Wrestling for Value: Inside the World of Appraisal Arbitrage

Introduction

In today's fast-evolving mergers and acquisitions landscape, a hidden battleground is emerging—one where minority shareholders can challenge the terms of a merger and potentially unlock significant hidden value. This arena is defined by appraisal rights, a legal mechanism that empowers investors who oppose a deal to bypass the standard merger payout and demand a court-determined "fair value" for their shares. With heightened market volatility and increased scrutiny of corporate transactions, these rights have taken center stage. They offer not only a crucial check on potential conflicts of interest but also an intriguing opportunity for hedge funds and activist investors to bet on a higher intrinsic value than what's offered in a merger.

Mechanics and Legal Nuances

Appraisal arbitrage is an investment strategy that capitalizes on the gap between a negotiated merger price and the court's eventual valuation of a company's shares. Hedge funds and other sophisticated investors target transactions where they suspect the deal undervalues the company—often due to conflicts of interest between buyers and controlling shareholders. To participate, these investors either vote against the merger or acquire shares from those who did not oppose the deal, thereby ensuring they qualify as dissenting shareholders under Delaware's Section 262.

Once the merger closes, these dissenters file an appraisal petition with the Delaware Chancery Court. Traditionally, the court uses a discounted cash flow analysis to establish a "fair value" for the shares. However, recent trends indicate a growing emphasis on market data—such as the deal price and the last closing market price—reflecting the belief that the stock market offers a reliable indicator of intrinsic value. By forgoing the merger payout upfront, investors position themselves to gain if the court awards a higher value, along with statutory interest (typically 5% over the Federal discount rate). Conversely, if the court deems the merger price fair or higher, investors may face significant legal expenses and lost opportunities.

A critical legal element in this process is voting share tracing. Delaware law mandates that only shares held by investors who vote against the merger qualify for appraisal, yet it does not require proof that these shares were owned before the merger announcement. The landmark *Transkaryotic Therapies, Inc.* case confirmed that investors could purchase shares after the announcement—as long as they dissent—broadening the field for those seeking a higher payout through appraisal rights.

Another key nuance lies in the timing of the valuation. Fair value is determined as of the merger's closing date, meaning that any market developments up to that moment can influence the outcome. In the *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.* case, the court initially relied on trading data from 30 days before the merger announcement, only to shift its focus to the market-tested deal price as new information emerged. This evolution underscores the courts' increasing reliance on current market indicators to reflect a company's true value.

In addition, successful appraisal claimants are entitled to statutory interest on any additional payout from the merger closing until payment. However, reforms enacted since 2016 have introduced a significant change: companies are now permitted to make pre-judgment payments. These payments allow a company to disburse a portion of the expected interest before the final court decision, effectively shortening the period over which statutory interest accrues. By limiting the accumulation of interest, these pre-judgment payments reduce the risk-free return component that once made appraisal arbitrage so attractive to investors. Merger agreements also often include

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"appraisal out" clauses, which enable buyers to cancel the deal if an excessive number of shareholders demand appraisal, thereby mitigating potential cash strain.

Hedge funds have long been drawn to appraisal arbitrage because it offers a compelling opportunity to secure outsized returns by challenging merger valuations. Between 2000 and 2014, these funds achieved gross returns averaging 98.2%, and from 2015 to 2019, they dominated arbitration filings—at times appealing up to 25% of all appraisal-eligible mergers in Delaware. The strategy hinged on identifying transactions where the merger price was set significantly below what many believed to be the intrinsic value of the target company. Typically, these were deals with a low premium—around 20% lower than the merger value—often stemming from conflicts of interest or minority squeeze-outs.

The appeal of appraisal arbitrage lies not only in the possibility of a substantial premium (often 20–30% or more) but also in the financial cushion provided by statutory interest payments. Even if a court ultimately ruled that the merger price was fair, the accrued interest (commonly around 5% above the Federal discount rate, and in some cases as high as 10% annually) offered a guaranteed return, effectively transforming these investments into quasi-bond opportunities. Additionally, the absence of a pre-announcement ownership requirement allowed hedge funds to purchase shares after the deal was announced—once the market had clarified the company's true value—thereby increasing their confidence in a favorable appraisal outcome.

However, the strategy comes with its own set of risks. Appraisal cases can be lengthy, often dragging on for 1 to 3 years, which ties up capital and increases legal expenses. Moreover, there is always the possibility that the court will determine a fair value that is below the merger price, as happened in some notable cases, or simply affirm the merger price, leaving arbitrageurs with only a modest interest return. Reforms—such as the previously mentioned 2016 legislative changes allowing companies to make pre-judgment payments to curb interest accrual—have further diminished the incentive by eroding the risk-free return that once made these investments so attractive.

These factors contributed to a marked decline in appraisal arbitrage activity after 2017. Following key judicial decisions that favored deal prices, filings dropped dramatically, and hedge fund participation fell from about 25% of eligible transactions in the mid-2010s to only 5% by 2019. Today, funds are much more selective, focusing their efforts on deals where there is clear evidence of mispricing or corporate governance issues rather than pursuing every potential opportunity.

Ultimately, appraisal rights serve as both a check on deal pricing and a strategic investment tool. While critics argue that this practice acts as a "merger tax" that may discourage M&A activity, proponents see it as a vital mechanism for protecting minority shareholders and ensuring that all investors receive a fair payout.

Appraisal Arbitrage in Action: Lessons from Dell, Dole, and Aruba

The trajectory of this strategy - from early successes to the landmark 2017 correction - demonstrates the shifting legal landscape and market assumptions that define its risks and rewards. Three cases - Dell, Dole, and Aruba - illustrate this transformation, highlighting both triumphs and cautionary lessons for investors.

Dole (2013–2015): When Appraisal (and Litigation) Exposed Underhanded Tactics

In 2013, David Murdock, Dole's [NYSE: DOLE] CEO and 40% owner, took the company private at $13.50 per share. The deal narrowly passed a shareholder vote but faced both appraisal claims from hedge funds and a class-action lawsuit.

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The Delaware Court of Chancery found that Murdock and his lieutenant had deliberately manipulated earnings forecasts and withheld positive news to depress Dole's share price before the buyout. As a result, in 2015, the court ruled that shareholders were entitled to damages of $2.74 per share.

While not a pure appraisal decision, the case validated appraisal arbitrageurs' suspicions that the deal price was unfairly low. Eventually, Murdock and Dole's directors settled, paying over $100m in damages to the class-action plaintiffs and another $233m in cash plus interest to hedge funds that pursued appraisal.

Dole is a rare instance of appraisal arbitrage playing a crucial role in uncovering misconduct. This case represents the best-case scenario for appraisal arbitrage, where the process exposed foul play and delivered substantial gains to dissenting shareholders.

Dell (2013–2017): The Battle over a Management Buyout

In 2013, Michael Dell and Silver Lake took Dell Inc. [NYSE:DELL] private for $13.75 per share. Some shareholders, believing this price was too low, pursued appraisal. In 2016, the Delaware Court of Chancery ruled Dell's fair value was $17.62 per share - a striking 28% premium over the deal price. The judge, Vice Chancellor Laster, based this decision on his own discounted cash flow analysis, disregarding the merger price entirely. This ruling encouraged appraisal arbitrageurs, reinforcing the belief that courts could uncover hidden value in transactions.

However, in 2017, the Delaware Supreme Court reversed this decision, criticizing the lower court for ignoring market evidence and emphasizing that Dell's sale process had been robust, with multiple bidders and no conflicts of interest.

This incident strongly signalled that, in an efficient market, a well-run sale process should be the best indicator of fair value. This marked a major shift: post-Dell, courts became much less inclined to override deal prices unless there were clear process deficiencies. What initially seemed like a major win for appraisal arbitrageurs turned into a disappointment, demonstrating that the strategy could backfire even in cases where a court initially ruled in their favour.

Aruba (2015–2019): The Cautionary Tale – When Appraisal Backfires

In 2015, Hewlett-Packard acquired Aruba for $24.67 per share. Some shareholders sought appraisal, expecting a court-ordered premium.

Instead, in 2018, Vice Chancellor Laster delivered a stunning decision: Aruba's fair value was just $17.13 per share - 31% below the merger price. Laster reasoned that the stock's 30-day unaffected market price (before merger speculation) was the most reliable indicator of intrinsic value. This outcome represented a worst-case scenario for appraisal arbitrageurs, who ended up with significantly less than if they had simply accepted the merger price.

In 2019, the Delaware Supreme Court modified the ruling, raising the fair value to $19.10 per share - calculated as the deal price minus merger synergies. While this softened the impact, dissenting shareholders still received less than the original deal price.

Aruba underscored the increasing judicial deference to market-based valuations and the significant risks of challenging a well-run sale process. This case serves as the ultimate cautionary tale for appraisal arbitrageurs – sometimes, the game doesn't just fail to deliver upside; it can actively harm investors who overestimate their odds.

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These cases illustrate the spectrum of outcomes appraisal arbitrage can yield. Dole demonstrated its potential benefits—appraisal rights served their intended purpose by preventing an unfair deal. Dell highlighted the risks—what seemed like a victory for dissenting shareholders was undone by a higher court's adherence to market pricing. Finally, Aruba revealed the dangers—pursuing appraisal can sometimes leave investors worse off than if they had taken the deal price.

Together, these cases chart the changing philosophy of Delaware courts, shifting from skepticism of deal prices to a firm trust in market efficiency. For investors, the lesson is clear: appraisal arbitrage is no longer a one-way bet, and the best predictor of fair value may well be the market itself.

Case Study: The Endeavor Appraisal Battle

One recent case of appraisal arbitrage relates to Endeavor Group [NYSE:EDR], a holding company for talent agencies and the majority owner of WWE and UFC. In April 2024, tech private equity firm Silver Lake announced its acquisition of Endeavor at $27.50 per share (TEV of $25bn). However, by early 2025, Endeavor's stock was trading well above $27.50 – at times in the mid-$30s – implying that investors thought the company was worth more than the agreed-upon buyout price. The primary driver of this price discrepancy was hedge fund activity, as arbitrageurs acquired shares in hopes of either pressuring Silver Lake into raising its offer or securing a higher court-determined valuation. A crucial factor in this valuation debate was Endeavor's 51% stake in TKO, the parent company of UFC and WWE. If TKO's stock performed strongly, as it did, its implied value suggested that Endeavor's fair price should be higher than the agreed buyout amount. Hedge funds contended that $27.50 was inadequate, arguing that it undervalued Endeavor based on TKO's trading price and broader growth prospects. Ultimately, the deal closed in March 2025, with Endeavor's stock at $29.25 – just a 9% premium to the purchase price.

Several hedge funds strategically acquired significant positions in Endeavor following the buyout announcement, ensuring they qualified as dissenting stockholders by abstaining from voting for the merger and formally demanding an appraisal before the February 4, 2025, deadline. These investors sought to leverage Delaware's appraisal rights laws to argue that Endeavor's fair value exceeded $27.50, with TKO's strong stock performance serving as a key valuation benchmark. The case exemplifies textbook appraisal arbitrage, where funds invest purely to challenge deal valuations in court, aiming for a higher payout. Silver Lake staunchly defended the $27.50 offer, emphasizing that it represented a significant premium over Endeavor's pre-deal stock price. As arbitrageurs pushed Endeavor's price above the buyout amount, Silver Lake took the unusual step of issuing a public statement condemning hedge funds for artificially inflating stock prices through speculative trading. Additionally, Silver Lake opted to withhold the merger payout from dissenting shareholders, exercising its right under Delaware law to delay payment until the conclusion of the appraisal case.

It should be noted that right before closing, renowned activist investor Carl Icahn bought into 8% of Endeavor's shares, resulting in expectations of a new class-action lawsuit. No court dates have been scheduled yet, though assuming shareholders decide to sue, the appraisal battle will center on several critical questions:

- **Valuation of TKO's Stake**: Whether TKO's trading price accurately reflects its contribution to Endeavor's fair value.
- **Deal Process Fairness**: Whether Silver Lake's acquisition process adequately protected minority shareholder interests.

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- **Market Price vs. Fundamental Value**: Whether the stock's post-announcement rise should influence the appraisal valuation

This case highlights the tension between sophisticated investors and private equity buyers, illustrating the ongoing debate over appraisal arbitrage. The outcome will determine whether hedge funds can still profit from appraisal litigation post-2017 when courts began favoring market prices over speculative valuation models. Silver Lake's hardline stance could set a precedent, discouraging future arbitrage attempts by demonstrating that holding out for appraisal may not guarantee a higher payout.

Global Perspectives on Appraisal Rights

While appraisal arbitrage thrives in Delaware, its global applicability varies:

- **United Kingdom**: Shareholders lack broad appraisal rights, relying instead on pre-deal activism and regulatory protections. UK company law and the Takeover Code prioritize majority rule, meaning that if 75% approve a takeover, the minority must accept it. Unlike Delaware, there is no routine mechanism for a fair value proceeding post-deal. Limited exceptions exist, such as squeeze-outs (when a buyer reaches 90% ownership), where minority shareholders can contest the price in court, though success is rare. This system favors upfront market-driven negotiation over post-closing litigation.

- **Canada**: Canada offers appraisal rights similar to Delaware under the Canada Business Corporations Act (CBCA) and provincial laws, allowing dissenting shareholders to seek "fair value" in court. While used less frequently than in Delaware, Canadian deals often include "dissent thresholds," which permit an acquirer to terminate the transaction if too many shareholders seek appraisal, discouraging large-scale arbitrage. It should be noted that US legal developments may have an impact on Canadian appraisal rights – Canadian courts have cited Delaware cases like Dell when considering fair value, importing their reasoning.

- **Germany**: Germany provides a court-driven price review in cases of squeeze-outs or certain mergers via the "Spruchverfahren" process. Unlike Delaware, German courts frequently adjust prices upward, though the process is notoriously slow, often taking years to resolve.

- **Other Jurisdictions**: Countries like France and Japan rely more on regulatory oversight and fairness opinions rather than shareholder-driven court challenges. Australia has dissenters' rights in specific restructurings but lacks a robust arbitrage culture due to fewer activist investors and cultural norms favoring consensus.

Overall, Delaware-style appraisal arbitrage is somewhat unique by attempting to balance both efficiency and fairness by keeping appraisal rights but discouraging misuse, whereas some other systems either open the door more cautiously or practically keep it closed. In Delaware, dissenting shareholders head to court; in London, they usually head to the pub – because there's little else to do if you don't like the deal.

Conclusion

Appraisal arbitrage has evolved from a lucrative strategy that once delivered extraordinary returns to a more nuanced and selective practice shaped by legislative reforms and judicial scrutiny. High-profile cases such as Dole, Dell, and Aruba illustrate both the potential rewards and the significant risks involved: while appraisal rights can expose undervalued deals and protect minority shareholders, they can also leave investors worse off if courts affirm

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or even undervalue the merger price. The recent decline in filings underscores that hedge funds are now more cautious, focusing only on deals with clear evidence of mispricing or conflicted processes.

Nevertheless, appraisal rights remain an important mechanism for maintaining fairness and transparency in mergers and acquisitions. Critics may view them as a "merger tax," but proponents argue they act as a vital check on controlling shareholders, ensuring that minority interests are not overlooked. As Delaware courts continue to refine the balance between market-based indicators and intrinsic valuations, and as jurisdictions worldwide adapt their own approaches, appraisal arbitrage will likely remain a critical—if more restrained—tool in the ongoing battle for fair value.

TAGS: Appraisal Arbitrage, Law, Hedge Fund, M&A, Shareholders, Fair Value

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