing bankruptcy.<sup>80</sup> An unrelated investor agreed to invest that capital on two conditions: 1) Midway's creditors agreed to certain cost concessions and 2) Midway's majority stockholder agreed to invest new capital himself.<sup>81</sup> The majority stockholder, creditors, and outside investor reached an agreement satisfying these conditions.<sup>82</sup> The agreement planned for a merger of Midway into a new entity of which the outside investor would own 67% and the former majority stockholder would own 22%.<sup>83</sup> The public shareholders were to be cashed-out for \$0.01 per share.<sup>84</sup> The agreement for cost concessions was in place before the date of the merger, but the cost concessions were contingent upon the merger.<sup>85</sup> The cashed-out shareholders sued for appraisal of their shares, claiming that the concessions should be included in the fair price of their shares.<sup>86</sup>

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79. *Id.* at 713; *Cede*, 1990 WL 161084, at \*19.

80. *Allenson v. Midway Airlines Corp.*, 789 A.2d 572, 577 (Del. Ch. 2001).

81. *Id.* at 576-77.

82. *Id.*

83. *Id.* at 573.

84. *Id.* at 579.

85. *Id.* at 578.

86. *Allenson v. Midway Airlines Corp.*, 789 A.2d 572, 573 (Del. Ch. 2001).

The *Allenson* court held that the concessions should not be included in the fair price of the cashed-out shares.<sup>87</sup> It reasoned that the value resulting from the creditors concessions even though non-speculative, did not *add value* before the completion of the merger, and thus could not be included in the fair value under *Cede*.<sup>88</sup> Value was not, and indeed could not be added before the merger, because Midway neither had the unilateral power to effect the concessions nor exercised any such power, given the contingent nature of the cost concessions.<sup>89</sup> According to the court, both powers are required under *Cede* in order to add value.<sup>90</sup>

The *Allenson* court held that the issue of unilateral power was merely a factual distinction between the *Allenson* facts and the facts of *Cede*.<sup>91</sup> The factual distinction supposedly could not be raised to the level of legal doctrine.<sup>92</sup> The legal doctrine according to the *Allenson* court is the supposed “value added” test from *Cede*.<sup>93</sup> But, this initial reasoning seems a bit disingenuous given how the *Allenson* court proceeded with its reasoning. It examined value added only in terms of whether Midway had the unilateral power to effect the concessions.<sup>94</sup> Midway did not have this power pre-merger, and that was essentially the end of the Court’s added value analysis.<sup>95</sup> So, the effect was that this “mere factual distinction” was raised to the level of a legal doctrine after all. It was in effect the whole test, albeit under the guise of “value added.”

## VI. ANALYSIS

The reasoning in *Allenson* has three specific problems, which together indicate the case was wrongly decided. First, the *Allenson* court did not apply the *Weinberger* holding, but instead it seemed to apply the proximate cause exception. Second, the court either misunderstood or misapplied the phrase “value added” in *Cede*. Finally, the court failed to distinguish *Cede* as a “nature of the enterprise” case and *Allenson* as not.

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87. *Id.* at 584-86.

88. *Id.*

89. *Id.*

90. *Id.* at 584-86.

91. *Allenson v. Midway Airlines Corp.*, 789 A.2d 572, 584 (Del. Ch. 2001).

92. *Id.*

93. *Id.*

94. *Id.* at 585.

95. *Id.* at 585.

A. *Application of the Proximate Cause Exception, Instead of the Weinberger Interpretation*

The *Allenson* reasoning looked suspiciously like an application of the proximate cause exception that the *Cede* chancery court unsuccessfully tried to create. The *Allenson* court argued that because the cost concessions would not exist but for the merger, they should be excluded from fair value. The underlying role of the proximate cause exception in the court's holding is apparent by the court's own admission that it was heavily influenced by "considerations of economic fairness."<sup>96</sup>

The *Allenson* court argued that because the acquiror in *Cede* was implementing the business plan at the time of the merger, it had subjected the minority stockholders to the economic risks of the plan.<sup>97</sup> Since they were subject to the plan's risks, they would be entitled to its benefits.<sup>98</sup> On the facts in *Allenson*, the court observed that the "minority shareholders bore none of the economic risk of the [c]oncessions"<sup>99</sup> because of their agreed upon exit before the concessions were effective.<sup>100</sup> The court concluded:

Unlike *Cede IV*, where the new value was contributed *pre-merger* by the acquiror, here the new value was contributed *post-merger* by both the acquiror and the former majority stockholder. In these circumstances, § 262(h) and *Cede IV* proscribe the inclusion of the new value (the concessions) in determining the fair value of Midway at the time of the merger.<sup>101</sup>

This emphasis on pre-merger and post-merger value resembles another incarnation of the proximate cause exception. The *Allenson* court excluded post-merger value that would not have existed but for the merger, for the same reasons the chancery court in *Cede* offered:<sup>102</sup> economic fairness.<sup>103</sup> This analysis and result are contrary to *Weinberger*. The proximate cause exception, as discussed above, is inconsistent with *Weinberger*.<sup>104</sup>

The court's disregard for *Weinberger* is clear by its invocation of section 262(h) without discussing the *Weinberger* interpretation of it.

96. *Allenson v. Midway Airlines Corp.*, 789 A.2d 572, 585-86 (Del. Ch. 2001).

97. *Id.*

98. *Id.*

99. *Id.* at 585.

100. *Id.* at 586.

101. *Id.* (emphasis in original).

102. *Cede & Co. v. Technicolor, Inc.*, 1990 WL 161084 at \*20 (Del. Ch. 1990).

103. *Allenson v. Midway Airlines Corp.*, 789 A.2d 572, 586 (Del. Ch. 2001).

104. See *supra* note 86 and accompanying text.

Taking *Weinberger* into account, the concessions were not proscribed under Section 262(h) as *Allenson* contended. *Weinberger* said:

Only the speculative elements of value that may arise from the ‘accomplishment or expectation’ of the merger are excluded. [T]his [is] a very narrow exception to the appraisal process, designed to eliminate use of *pro forma* data and projections of a speculative variety relating to the completion of a merger.<sup>105</sup>

In *Allenson*, the court admitted that the concessions were not speculative.<sup>106</sup> They were subject to an agreement. Furthermore, the concessions arose from the accomplishment of the merger because the concessions were made contingent on the merger by the agreement.<sup>107</sup> Therefore, the concessions were not proscribed under the *Weinberger* interpretation of Section 262(h); they should have been included.<sup>108</sup>

It was not for the chancery court to decide whether the *Weinberger* holding was economically undesirable. Such considerations should only be relevant when there is not clear Supreme Court authority on point. Here *Weinberger* was directly on point and dictated the opposite outcome.

#### B. *Allenson* Misunderstood or Misapplied the “Value Added” Concept

The *Allenson* court either misunderstood or misapplied the phrase “value added” in *Cede*. The *Cede* court said:

In a two-step merger, to the extent that *value has been added* following a change in majority control before cash-out, it is still value attributable to the going concern . . . on the date of the merger. Consequently, *value added* to the going concern by the ‘majority acquiror,’ during the transient period of a two-step merger, accrues to the benefit of all shareholders and must be included in the appraisal process on the date of the merger.<sup>109</sup>

It is more likely that the *Cede* court included the phrase “value added” only to focus the chancery court on determining *how much* value to attribute to a given element of future value, rather than as a test to determine *whether* to consider future value as understood by the *Allenson* court. In *Cede* the value added between the steps of the merger is not the same as the value added at the time of Perelman’s actual sale of the assets months later. Standard valuation methods would re-

105. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

106. *Allenson*, 789 A.2d at n.17.

107. *Id.* at 581-82.

108. See *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 296 (Del. Super. 1996) (quoting *Weinberger*, 457 A.2d 701, 713 (Del. 1983) but adding the phrase “and should”: “elements of future value. . . not the product of speculation, may [and should] be considered.”).

109. *Id.* at 298-99.

quire that some type of discount be applied to determine the value of those future transactions at the time of the merger. It is more likely that the *Cede* court was merely focusing on this fact, rather than creating a whole new test.

As this article has argued, the appropriate rule is laid out in *Weinberger*: “[Non-speculative] elements of future value . . . may [and should be] considered.”<sup>110</sup> By shifting the focus to whether value was added before the merger, instead of whether the value was speculative, the *Allenson* court precluded any consideration of future value arising from the merger. But, non-speculative value arising from the completion of a merger was specifically included by *Weinberger*. The two holdings are inconsistent.

However, even if, for the sake of argument, one accepts the *Allenson* concept of a value added test, the court has misapplied it. It is not as obvious as *Allenson* suggests that the pre-merger concessions agreement did not add value to Midway before the merger. For this to be true one would have to accept that the concessions agreement was of no value until it was either actually exercised or the contingent event (the merger) occurred. By its ruling the court suggests that Midway was not more valuable with the agreement than without it because it was contingent. It seems odd to assume that an agreement is valueless before its execution merely because the agreement is contingent.

The agreement at least should have added value to the majority shareholder's interest. This is evident by merely inquiring whether the majority interest in Midway would be more valuable with the agreement than without it, even though it is contingent. The answer is, of course it would be. The question of what dollar value should be attributed to the agreement is a separate question. If the agreement is being valued at some point before the merger, it generally should be discounted because of its contingent nature. However, it should not be if it is valued on the day of the merger, as the appraisal law requires. The contingent aspect is moot at that point; the contingent event has occurred.

So, if the agreement should have added value to the majority shareholder's interest pre-merger, it also should have added value to the minority interest pre-merger. It should not be dispositive that the minority stockholders were not to share in the post-merger company, and both *Weinberger* and *Cede* teach that it is not dispositive. *Weinberger's* comments on future value assume that the minority share-

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110. *Weinberger*, 457 A.2d at 713.

holders were not going to share in this value. The issue of future value is only relevant if the minority stockholders have been cashed-out in the merger. Therefore, under *Weinberger* it is not dispositive that the minority shareholders were not intended to share in the post-merger company. Similarly, *Cede* included the value of Perelman's planned transactions even though they were executed post-merger.<sup>111</sup> His pre-merger plans are analogous to the pre-merger concessions agreement, and the post-merger completion of the Technicolor transactions are analogous to the post-merger concessions to Midway. Therefore, also under *Cede* it is not dispositive that the minority stockholders were not intended to share in the post-merger company. So, even under the *Allenson* court's own added value test, the other result should have been reached.

### C. *Nature of the Enterprise Cases*

The *Allenson* court failed to distinguish *Cede* as a "nature of the enterprise" case and *Allenson* as not. Again, *Weinberger* said that "[non-speculative] elements of future value, including the nature of the enterprise, may [and should] be considered."<sup>112</sup> The phrase "including the nature of the enterprise" seems to indicate that the nature of the enterprise is only one type of future value that should be considered. In *Cede*, the court recognized that the Perelman plan changed the "nature of the enterprise" and became the "operative reality" of the company.<sup>113</sup> Since the *Cede* opinion dealt with an instance of "nature of the enterprise" value, it should be read cautiously with respect to other types of value.

The cost concessions in *Allenson* seem like another type of value. They are more like more discreet elements of value. This article argued above that the concessions agreement and its execution are analogous to the Perelman plan and its execution. They are similar because the initial agreement and the Perelman plan both added limited value before the merger by laying a foundation for their execution after the merger. But they are also different. The Perelman plan was a business plan for radically changing the fundamental nature of the enterprise. The cost concessions, although part of a major overall restructuring, did not change the fundamental nature of the enterprise *per se*. Rather, they were very discreet elements of value, not nearly as wide-ranging in scope.

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111. See *Cede*, 684 A.2d at 296.

112. *Weinberger*, 457 A.2d at 713.

113. See *Cede*, 684 A.2d at 293.

Maybe the inclusion of "nature of the enterprise" value in appraisal should hinge on whether the majority acquiror has unilateral power to change the nature of the enterprise, as *Cede* suggests and *Allenson* requires. The unilateral power requirement might make sense for "nature of the enterprise" value because such a broad directional change might not be the "operative reality" of the company without clear authority to effect the change. For example, Perelman's plan for the company probably would have been speculative without authority for him to effect his plan. While this theory is plausible, it is still debatable.

On the other hand, the unilateral power requirement might be too strict a standard for merely ensuring that a change in the nature of an enterprise has a proper basis in reality. For example, a merger agreement that agrees to change the nature of the enterprise seems to satisfy the need for a basis in reality, even if it would not provide for any unilateral authority to begin implementing those changes pre-merger. How this type of arrangement should be handled is not clear from *Cede*, but *Allenson* suggests such value should not be included.

Regardless, even if "unilateral power" should be a requirement for all "nature of the enterprise" cases, such a requirement should not necessarily be applied to cases like *Allenson* in which future value does not depend on a fundamental change in the nature of the enterprise. The cost concessions are discreet elements of value. Unlike a strategic plan to change the nature of the enterprise, the concessions are not in jeopardy of lacking a basis in reality. Unlike Perelman's plan, they were cemented by a contract. They have a non-speculative basis in reality. This is all that should be required. It is all that *Weinberger* requires.

## VII. A LOOSE END: *Cavalier Oil*

The Delaware Supreme Court's language from *Cavalier Oil Corp. v. Harnett*,<sup>114</sup> discussed in *ONTI*,<sup>115</sup> on its face appears contrary to the thesis of this article. It was decided after *Weinberger* so arguably it might limit the *Weinberger* holding. In *Cavalier Oil*, William Harnett was cashed-out of a closely held corporation via a short-form merger.<sup>116</sup> He sued for appraisal.<sup>117</sup> One of the main questions that the court considered was whether his misappropriation of a corporate opportunity claim could be considered as an element of value in the

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114. 564 A.2d 1137, 1144 (Del. 1989).

115. *ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 909-11 (Del. Ch. 1999).

116. *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1139 (Del. 1989).

117. *Id.*

appraisal process.<sup>118</sup> The court upheld the lower court's determination that it could be considered in appraisal even though it related to a breach of a fiduciary duty, a claim that should normally be maintained in a separate action.<sup>119</sup>

In its general statements about appraisal law, the *Cavalier Oil* court said a company should be valued "without regard to post-merger events or other possible business combinations."<sup>120</sup> On its face, this statement appears to prohibit consideration of the concessions in *Allenson*. The concessions could be characterized as a "post-merger event."

Without even questioning the meaning of *Cavalier Oil*, one possible rebuttal is that while the actual concessions occurred post-merger in *Allenson*, the concessions agreement was signed before the merger. The signing of the agreement added value to the going concern and was not a post-merger event.

However, the precise meaning of *Cavalier Oil* should be questioned. In light of *Weinberger*, the *Cavalier Oil* statement is logical when it is understood that only "post-merger events" and "subsequent business combinations" that were *speculative* at the time of the merger should be disregarded in appraisal. Not all post-merger events or business combinations should be disregarded. *Weinberger* contemplated the inclusion of post-merger events. Subject to the non-speculative requirement, it expressly includes in appraisal both "elements of value arising from the completion of the merger" and "future value." Moreover, *Cede* involved consideration of post-merger events, the eventual sale of Technicolor's assets that were non-speculatively contemplated on the date of the merger. Even *Bell v. Kirby Lumber*,<sup>121</sup> the case that the *Cavalier Oil* court cited for support of its statement, supports this view.<sup>122</sup> It stated:

Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.<sup>123</sup>

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118. *Id.* at 1143.

119. *Id.*

120. *Id.* at 1144.

121. 413 A.2d 137 (Del. 1980).

122. *Id.* at 141.

123. *Id.*

Future sales and earnings are post-merger events, and if they are non-speculative they should be included in appraisal. It seems that only if the post-mergers events were unknown at the time of the merger or if their occurrence was a matter of speculation at the time of the merger should they be disregarded in appraisal. This interpretation of *Cavalier Oil* is consistent with *Weinberger*, *ONTI*, and *Cede*, but not *Allenson*. It suggests the court in *Allenson* held incorrectly.

### VIII. A FINAL ILLUSTRATION FROM *Grimes*

The facts of *Grimes* can help illustrate this article's argument. Recall that *Grimes* said a failure to have access to routers makes any sales forecasts of them speculative.<sup>124</sup> This makes sense, but suppose the facts of *Grimes* are changed slightly. Hypothetically, if Vitalink had access to routers before the NSC tender offer or the cash-out, then the sales forecasts should be evidence of non-speculative future value. The company has the product, the market, and a loyal client base. *Grimes* suggests that such sales forecasts would not be speculative, all other things being equal.<sup>125</sup>

Change the facts of *Grimes* once again. Suppose the access to routers came from a one-step merger agreement with NSC that cashed-out a minority shareholder and some sales forecasts were created on this basis between the signing of the merger agreement and its effective date. The *Allenson* decision seems to suggest that if access to the routers came through a merger agreement rather than an independent OEM contract it would determine whether the forecasts would be included in an appraisal value. This approach hardly seems fair to the minority shareholder or consistent with *Weinberger*. Sales forecasts of NSC supplied routers would be evidence of non-speculative future value arising from the completion of the merger. This fits squarely within *Weinberger*. Even though this hypothetical merger agreement would exclude minority shareholders from participating in the benefits of the future router sales by cashing them out, it does not mean that value is not already part of their shares by virtue of the merger agreement and the plan to sell routers.

Furthermore, this last hypothetical might present a "nature of the enterprise" scenario. Substituting routers for bridges may change the nature of the enterprise. If it does, should one party be required to have the unilateral power to implement this change for it to be includable in the appraisal value, as *Allenson* would require? As the hypo-

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124. *Grimes v. Vitalink Communications. Corp.*, 1997 WL 538676 at \*6 (Del. Ch. 1997).

125. *See id.*

thetical is proposed, neither party has this power. One or both parties may begin to prepare for the sale of routers in the interim between the date that the merger agreement is signed and the date that the merger becomes effective, but neither can implement it unilaterally. But, this should not matter. On the date of the merger the value is non-speculative, and because it is arising out of the completion of the merger it should be included in the fair price under *Weinberger*.

## IX. CONCLUSION

This article has argued that *Allenson* was not properly decided in light of *Weinberger* and *Cede*. Three things were wrong with the court's reasoning in *Allenson*. First, the *Allenson* court did not apply the *Weinberger* holding, but instead seemed to apply the proximate cause exception. The proximate cause exception is inconsistent with *Weinberger*, and the plain language of *Weinberger* suggests a different outcome in *Allenson*.

Second, the *Allenson* court misunderstood or misapplied the phrase "value added" in *Cede*. It is more likely that the phrase "value added" was used only to focus the chancery court on determining *how much* value to attribute to a given element of future value, rather than as a test to determine *whether* to consider future value as understood by the *Allenson* court. However, even if "value added" were the test, the court seems to have misapplied it. The concessions agreement should have added value to Midway before the merger. By its ruling the *Allenson* court suggested that somehow Midway was not more valuable with the agreement than without it merely because it was contingent. The agreement should at least have added value to the majority shareholder's interest. And, if the agreement by itself should have added value to the majority shareholder's interest pre-merger, it also should have added value to the minority interest pre-merger. *Cede* and *Weinberger* both support the idea that merely being cashed-out at the time of the merger is not dispositive of the question of whether the cashed-out shareholders deserve a share of non-speculative post-merger value.

Third, the *Allenson* court failed to distinguish *Cede* as a "nature of the enterprise" case and *Allenson* as not. "Nature of the enterprise" value is only one type of future value that should be considered. The cost concessions in *Allenson* do not seem like the "nature of the enterprise" type of value. Rather, the cost concessions seem like more discreet elements of value. While the unilateral power requirement might ensure that broad directional changes are the "operative reality" for "nature of the enterprise" cases, such a requirement should not be

applied when future value does not depend on a fundamental change in the nature of the enterprise. *Allenson* is this type of case. The cost concessions are not in jeopardy of lacking a basis in reality. Therefore, the nature of the enterprise reasoning should not be applied to them. They already have a non-speculative basis in reality. For all three of these reasons, *Allenson* was not properly decided.