

# DISSENTERS' RIGHTS: AN ANALYSIS EXPOSING THE JUDICIAL MYTH OF AWARDING ONLY SIMPLE INTEREST

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## I. INTRODUCTION

If a corporation is the subject of a merger, acquisition, or other fundamental corporate change, a party holding stock in that corporation can go to court to receive the "fair value" of those shares.<sup>1</sup> However, the Delaware Supreme Court recently<sup>2</sup> perpetuated the judicial myth that awarding simple interest<sup>3</sup> in an appraisal proceeding is sufficient to compensate a shareholder for loss of use of that shareholder's money during the valuation proceeding.<sup>4</sup>

This Note proposes that to fully compensate a shareholder for loss of use of money, it is essential, rather than discretionary, that courts begin to apply a more enlightened approach adequately accounting for the economic reality of the investment world. As this Note demonstrates, such an approach necessarily involves awarding compound interest through application of future value concepts.

Part II of this Note explains the evolution of the appraisal rights action from its common law origins to its modern availability in Delaware and every other state. Next, Part III illustrates the financial concepts of simple and compound interest and details the rules for receiving interest in a Delaware appraisal proceeding. Part IV describes the "time value of money," and applies future value concepts to appraisal actions. Part V then discusses the Delaware appraisal proceeding, describing both the "Prudent Investor Approach" and the proposed "Modified Prudent Investor Approach." Finally, Part VI analyzes prominent appraisal cases from both Delaware and other states in order to explain the methods of awarding interest. Part VI also demonstrates why compound interest is necessary in appraisal proceedings.

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1. This judicial avenue is commonly referred to as an appraisal proceeding, or more generally, dissenters' rights. *See infra* notes 5 - 33 and accompanying text.

2. *See* *Rapid-American Corp. v. Harris*, 603 A.2d 796 (Del. 1992).

3. *See infra* notes 41 - 46 and accompanying text for a discussion of both simple and compound interest.

4. This Note focuses primarily on the corporate law of Delaware. Although New York is the leading state based on total incorporations, Delaware is the state in which more than half of the Fortune 500 companies are incorporated. *See* LEWIS D. SOLOMON, ET. AL., CORPORATIONS: LAW AND POLICY 206, n.\* (Revised Preliminary 3d. Edition 1993). *See also* Comment, *Law For Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 861-62 (1969) ("Delaware, like any other good businessman, tries to give the consumer what he wants. In fact, those who will buy the product are not only consulted about their preferences, but are also allowed to design the product and run the factory.").

## II. THE EVOLUTION OF SHAREHOLDER RIGHTS

### A. Common Law

At common law, one shareholder possessed the power to dissent and thus could prevent a corporate merger<sup>5</sup> from occurring.<sup>6</sup> This power effectively gave each shareholder the ability to veto all extraordinary corporate changes. The underlying rationale was that the shareholder had invested in a continuing enterprise which should not be fundamentally modified against a shareholder's will.<sup>7</sup> Eventually, legislators began to recognize that a healthy economy requires commercial and business growth,<sup>8</sup> and states began to enact statutes removing this power from individual shareholders.<sup>9</sup>

In addition to these statutory changes, courts at this early date also began to erode the ability of one shareholder to block a merger by allowing dissenting shareholders the right to receive the cash value of their stock.<sup>10</sup> To compensate the shareholders<sup>11</sup> for this lost "right," state legislatures began to provide dissenting<sup>12</sup> shareholders the right to demand the "fair value" of their stock

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5. A "merger" refers to the absorption of one corporation (the "target company") by another corporation (the "acquiring company"), in which the target company loses its legal identity and the acquiring company retains its own name and acquires the assets, liabilities, franchises, and powers of the target company. *Morris v. Investment Life Ins. Co.*, 272 N.E.2d 105, 108 (Ohio 1971). "Of necessity, the [target company] ceases to exist as a separate business entity." *Id.* However, a merger, as referred to in this Note, should not be confused with a "consolidation," in which the existence of all the corporations involved in the consolidation extinguishes as they become part of a new corporation. Nonetheless, mergers and consolidations are usually treated almost identically in state corporation acts.

6. See *Chicago Corp. v. Munds*, 172 A. 452, 455 (Del. Ch. 1934) ("At common law it was in the power of any single stockholder to prevent a merger.") (emphasis added). See also Michael G. Schinner, *Dissenting Shareholders' Statutory Right to Fair Cash Value: Armstrong v. Marathon Oil Co.*, 22 AKRON L. REV. 261, 265 (Winter 1989); J. Kirkland Grant, *Appraisal Rights: Allowance for Prejudgment Interest*, 17 B.C. INDUS. & COMM. L. REV. 1, 1 (1975) [hereinafter Grant].

7. Grant, *supra* note 6, at 1 & n.3.

8. See *Chicago Corp. v. Munds*, 172 A. at 455. See generally Note, *The Dissenting Shareholder's Appraisal Remedy*, 30 OKLA. L. REV. 629 (1977); Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966); Note, *Corporation Law - Dissenting Stockholder's Right of Appraisal - Determination of Value*, 28 N.Y.U. L. REV. 1021 (1953).

9. Every state eventually enacted statutes which remove the requirement of unanimity of shareholders for "fundamental changes" in a corporation, such as a merger or a sale of all or substantially all of the corporation's assets. For the modern statutes, see *infra* note 31. See generally Revised Model Business Corporation Act [hereinafter R.M.B.C.A.] § 13.01 et. seq. (1993).

10. See, e.g., *Lauman v. Lebanon Valley R.R. Co.*, 30 Pa. 42 (1858).

11. See DEL. CODE ANN. tit. 8, § 262(a) (1993) (defining "stockholder" in relation to appraisal rights as "a holder of record of stock in a corporation and also a member of record of a nonstock corporation"). See also R.M.B.C.A. § 13.01(7) (defining a "shareholder" as "the record shareholder or the beneficial shareholder"). This Note focuses mainly on Delaware corporate law. However, the R.M.B.C.A. often influences the corporate codes of all fifty states and the District of Columbia. For a thorough discussion of the most recent Model Act, see Henry F. Johnson & Paul Bartlett, Jr., *Is a Fistful of Dollars The Answer? A Critical Look at Dissenters' Rights Under the Revised Model Business Corporation Act*, 12 J.L. & COM. 211 (1993).

12. See R.M.B.C.A. § 13.01(2) (defining a "dissenter" as "a shareholder who is entitled to dissent from corporate action under section 13.02 [Right to Dissent] and who exercises that

through judicial appraisal.<sup>13</sup> Underlying this change in the law was the recognition by both courts and legislators that the common law rule was outdated and served only to inhibit valid corporate interests.<sup>14</sup> This new body of law created what is now known as "dissenters' rights."

### B. Dissenters' Rights

Dissenters' rights is a distinctive remedy accorded only in certain circumstances provided by statute.<sup>15</sup> The purpose of such statutes, commonly referred to as appraisal statutes,<sup>16</sup> is to allow a shareholder who opposes a substantial change in a corporation to "sell out" his or her interest in that corporation.<sup>17</sup> The primary purpose of an appraisal action is to assign an appropriate dollar value to the dissenting shareholder's stock. Indeed, courts in many states, including Delaware, view the valuation of the stock as the sole issue in an appraisal proceeding.<sup>18</sup>

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right when and in the manner required by sections 13.20 through 13.28 [Procedure For Exercise of Dissenters' Rights]"

13. See *Reynolds Metals Co. v. Colonial Realty Corp.*, 190 A.2d 752, 755 (Del. 1963); *Hariton v. Arco Electronics, Inc.*, 182 A.2d 22, 25 (Del. Ch. 1962); *Chicago Corp. v. Munds*, 172 A.2d 452, 455 (Del. Ch. 1934). See also DEL. CODE ANN. tit. 8, § 262 (1993) (Appraisal Rights); R.M.B.C.A. §§ 13.30 and 13.31 (Judicial Appraisal of Shares). For a compilation of the modern dissenters' rights statutes, see *infra* note 31.

14. This rule also had the obvious effect of impairing the rights of a corporate majority to wield control over the corporation's activities. See generally Comment, *Statutory Merger and Consolidation of Corporations*, 45 YALE L. J. 105 (1935); Norman D. Lattin, *Equitable Limitations on Statutory or Charter Powers Given to Majority Stockholders*, 30 MICH. L. REV. 645 (1932); George S. Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares*, 19 CAL. L. REV. 349 (1931); Morton J. Horwitz, *The Transformation in the Conception of Property in American Law, 1780 - 1860*, 40 U. CHI. L. REV. 248 (1973).

15. *Miller v. Magline, Inc.*, 306 N.W.2d 533, 535 (Mich. Ct. App. 1981). See *infra* note 31 for the state appraisal statutes.

16. In certain cases such as fraud or misrepresentation, an appraisal action may not be sufficient to compensate a shareholder for his loss. In these types of cases other claims may exist which provide the additional recovery necessary to fully redress the shareholder. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983) ("The appraisal remedy . . . may not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved."); *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1106 (Del. 1985) (unfair dealing claims, based upon breaches of the duties of loyalty and care, "are issues which an appraisal cannot address"). See generally Steven D. Gardner, Note, *A Step Forward: Exclusivity of the Statutory Appraisal Remedy For Minority Shareholders Dissenting From Going-Private Merger Transactions*, 53 OHIO ST. L. J. 239 (1992).

17. See *DuVall v. Moore*, 276 F.Supp. 674, 683-84 (N.D. Iowa 1967) ("The great majority of appraisal statutes were not intended to do more than permit shareholders who disagreed with the fundamental change to have their interests purchased and to retire from the company.").

18. *Kaye v. Pantone, Inc.*, 395 A.2d 369, 375 (Del. Ch. 1978). The court explained that raising issues unrelated to the precise issue of value would only confuse value determination, and therefore such extraneous issues should be avoided if possible. *Id.*

Traditionally, the value of dissenting stockholders' shares was computed by applying the actual market value,<sup>19</sup> net asset value,<sup>20</sup> investment value,<sup>21</sup> or true intrinsic value approach.<sup>22</sup> Clearly, there are a seemingly infinite number of methods that can be used to determine the value of dissenting shareholders' stock, including liquidation value, net equity value, earnings value of the stock or dividends prospects, and post-merger or synergistic gain.<sup>23</sup> Prior to 1983, Delaware courts applied a regimented valuation formula which ineffectively attempted to account for these types of factors. However, in *Weinberger v. UOP, Inc.*,<sup>24</sup> the Delaware Supreme Court liberalized its valuation method, stating that its former "structured and mechanistic procedure"<sup>25</sup> must give way to any technique which is generally considered to be acceptable in the financial community.<sup>26</sup> Subsequent to *Weinberger*, the Delaware Supreme Court has reaffirmed the appropriateness of its new valuation method.<sup>27</sup>

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19. See *In re Watt & Shand*, 304 A.2d 694, 698 n.7 (Penn. 1973). The court in *Watt & Shand* defined market value as "the price at which the stock was selling on the market prior to the action which is objected to, disregarding any change in price due to the action." *Id.*

20. See *id.* The court defined net asset value as "the share which the stock represents in the value of the net assets of the corporation." *Id.* "Such assets include every kind of property and value, whether realty or personalty, tangible or intangible, including good will and the corporation's value as a going concern." *Id.*

21. See *id.* The court defined investment value as "an estimate of present worth in light of past, present and prospective financial records of the company and [investment value] is obtained by capitalizing earnings." *Id.* "There are two basic steps in the capitalization process: [1] calculation of a representative annual earnings figure, and [2] choice of a capitalization ratio which reflects the stability and predictability of earnings of the particular corporation." *Id.*

22. See *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1186 (Del. 1988) ("Value was traditionally arrived at by determining 'the true or intrinsic value' of the shareholders' proportionate interest in the company, valued on a going-concern rather than a liquidated basis.")

23. See generally Joseph M. Coleman, *The Appraisal Remedy in Corporate Freeze-Outs: Questions of Valuation and Exclusivity*, 38 SW. L.J. 775 (1984); Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974).

24. 457 A.2d 701 (Del. 1983). For a thorough discussion of *Weinberger*, see Gregory D. Jordan, *Price and Purpose: The Two Faces of Fairness in Weinberger v. UOP, Inc.*, 13 MEM. ST. U. L. REV. 384, 396-403 (1983). See also John T. McLean, *Minority Shareholders and Cashout Mergers: The Delaware Court Offers Plaintiffs Greater Protection and a Procedural Dilemma - Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), 59 WASH. L. REV. 119 (1983).

25. The procedure to which the court was referring was the so-called "Delaware block" method, a technique which the Delaware courts diligently applied in valuation proceedings for decades. The "Delaware block" is simply a weighted average method of valuation. In its basic form, this technique assigns a certain weight to the value elements of a company (i.e., its assets, earnings, market price, etc.). Then, the value of the stock is computed simply by multiplying these value elements by their respectively determined weights. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 712 (Del. 1983). For a discussion of the Delaware Block method, see William S. Allred, *Chipping Away at the Delaware Block: A Critique of the Delaware Block Approach to the Valuation of Dissenters' Shares in Appraisal Proceedings*, 8 W. NEW ENG. L. REV. 191 (1986). See also *In re General Realty & Utilities Corp.*, 52 A.2d 6, 14-15 (Del. Ch. 1947) (demonstrating application of the Delaware Block technique).

26. See *Weinberger v. UOP, Inc.*, 457 A.2d at 713.

27. See, e.g., *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1187 n.7 (Del. 1988) ("We once again recognize that...[the "Delaware Block"] is outmoded, with statutory appraisal requiring consideration of *all relevant factors* involving the value of the company.") (emphasis added).

### C. Individual State Appraisal Rights

Under Delaware law, persons holding stock in a Delaware corporation<sup>28</sup> are entitled to an appraisal of the fair value<sup>29</sup> of their shares by the Court of Chancery.<sup>30</sup> Such appraisal rights statutes exist in all other states and the District of Columbia.<sup>31</sup> As a general rule, courts liberally construe appraisal

28. As used in this Note, a "Delaware corporation" simply refers to a corporation incorporated under the Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 101 et seq.

29. In Delaware, the reviewing court accords a high level of deference to the "fair value" as determined by the trial court in an appraisal proceeding. Generally, the reviewing court defers to the lower court's valuation of the stock. See *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 175 (Del. 1991); *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 258-59 (Del. 1991); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1146 (Del. 1989).

30. See DEL. CODE ANN. tit. 8, § 262(a). This valuation is subject, however, to the circumstances described in Section 262, subsections (b) and (c). DEL. CODE ANN. tit. 8, § 262(a). Section 262(b) of the Delaware statute is fairly representative of the appraisal statutes of other states, and states:

(b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation . . . :

(1) Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (i) listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or (ii) held of record by more than 2,000 stockholders; and further provided that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 [Merger or Consolidation of Domestic Corporations] of this title.

(2) Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation . . . to accept for such stock anything except:

a. Shares of stock of the corporation surviving or resulting from such merger or consolidation;

b. Shares of stock of any other corporation which at the effective date of the merger or consolidation will be either listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or held of record by more than 2,000 stockholders;

c. Cash in lieu of fractional shares of the corporations described in the foregoing subparagraphs a. and b. of this paragraph; or

d. Any combination of the shares of stock and cash in lieu of fractional shares described in the foregoing subparagraphs a., b. and c. of this paragraph.

DEL. CODE ANN. tit. 8, § 262(b).

31. See ALA. CODE § 10-2A-162 (1993); ALASKA STAT. § 10.06.574 (1992); ARIZ. REV. STAT. ANN. § 10-081(L) (1993); ARK. CODE ANN. § 4-27-1302 (Michie 1991); CAL. CORP. CODE § 1300 (West 1993); COLO. REV. STAT. § 7-4-123 (1993); CONN. GEN. STAT. ANN. § 33-373 (West 1993); DEL. CODE ANN. tit. 8, § 262 (1993); D.C. CODE ANN. § 29-240 (1993); FLA. STAT. ANN. § 607.1320 (West 1993); GA. CODE ANN. § 14-2-1302 (Michie 1993); HAW. REV. STAT. § 415-80 (1992); IDAHO CODE § 30-1-80 (1993); ILL. REV. STAT. ch. 805 para. 5/11.65 (1993); IND. CODE § 23-1-44-8 (1993); IOWA CODE ANN. § 490.1302 (West 1992); KAN. STAT. ANN. § 17-6712 (1992); KY. REV. STAT. ANN. § 271B.13-020 (Michie/Bobbs-Merrill 1993); LA. REV. STAT. ANN. § 12:131 (West 1992); ME. REV. STAT. ANN. tit. 13-A § 909 (West 1992); MD. CODE ANN., CORPS. & ASS'NS § 3-202 (1992); MASS. GEN. LAWS ANN. ch. 156B, § 85 (West 1992); MICH. COMP. LAWS ANN. § 450.1762 (West 1993); MINN. STAT. ANN. § 302A.471 (West 1992); MISS. CODE ANN. § 79-4-13.02

statutes in favor of the dissenting shareholder.<sup>32</sup> However, in the absence of a specific statutory right, a dissenting stockholder does not have a right to an appraisal remedy.<sup>33</sup>

### III. INTEREST

Appraisal awards include payment of either simple or compound interest to the dissenting shareholder. This interest is to compensate the shareholder for the loss of use of money during the appraisal proceeding. Simply, the interest serves as a return on the shareholder's investment. All investment opportunities are comparable on one common basis: the return which they are expected to provide the investor. Therefore, since an appraisal award is designed to compensate shareholders for loss of use of money, the form of interest awarded to the shareholders becomes significant. If the return is not adequate, then the shareholders will not be fully compensated for the loss of use of money.

If the hypothetical Average Joe is asked whether he would rather receive one dollar today or one dollar one year from now, the answer would in all likelihood be that Joe, and everyone else, would rather have the money today. Although Joe may not know it, his decision is governed by the financial concept of "interest." Notwithstanding the fact that the computation and application of interest can become relatively perplexing,<sup>34</sup> the underlying premise is fairly simple. Specifically, it is universally understood that the use of money has a cost. In other words, something must be given up to use money, and something must be received in order to entice people to loan money. This "something" is interest.

#### A. Interest Generally

Because it is not uncommon for appraisal proceedings to extend over several years, a decade, or even longer,<sup>35</sup> the question of whether to award

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(1991); MO. ANN. STAT. § 351.455 (Vernon 1992); MONT. CODE ANN. § 35-1-827 (1991); NEB. REV. STAT. § 21-2079 (1992); NEV. REV. STAT. § 78.481 (1991); N.H. REV. STAT. ANN. § 293-A:81 (1991); N.J. REV. STAT. ANN. § 14A:11-1 (West 1993); N.M. STAT. ANN. § 53-15-3 (Michie 1993); N.Y. BUS. CORP. LAW § 910 (McKinney 1993); N.C. GEN. STAT. § 55-13-02 (1992); N.D. CENT. CODE § 10-19.1-87 (1991); OHIO REV. CODE ANN. § 1701.74 (Anderson 1991); OKLA. STAT. ANN. tit. 18, § 1091 (West 1992); OR. REV. STAT. § 60.554 (1992); 15 PA. CONS. STAT. ANN. § 1571 (1992); R.I. GEN. LAWS § 7-1.1-73 (1992); S.C. CODE ANN. § 33-13-102 (Law. Co-op. 1991); S.D. CODIFIED LAWS ANN. § 47-6-23 (1993); TENN. CODE ANN. § 48-23-102 (1993); TEX. BUS. CORP. ACT. ANN. art. 5.11 (West 1992); UTAH CODE ANN. § 16-10a-1302 (1993); VT. STAT. ANN. tit. 11, § 2003 (1992); VA. CODE ANN. § 13.1-730 (Michie 1993); WASH. REV. CODE § 24.06.245 (1992); W. VA. CODE § 31-1-153 (1993); WIS. STAT. ANN. § 180.1302 (West 1993); WYO. STAT. § 17-16-1302 (1993).

32. See, e.g., *Bohrer v. United States Lines Co.*, 224 A.2d 348, 351 (N.J. Super. Ct. 1966) ("It is ... the policy that our appraisal statute be construed liberally in favor of dissenting stockholders.... A liberal construction, rather than a rigid and technical one, should govern in [an appraisal proceeding].").

33. See, e.g., *Opdyke v. Security Sav. & Loan Co.*, 105 N.E.2d 9, 22 (Ohio 1952). See also *In re Miglietta*, 39 N.E.2d 224, 228 (N.Y. 1942) (explaining that it would be unreasonable in the ascertainment of legislative intent not to give weight to a failure to provide in the statute for appraisal and payment of the dissenting shareholders' stock). All of the states and the District of Columbia now have statutory dissenters' rights. See *supra* note 31.

34. See *infra* notes 41 - 46 and accompanying text for a discussion of both simple and compound interest.

35. See *infra* note 69 for a sample of the length of litigation common in appraisal valuations.

interest is of great importance. Interest is simply a reimbursement or compensation for the use of money,<sup>36</sup> and is not intended to be a penalty<sup>37</sup> nor an expense of litigation.<sup>38</sup> A number of courts have stated that simple interest is adequate compensation, even in cases of fraud.<sup>39</sup> However, this Note demonstrates that simple interest is not sufficient to compensate dissenting shareholders for the loss of use of their money during the appraisal proceeding and thus should have no place in an appraisal action. Obviously, this is a stark minority view, and the majority of courts are only willing to award simple interest.<sup>40</sup>

### B. Simple Interest

The least complicated method of interest, as its name implies, is simple interest. Simple interest allows for the computation of interest only on the amount of principal, and thus affords no payment of "interest on interest."<sup>41</sup> In other words, simple interest involves no compounding.<sup>42</sup>

36. See *Pegues v. Mississippi State Employment Serv.*, 899 F.2d 1449, 1453 (5th Cir. 1990); *Western Plains Serv. Corp. v. Ponderosa Development Corp.*, 769 F.2d 654, 657 (10th Cir. 1985); *Francis I. duPont & Co. v. Universal City Studios, Inc.*, 343 A.2d 629, 634 (Del. Ch. 1975); *Wilson v. Great American Indus., Inc.*, 746 F.Supp. 251, 267-68 (N.D. N.Y. 1990), *amended on reconsideration*, 763 F.Supp. 688 (N.D. N.Y. 1991), *reconsideration denied*, 770 F.Supp. 85 (N.D. N.Y. 1991).

37. See *Pegues v. Mississippi State Employment Serv.*, 899 F.2d at 1453; *Wilson v. Great American Indus. Inc.*, 746 F.Supp. at 267-68; *United States v. United Drill & Tool Corp.*, 183 F.2d 998, 1001 (D.C. Cir. 1950).

38. *Preston v. Thompson*, 565 F.Supp. 294, 302 (N.D. Ill. 1983).

39. See, e.g., *Dale v. Thomas H. Temple Co.*, 208 S.W.2d 344, 354 (Tenn. 1948); *McCarthy v. Brockton Nat. Bank*, 50 N.E.2d 196, 202 (Mass. 1943). However, the underlying motivation of the courts in stating that simple interest is adequate seems to be an historic distaste for compound interest, not a legitimate feeling that simple interest provides full redress. See *infra* Part III, Subsection D for a discussion of the cause of this judicial distaste for compound interest.

40. See, e.g., *Rapid-American v. Harris*, 603 A.2d 796 (Del. 1992); *In the Matter of the Appraisal of Shell Oil Co.*, 607 A.2d 1213 (Del. 1992); *Neal v. Alabama By-Products Corp.*, 588 A.2d 255 (Del. 1991); *Francis I. duPont & Co. v. Universal Studios, Inc.*, 343 A.2d 629 (Del. Ch. 1975).

41. See ROBERT M. CROWE, *TIME AND MONEY: USING TIME VALUE ANALYSIS IN FINANCIAL PLANNING* 1.2 (1987); DAVID L. SCOTT & W. KENT MOORE, *FUNDAMENTALS OF THE TIME VALUE OF MONEY* 12 (1984).

42. SCOTT & MOORE, *supra* note 41, at 12. For example, assume that Average Joe deposits \$1,000 in a bank account that pays 5 per cent annual simple interest. At the end of one year, Joe would have \$1,050 in the account.

The extra \$50 is the interest Joe has earned on his money. This interest payment represents Joe's compensation for giving up the use of \$1,000 for one year. The formula for computing simple interest is:

$$P_n = P_0(1 + ni)$$

where:

$P_n$  = ending balance, including interest earned

$P_0$  = beginning amount of principal

$n$  = number of periods that interest is being paid

$i$  = interest rate being paid for each period.

Therefore, in Joe's example,  $P_1 = \$1,000[1 + (1)(.05)] = \$1,050.00$ .

Similarly, if Joe were instead to deposit his \$1,000 in a certificate of deposit for ten years at 5 per cent annual simple interest, Joe would have a total ending balance of \$1,500. Thus,  $P_{10} = \$1,000[1 + (10)(.05)] = \$1,500.00$ . In other words, Joe is earning \$50 of interest every year for ten years. At the end of the ten years, Joe will have accumulated \$500 in interest payments.

However, one of the shortfalls of simple interest is that, even though after the first of ten years the account has accumulated \$50 in interest, Average Joe is not compensated for letting the bank use his money for the remaining nine years.<sup>43</sup> This anomaly takes the analysis back to the fundamental premise that Average Joe, and any other reasonable investor, would not give up a dollar today in order to receive only that same dollar in the future. Instead, Joe will only be willing to give up a dollar today if he will receive that dollar *plus interest* in the future. Therefore, since Joe did not receive compensation for the interest he earned at the end of each year, he has not been fully compensated for the use of his money. In other words, the only way to achieve full compensation is to require the bank to pay for the use of Joe's interest during the period of time that Joe did not have use of such interest. This compensation is best accomplished through application of compound interest.

### C. Compound Interest Generally

In the most basic sense, compound interest is nothing more than interest on interest.<sup>44</sup> The concept is that the interest is aggregated with the principal at the time the principal comes due.<sup>45</sup> Therefore, the interest itself is able to earn interest after such aggregation.<sup>46</sup> The importance of this interest method becomes readily apparent when a simple two-party loan is considered. For example, assume that a borrower borrows a certain amount of principal from the lender. Once interest becomes due, say after one year, the borrower is not only using the principal amount of the loan, but also the accrued interest. Although this interest is owed to the lender, it has not been paid. Therefore, the borrower must pay for the use of the interest funds as well as the principal

43. See *supra* note 42 (describing the return on a ten year certificate of deposit). The economic reality of this undercompensation is that Joe has given the bank a "free loan" of the interest he earned at the end of each year but did not receive until after the ten year period lapsed. Specifically, although Joe had earned \$50 at the end of the first year, he did not receive this \$50 until nine years later, and then Joe only received the same \$50, not \$50 plus nine years worth of interest on the \$50.

44. *Madison Personal Loan Co. v. Parker*, 124 F.2d 143, 145 (2d Cir. 1941). The formula for computing compound interest is:

$$P_n = P_0(1 + i/m)^{mn}$$

where:

- $P_n$  = ending balance, including interest earned
- $P_0$  = beginning amount of principal
- $m$  = number of compounding periods per year
- $n$  = number of years
- $i$  = annual interest rate.

Therefore, if Joe invests \$1,000 in a ten year CD paying 5 per cent interest compounded annually, he will have \$1,628.89 at the end of ten years. This amount is computed as follows:

$$P_{10} = \$1,000(1 + .05/1)^{(1)(10)} = \$1,628.89$$

Note that since this investment pays compound interest, it earns \$128.89 more than the same investment paying only simple interest. See *supra* note 42 for the same investment computed with simple interest. This additional interest serves to compensate Average Joe for the use of his interest for the time period after it was earned. This makes logical sense: because Joe was without use of the interest earned but not yet received during the ten years, while the bank had use of that money, the opportunity cost given up by Joe should be paid by the bank. See *infra* note 64 for a description of opportunity cost.

45. *Wieland v. Loon*, 116 N.W.2d 391, 393 (S.D. 1962).

46. See *id.*

funds borrowed. If the use of interest is not paid for by the borrower, the borrower will effectively receive a "free loan" of that interest.

#### *D. Application of Compound Interest*

American courts have historically frowned upon compound interest.<sup>47</sup> This distaste for compound interest comes predominantly from its perceived "penal" nature when applied in certain circumstances. Specifically, once interest is paid on accrued interest, the amount due increases more rapidly than if simple interest were awarded. When an award of compound interest is compared with an award of simple interest, the disparity between the two is often substantial. This contrast between sizes of awards produces the seemingly penal nature of compound interest. However, once it is recognized that the interest owed but not yet paid represents part of the money which is being used by the borrower, it becomes readily apparent that the use of this accrued interest also has a cost. The lender can only be compensated for this cost by computing interest on the interest already owed, and this is accomplished through the use of compound interest.

Although courts generally adhere to the basic rule that interest should not be able to itself earn interest,<sup>48</sup> the common law has carved out some exceptions, including settlement of accounts,<sup>49</sup> judgments and decrees where the interest due has effectively been lumped together with the principal,<sup>50</sup> actions against administrators, executors, and other fiduciaries,<sup>51</sup> and a guardian guilty of simple wrongdoing.<sup>52</sup> However, statutes which recognize compound interest have partially superseded judicial reluctance to award compound interest.<sup>53</sup>

#### *E. Delaware Rules for Receiving Interest*

Delaware law gives courts in appraisal proceedings discretion to award payment of either simple or compound interest along with the judicially determined value of the shares of stock.<sup>54</sup> Interestingly, prior to an amendment of Section 262 in 1967, some Delaware courts held that they possessed no statutory authority that would enable them to award interest from the effective date of

47. See *Hartford School Dist. v. Commercial Nat. Bank*, 188 S.W.2d 638, 640 (Ark. 1945); *Blakeslee's Storage Warehouses v. Chicago*, 17 N.E.2d 1, 2-3 (Ill. 1938); *Hamilton v. Wheeling Public Serv. Co.*, 107 S.E. 401, 403 (1921); *Levens v. Briggs*, 28 P. 15, 16 (Or. 1891); *Young v. Hill*, 67 N.Y. 162, 167 (1876); *Cox v. Smith*, 1 Nev. 161, 168-69 (1865).

48. *Securities Finance Co., Inc. v. Maranto*, 119 So.2d 120, 123 (La. Ct. App. 1960).

49. See *Young v. Hill*, 67 N.Y. at 177.

50. See *Hamilton v. Wheeling Public Service Co.*, 107 S.E. at 403.

51. See *Buder v. Fiske*, 174 F.2d 260, 274-75, modified on rehearing on other grounds, 177 F.2d 907 (8th Cir. 1949); *Shulkin v. Shulkin*, 16 N.E.2d 644, 652 (Mass. 1938). However, compound interest is usually only applied against a fiduciary in drastic cases of impropriety. See *Douglas v. Westfall*, 248 P.2d 68, 72 (Cal. Dist. Ct. App. 1952); *In re Reed's Estate*, 259 P. 815, 819 (Wyo. 1927).

52. See *Gaver v. Early*, 215 P. 394, 395 (Cal. 1923); *Mather v. Heath*, 15 N.W. 126, 127 (Wis. 1883).

53. See, e.g., *United States v. Glasser*, 287 F.2d 433, 434 (7th Cir. 1961) (involving 26 U.S.C.A. § 294(b) (1939)).

54. See DEL. CODE ANN. tit. 8, § 262(i) (providing that "[t]he Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Interest may be simple or compound, as the Court may direct.") (emphasis added).

the merger in an appraisal proceeding.<sup>55</sup> However, a few Delaware courts at this time went a step further and held that since the appraisal remedy was purely statutory, the interest was not required to be paid as of the effective date of the merger. Instead, these courts stated that the applicable date was when the shareholder judicially established a lawfully recognizable right to payment.<sup>56</sup> Today, once a court computes a satisfactory rate of interest, it typically awards interest from the merger date to the date of payment.<sup>57</sup> However, prior to the 1967 amendment of Section 262, some Delaware courts would only award interest from the date required by statute.<sup>58</sup>

Many states have appraisal statutes which are similar to Section 262(i) of the Delaware General Corporation Law in that they allow a court to order either simple or compound interest along with the judicially determined value of shares of the stock.<sup>59</sup> In Delaware, the decisions of whether to award interest, the proper rate to be applied, and whether to award simple or compound interest are within the court's discretion.<sup>60</sup> However, Delaware courts awarding interest pursuant to Section 262(i) have stated that this decision to award interest is not meant to increase the value of the shares resulting from the appraised valuation,<sup>61</sup> nor is it to be implemented as a punitive device.<sup>62</sup> To avoid either of these pitfalls, courts commonly combine the rates of return from an assortment of investments to establish a fair and appropriate average interest rate.<sup>63</sup>

#### IV. TIME VALUE OF MONEY

"Boy oh boy, a dollar sure doesn't buy what it used to!" Although this oft-heard adage is somewhat dated, it nevertheless remains true in today's financial world. One reason today's dollar doesn't seem to "buy what it used to" is because that dollar *really is* worth less today than it was in the past. That dollar is worth less today not only because the dollar itself is inherently less

55. See, e.g., *Meade v. Pacific Gamble Robinson Co.*, 51 A.2d 313, 321 (Del. Ch. 1947).

56. See, e.g., *In re General Realty & Utilities Corp.*, 52 A.2d 6, 16 (Del. Ch. 1947).

57. See *Bell v. Kirby Lumber Corp.*, 413 A.2d 137, 149 (Del. 1980) (finding no abuse of discretion in an award of interest from the date of merger to date of payment).

58. See, e.g., *In re General Realty & Utilities Corp.*, 52 A.2d 6, 16 (Del. Ch. 1947) (noting that interest is not to be paid from the effective date of the merger, but instead when the court enters its decree disposing of the exceptions to the appraiser's report, and determining the value of the stock).

59. See *supra* note 31 for the modern appraisal statutes of all fifty states and the District of Columbia.

60. See DEL. CODE ANN. tit. 8, 262(i). See also *Bell v. Kirby Lumber Corp.*, 413 A.2d at 149; *Lebman v. National Union Elec. Corp.*, 414 A.2d 824, 828-29 (Del. Ch. 1980). However, even under the pre-1967 version of § 262(i), the court possessed the discretion to determine interest since this statute provided that an appraiser be appointed to value the stock in question. See, e.g., *Sporborg v. City Specialty Stores, Inc.*, 123 A.2d 121 (Del. Ch. 1956).

61. See *Francis I. duPont & Co. v. Universal City Studios, Inc.*, 343 A.2d 629, 634 (Del. Ch. 1975).

62. *Rapid-American Corp. v. Harris*, 603 A.2d 796, 808 (Del. 1992). See generally *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950).

63. See *Lebman v. National Union Elec. Corp.*, 414 A.2d at 829. See generally *Charlip v. Lear Siegler, Inc.*, C.A. No. 5178 (Del. Ch. July 2, 1985); *Robbins & Co. v. A. C. Israel Enterprises, Inc.*, C.A. No. 7019 (Del. Ch. Oct. 2, 1985); *Tannetics, Inc. v. A. J. Indus., Inc.*, C.A. No. 5306 (Del. Ch. Dec. 16, 1980).

valuable, but because something was given up in order to delay receiving the dollar. That "something" may have been the ability to earn interest, or some other type of beneficial consumption avoided by not having use of that money over time. The earnings or consumption given up is an "opportunity cost." Therefore, some device is necessary in order to equate the old dollar with the new. This device is interest, and it expresses itself through the time value of money.<sup>64</sup>

### A. Future Value

Future value refers to the amount into which a present sum of money will grow when compounded<sup>65</sup> for several time periods into the future.<sup>66</sup> In other words, if Average Joe has \$100 in his hand today, what will this \$100 be worth in ten years? <sup>67</sup> The importance of applying future value concepts when awarding interest becomes increasingly clear when the length of time for litigating an appraisal proceeding is considered.<sup>68</sup>

### B. Applying Future Value Concepts to the Appraisal Proceeding

It is common for appraisal litigation to span several years or a decade or more from beginning to end.<sup>69</sup> Under Delaware appraisal law, dissenting shareholders are effectively deprived of all rights incident to equity ownership during the litigation. Specifically, from and after the effective date of the merger, dissenting shareholders lose their right to vote their shares and to receive dividend payments.<sup>70</sup> In addition, the court may require the dissenting stockholders to submit their stock certificates to the Register in Chancery for

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64. Specifically, people prefer money today over money tomorrow because of what economists call an "opportunity cost." The opportunity cost of an activity is simply "the value of the lost opportunity to engage in the best alternative activity ... with the same resource." CROWE, *supra* note 41 at 1.1. See also GARY E. CLAYTON & CHRISTOPHER B. SPIVEY, *THE TIME VALUE OF MONEY* 1 (1978). Therefore, if Average Joe waits for, say, one year to receive a sum of money, Joe's opportunity cost is the use to which that money *could* have been put during the year, whether through investing, spending or some other use valuable to Joe. See generally CROWE, *supra* note 41, at 1.2.

65. See *supra* notes 44 - 46 and accompanying text for a discussion of compound interest.

66. See CLAYTON & SPIVEY, *supra* note 64, at 5. A similar concept is that of the present value of a sum of money. In contrast to future value, present value analysis begins with a known amount of money in the future, and determines the current or present value of that amount. For a thorough discussion of present value and its application, see SCOTT & MOORE, *supra* note 41, at 61-96. See also CLAYTON & SPIVEY, *supra* note 64, at 22-40; CROWE, *supra* note 41, at 3.1-3.6.

67. See *supra* note 42 and note 44 and accompanying text for related discussion and examples of investments paying both simple and compound interest.

68. See *infra* note 69 for a listing of several appraisal cases and their elapsed litigation periods.

69. See, e.g., *In re Valuation of McCloon Oil Co.*, 565 A.2d 997 (Me. 1989) (almost thirteen years from date of merger to end of litigation); *Rapid-American Corp. v. Harris*, 603 A.2d 796 (Del. 1992) (ending just eight days short of ten years from date of merger); *In the Matter of Shell Oil Co.*, 607 A.2d 1213 (Del. 1992) (twelve days short of seven years from date of merger); *Alabama By-Products v. Neal*, 588 A.2d 255 (Del. 1991) (five and one-half years after merger); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989) (almost five years after merger); *Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1122 (Mass. 1986) (over nine years from merger); *Universal City Studios v. Francis I. duPont & Co.*, 334 A.2d 216 (Del. 1975) (eight years, ten months after merger).

70. See DEL. CODE ANN. tit. 8, § 262(k).

notation thereon of the pendency of the appraisal proceeding.<sup>71</sup> Notwithstanding the long period of time in which investors are deprived of the use of their money, the Delaware courts continue to award only simple interest in appraisal actions. As this Note has demonstrated, a borrower clearly must pay for the use of interest owed but not yet paid. Therefore, the corporation owes the shareholder for the cost of using the shareholder's interest. In order to fully compensate the dissenting shareholder for the loss of use of money, future value concepts must be applied.<sup>72</sup>

The lost value to the shareholders is best computed as the future value of the judicially determined value of the stock. More specifically, the judicially determined value of the stock at the time of the merger, computed for the number of years over which the appraisal litigation spanned, compounded annually at the judicially determined interest rate, provides the only accurate estimate of the amount due the shareholder. In this way, the shareholder is compensated for the use of all money due but not yet received. This amount includes both the judicially determined price of the stock and the interest earned but not yet paid to the shareholder. As this Note has demonstrated, neither amount can be used without a cost.

By applying this method, the court will be able to look back over the appraisal proceeding with the added benefit of proverbial 20/20 hindsight. This retroactive evaluation is advantageous because, at the time the calculation is made, the court knows the judicially determined value of the shares, how long the money was out of the shareholders' hands, and the appropriate interest rate to be applied. Since interest is awarded as compensation to the shareholders for use of their money during the appraisal proceedings, the court will be able to accurately calculate the amount due the shareholders.<sup>73</sup>

This future value formula best allows the court to fulfill the goal of accurately compensating the shareholders for loss of use of money. At the same time, the method provides a workable judicial rule. Additionally, the future value method saves valuable court time since shareholders will no longer have

71. DEL. CODE ANN. tit. 8, § 262(g).

72. See Grant, *supra* note 6 at 19-20, stating:

[I]n the absence of compound interest, the corporation could force the dissenter to sell his shares at less than fair value. If the corporation initially makes a low settlement offer, lengthy appraisal proceedings are inevitable. However, the allowance of only simple interest on the appraisal award could, in some cases, result in a situation where it would be more profitable for the shareholder to accept the settlement offer and invest the money in a savings account, drawing interest compounded quarterly, rather than go through the lengthy appraisal process. This result is clearly inconsistent with the purpose of the appraisal statutes which is to guarantee the dissenting shareholder the fair value for his shares and to encourage the corporation to make a fair settlement offer.

73. To calculate this amount due, it is necessary to retroactively apply the future value formula in order to determine the precise compensation. Therefore

$$P_n = P_0(1 + i/m)^{mn}$$

where:

- $P_n$  = total amount due, including interest, to the shareholders for loss of use of money during the appraisal proceedings
- $P_0$  = judicially determined value of the stock
- $m$  = number of compounding periods per year
- $n$  = number of years from date of merger to decision
- $i$  = judicially determined annual interest rate.

to attempt to convince the court just exactly what they would have done with their money (i.e., their subjectively determined opportunity cost). Instead, the opportunity cost is automatically built into the formula and thus is properly reimbursed through the use of future value concepts. Since the court has already determined the appropriate interest rate to be applied, after consideration of all "relevant factors,"<sup>74</sup> application of the future value formula is purely mechanical.

### C. Frequency of Compounding

This Note proposes annual compounding of interest awards in appraisal proceedings. With weekly, daily or even more frequent compounding occurring in today's financial markets, annual compounding is clearly not sufficient to compensate for loss of use of money. Specifically, the market recognizes that money has a cost, regardless of whether that money is the principal amount of a loan or the accrued interest owed on that loan. However, compounding of *any* frequency is a tremendous step for the courts to take. Therefore, the annual compounding future value formula presented in this Note should be adopted, with the discretion as to frequency of compounding left in the capable hands of each court. Once the justification and necessity for awarding compound interest in appraisal actions is understood, the courts will then be able to apply more frequent, and thus more accurate compounding periods.

## V. THE DELAWARE APPRAISAL PROCEEDING

### A. Delaware Dissenters' Rights

As previously noted, Delaware statutory law permits dissenting shareholders to receive the judicially determined "fair value" of their shares of stock in a "going concern."<sup>75</sup> In determining the elusive fair value of corporate stock, the court must take into account "all relevant factors."<sup>76</sup> Moreover, the Delaware Supreme Court has recognized that there is "*no one exclusive means* for assigning value to a Delaware corporation for purposes of an appraisal."<sup>77</sup> Further, a significant factor, perhaps the most significant, in the valuation

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74. DEL. CODE ANN. tit. 8, § 262(h).

75. DEL. CODE ANN. tit. 8, § 262. See also *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989); *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950).

76. DEL. CODE ANN. tit. 8, § 262(h). The statute states:

After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. In determining the fair rate of interest, the Court may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding.

*Id.* See also *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 174 (Del. 1991); *Alabama By-Products*, 588 A.2d at 257-58; *Cavalier Oil Corp.*, 564 A.2d at 1144; *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

77. *Rapid-American Corp. v. Harris*, 603 A.2d 796, 805 (Del. 1992) (emphasis added). See also *Weinberger v. UOP, Inc.*, 457 A.2d at 713-14.

analysis is the very "nature of the enterprise" involved in the valuation.<sup>78</sup> However, the Delaware Supreme Court has consistently held that a dissenting stockholder is allowed to recover only his "proportionate interest in a going concern,"<sup>79</sup> or in other words, only "that which has been taken from him".<sup>80</sup>

### *B. The Prudent Investor Approach*

Before 1981, Delaware courts applied the "prudent investor" standard to determine the appropriate interest rate in an appraisal proceeding.<sup>81</sup> The prudent investor approach focuses solely on the interest rate which a prudent investor could have received on his or her money, without regard to the cost the corporation would have had to pay to borrow funds.<sup>82</sup> Recognizing the inherent limitations of this method, the General Assembly amended Section 262(h) in 1981 to provide that the court may consider "all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding" in determining a fair rate of interest.<sup>83</sup> This amendment clearly broadens the ability of a court to look beyond the prudent investor approach in finding a fair rate of interest.<sup>84</sup>

### *C. The Modified Prudent Investor Approach*

Although Delaware courts do not use the prudent investor approach nearly as often as they did in the past,<sup>85</sup> its underpinnings provide support for what this Note proposes as the "Modified Prudent Investor Approach."<sup>86</sup> This

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78. See *Rapid-American Corp. v. Harris*, 603 A.2d at 806. See also *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144-45 (Del. 1989); *Tri-Continental Corp. v. Batty*, 74 A.2d at 73.

79. *Tri-Continental Corp. v. Batty*, 74 A.2d at 72.

80. *Id.* See also *Cavalier Oil Corp. v. Harnett*, 564 A.2d at 1144; *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1186 (Del. 1988); *Weinberger v. UOP, Inc.*, 457 A.2d at 714.

81. See, e.g., *Lebman v. National Union Elec. Corp.*, 414 A.2d 824, 829 (Del. Ch. 1980) (focusing on the return a shareholder could have realized on a comparable investment); *Steinhart v. Southwest Realty and Development Co.*, Del. Ch., C.A. No. 583, Hartnett, V.C. (December 28, 1981) (adding the average yield on money market funds to arrive at the appropriate interest rate); *Tennetic, Inc. v. A. J. Industries, Inc.*, DEL. CH., 6 DEL. J. CORP. L. 347 (December 16, 1980) (applying short-, medium- and long-term rates on United States Treasury Bills, savings deposits held in mutual savings banks, Moody's Triple A Corporate Bond average, and Standard & Poor's Industrial Average in order to arrive at the appropriate interest rate).

82. See *Charlip v. Lear Stiegler, Inc.*, C.A. No. 5178, at 3. See also *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 222-23 (Del. 1975) ("[t]herefore it was proper to focus on what would have been the rate of interest at which a prudent investor could have invested money rather than in focusing on how much it would have cost the corporation to borrow money.").

83. DEL. CODE ANN. tit. 8, § 262(h).

84. See *Charlip v. Lear Siegler, Inc.*, C.A. No. 5178 (Del. Ch. July 2, 1985) at 2.

85. See *supra* notes 81 - 84 and accompanying text for a discussion of the prudent investor approach and its erosion since 1981.

86. This proposed method originated in the *Rapid-American Corp. v. Harris*, 603 A.2d 796 (Del. 1992) litigation. Specifically, David Harris, the dissenting shareholder in *Rapid-American* [hereinafter *Harris*], argued that no prudent investor with a long-term investment horizon - such as that necessitated by an appraisal proceeding - would select an investment that paid merely simple interest. See Reply Brief of Appellees/Cross Appellants in Support of Cross-Appeal at 10, *Rapid-American Corp. v. Harris*, 603 A.2d 796 (Del. 1992) (No. 6462) [hereinafter *Reply Brief*]; Petitioner's Post-Trial Memorandum at 68-69, *Harris v. Rapid-*

approach is designed to avoid the otherwise necessary speculation by the court which results from attempting to quantify shareholders' opportunity costs.<sup>87</sup>

The only way an investor is likely to give up the security of a known payment is through the enticement of receiving a correspondingly higher return in the future. In other words, a return high enough to compensate for the inability to receive such frequent periodic payments along the way will be necessary to secure the use of that investor's funds. Therefore, courts should recognize that periodic payments are almost universally made on long-term investments. As a result, compound interest is the best way to most closely approximate appraisal valuation awards with these types of investments.

When viewed in this light, the question of whether the prudent investor would put his or her money into an investment vehicle paying periodic income is always answered in the affirmative, while the specific types of alternatives (i.e., those resulting in the appropriate interest rate or opportunity cost) can still be decided on a case-by-case basis. This method allows the court to combine the benefit of applying an appropriate rate of return with the goal of proper compensation of the shareholder for the loss of use of money. As this Note has demonstrated, compound interest is necessary to fully compensate dissenting shareholders. This is true no matter what method the court chooses to use in determining the applicable rate of interest.

## VI. CASE ANALYSIS

### A. Simple Interest in Delaware Appraisal Proceedings

#### 1. Rapid-American

##### a. Holding

In *Rapid-American Corp. v. Harris*,<sup>88</sup> the Delaware Supreme Court held that the Court of Chancery did not abuse its discretion in awarding simple interest in an appraisal proceeding.<sup>89</sup> However, the court also acknowledged that Delaware courts had not been presented with the opportunity to explicitly address the factors used to determine whether simple or compound interest

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American Corp., 603 A.2d 796 (No. 6462) [hereinafter Memorandum]; Petitioner's Post-Trial Reply Memorandum at 35, *Harris v. Rapid-American Corp.*, 603 A.2d 796 (No. 6462) [hereinafter Reply Memorandum] [all of which are on file with the Delaware Supreme Court and the Arizona Law Review]. Harris contended that since all of the investment choices presented by the parties at trial paid interest on a periodic basis, so too should Harris be compensated for this lost ability to reinvest by at least a semi-annual compounding period. See Reply Brief at 10-11, *Rapid-American* (No. 6462); Memorandum at 69, *Rapid-American* (No. 6462); Reply Memorandum at 35, *Rapid-American* (No. 6462).

87. The opportunity cost referred to here is the rate of interest given up by shareholders in having their money tied up in the corporation's stock during the appraisal proceedings. See *supra* note 64 for a description of opportunity costs.

88. 603 A.2d 796 (Del. 1992).

89. *Rapid-American Corp. v. Harris*, 603 A.2d at 808.

should be awarded.<sup>90</sup> Nevertheless, the court went on to explain that, when the statutory law is clear, the analysis often ends with the statute itself.<sup>91</sup>

In *Rapid-American*, the applicable statute stated "interest may be simple or compound, as the Court may direct."<sup>92</sup> The court explained that this statute was "clear and precise," stating that Section 262(i) "clearly gives the trial court absolute discretion to determine the form of interest it will award in a statutory appraisal action."<sup>93</sup>

#### b. Background Facts

Rapid-American Corporation (hereinafter Rapid-American) was a publicly held conglomerate.<sup>94</sup> In 1980, Rapid-American announced its plans for a merger with Kenton Corporation (hereinafter Kenton).<sup>95</sup> After employing financial advisors<sup>96</sup> to determine the "fairness" of the merger price, Rapid-American settled on a compensation package worth roughly \$28 per share.<sup>97</sup> Instead of accepting the \$28 per share amount, Harris and other dissenting shareholders brought an appraisal action for a judicial valuation of their shares of Rapid-American stock.<sup>98</sup> Harris filed suit in the Delaware Court of Chancery

90. *Id.*

91. *Id.*

92. DEL. CODE ANN. tit. 8, § 262(i).

93. *Rapid-American Corp. v. Harris*, 603 A.2d at 808. The Court went on to state that: [The court] must take into account 'all relevant factors' in reaching its decision. While not exhaustive, some of these factors can include the considerations enumerated in 8 Del. C. § 262(h). [Section 262(h) states] 'in determining the fair rate of interest, the Court may consider . . . the rate of interest which the surviving or resulting corporation would have to pay to borrow money during the pendency of the proceeding.'

*Id.* at 809.

94. Ninety-nine per cent of Rapid-American's net sales, and the bulk of its operating profits, were derived from three wholly-owned subsidiaries: McCrory Corporation [hereinafter McCrory], Schenley Industries, Inc. [hereinafter Schenley], and McGregor-Duniger, Inc. [hereinafter McGregor]. See *Rapid-American Corp. v. Harris*, 603 A.2d at 799.

95. *Id.* at 800. Kenton was the acquiring company and began to purchase shares of Rapid-American. At the same time, Rapid-American began buying back its own shares as well. Ultimately, the consolidation would result in combining Rapid-American and Kenton into a newly-formed corporation.

96. Rapid-American retained an independent Transaction Review Committee (hereinafter TRC) to consider the merger price. The TRC in turn employed Bear Sterns & Co. for the purpose of providing financial advice, and also hired Standard Research Consultants (hereinafter SRC) to evaluate the fairness of the proposed compensation package to the holders of Rapid-American stock. After a six month study, SRC concluded that the proposed package of approximately \$28 per share was indeed a fair offer. See *Rapid-American Corp. v. Harris*, 603 A.2d at 800.

SRC's method of valuation looked at Rapid-American on a consolidated basis. *Id.* The valuation technique examined Rapid-American through an analysis of earnings and dividends. *Id.* SRC accomplished this analysis by calculating price/earnings ratios for each subsidiary and adjusting the figures so as to take into account certain dividend ratios. *Id.* Then SRC computed the contribution of each subsidiary to the parent corporation's operating income for a fixed period of time in order to calculate Rapid-American's ultimate value. *Id.* Finally, SRC compared its figures with several established financial ratios of similarly situated corporations. *Id.*

97. This compensation package included \$45 principal in a newly-issued 10 per cent sinking fund subordinated debenture (worth approximately \$24.75), \$3 in cash, and an additional \$.25. See *Rapid-American Corp. v. Harris*, 603 A.2d at 800. The nominal cash fee provided settlement consideration for certain derivative suits that were pending at the time. *Id.*

98. Harris and the other petitioners collectively owned 58,400 shares of Rapid-American stock prior to the merger. Harris employed Willamette Management Associates, Inc. (hereinafter WMA) who evaluated the compensation package differently than SRC by looking separately at

under Section 262 of the Delaware Code, arguing that the compensation package offered for Rapid-American stock did not reflect its fair value. Following a trial, the Court of Chancery held that Harris was entitled to \$51 per share, instead of the \$28 per share offered to the stockholders, with simple interest thereon.<sup>99</sup> As a result of this value determination, Rapid-American appealed to the Delaware Supreme Court.

### c. Analysis

The Delaware Supreme Court explained that Section 262(i) gives the court discretion to award either simple or compound interest.<sup>100</sup> In light of these broad powers vested in the trial court under Section 262(i), the court concluded that there was no abuse of discretion by the lower court in awarding only simple interest.<sup>101</sup> However, even if within its discretion, the trial court's decision in *Rapid-American* is based upon incomplete reasoning. The result of this lack of thorough analysis is that dissenting shareholders such as Mr. Harris are not fully compensated for their monetary loss.

In justifying its decision to award simple interest, the court simply decided "not to depart from [its] standard practice of allowing only simple interest."<sup>102</sup> The trial court's reasoning, while concededly long on tradition, fails to recognize the economic necessity of compound interest. Although the court grounds its "standard practice of allowing only simple interest" on Delaware precedent, it does not analyze the motivations supporting that precedent.<sup>103</sup> Specifically, the court bases this "standard practice" upon *Charlip v. Lear Siegler, Inc.*,<sup>104</sup> *Neal v. Alabama By-Products Corp.*,<sup>105</sup> *Pinson v. Campbell-Taggart, Inc.*,<sup>106</sup> and *Francis I. duPont & Co. v. Universal Studios, Inc.*<sup>107</sup> without any effort to compare the reasoning in such cases with the case at bar.<sup>108</sup>

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each of Rapid-American's subsidiaries. WMA reasoned that this "segmented" technique was more appropriate because there was no similar conglomerate with which to compare Rapid-American. *Id.* However, in the end the trial court rejected both valuation methods and instead adopted a modified version of WMA's approach. *See id.*

99. *See* *Rapid-American Corp. v. Harris*, 603 A.2d 796, 798 (Del. 1992).

100. *Id.* at 808.

101. *Id.* at 809. Specifically, the Court noted that the trial court "must take into account 'all relevant factors' in reaching its decision. While not exhaustive, some of these factors can include the considerations enumerated in 8 Del. C. § 262(h) . . . [which include] the rate of interest which the surviving or resulting corporation would have to pay to borrow money during the pendency of the proceeding." *Id.*

102. *Id.* at 807 (citing *Harris v. Rapid-American Corp.*, slip op. at 43, 1990 WL 146488).

103. *See* *Rapid American Corp. v. Harris*, 603 A.2d at 807.

104. 1985 WL 11565 (Del. Ch.) at 4. *Charlip* contains perhaps the most striking language to illustrate the lack of reasoning used by the court. The court states "[a]lthough this Court has always awarded simple interest in the past, certain dicta in [*Francis I. duPont v. Universal City Studios, Inc.*, 343 A.2d 629, 635, n.\*\*\* (Del. Ch. 1975)] suggests that an award of simple interest might not be appropriate in all appraisal cases. No authority is cited for this statement and I am not persuaded that it provides sufficient precedent for departure from the historical basis for all allowance of simple interest." *Charlip v. Lear Siegler, Inc.*, 1985 WL 11565 (Del. Ch.) at 4.

105. 1990 WL 109243 (Del. Ch.), *aff'd*, 588 A.2d 255 (Del. 1991).

106. 1989 WL 17438 (Del. Ch.).

107. 343 A.2d 629 (Del. Ch. 1975).

108. *See* *Rapid-American Corp. v. Harris.*, 603 A.2d 796, 807.

This Note recognizes the distinction between the permissive ability of the trial judge to award compound interest, as expressed in the dicta from *Francis I. duPont*,<sup>109</sup> and a blanket legal rule that such dicta precludes compound interest from *ever* being awarded in a Delaware appraisal proceeding, as the above quoted language from *Charlip* indicates. As such, the decision whether to award compound interest should warrant, at the very least, an analytical consideration of its applicability rather than a complete bar to its use in all appraisal proceedings. This consideration is all the more appropriate when the decision of the court to award simple interest is based purely upon traditional grounds. Oliver Wendell Holmes described this situation most aptly when he stated:

It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past.<sup>110</sup>

One reason contributing to the *Rapid-American* court's hesitancy to depart from tradition is that the court, although perhaps somewhat unwittingly, combines the separate steps of determining the appropriate rate of interest to be applied and deciding whether to award simple or compound interest.<sup>111</sup> Whatever method is used to arrive at the appropriate rate of interest to be applied in a particular case, the question of whether to award compound interest should be kept wholly separate. In addition, the latter question should always be answered in the affirmative, since, as this Note has demonstrated, compound interest is the only way to fully compensate the shareholder for the loss of use of money.

Since an endless supply of investment alternatives exist in today's financial marketplace, the prudent investor will invest his money in that alternative which provides the highest *total* return. Thus, an investment paying only 7 per cent interest per year, *compounded daily*, is preferable to an alternative paying 7.2 per cent *simple* interest per year, since the *total return* of the former is greater than the latter.<sup>112</sup> Although daily compounding may be out of the question for appraisal proceedings due to its supposed "penal" nature under certain circumstances,<sup>113</sup> it does illustrate the fact that *some* amount of compounding is necessary. Once the courts understand why such compounding is

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109. 343 A.2d 629, 635 (Del. Ch. 1975).

110. Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897).

111. This confusion is not altogether unwarranted, as the statute itself almost seems to perpetuate the commingling of these two decisions. See DEL. CODE ANN. tit. 8, § 262(i) ("The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Interest may be simple or compound, as the Court may direct.").

112. When computed using the future value formula, *supra* note 44, the \$10,000 invested at 7 per cent interest compounded daily yields a total return after one year of \$10,725.01. In contrast, by using the simple interest formula, *supra* note 42, the same \$10,000 invested at 7.2 per cent simple interest only yields a total return of \$10,720.00. The explanation of this result is that daily compounding allows the investor to accumulate interest on the interest already earned, from day one.

113. See Part III D, *supra* for an explanation of the seemingly "penal" nature of compound interest.

necessary, the frequency of compounding periods can remain within their discretion on a case-by-case basis. Following this analysis, if the proceedings have taken less than one year, an unlikely scenario in today's time-consuming appraisal litigation, then simple interest might in fact be adequate. However, if the judicial valuation extends beyond one year, the more likely scenario, then compounding is necessary in order to ensure full compensation.<sup>114</sup>

At present, it seems there is little chance that Delaware courts will depart from the reasoning employed in *Rapid-American*. Thus, dissenters are not likely to receive full compensation for the loss of use of their money during the appraisal proceedings. In addition, the scarce base of reasoning upheld by the court in *Rapid-American*<sup>115</sup> has directly influenced at least one equally questionable opinion.<sup>116</sup>

## 2. Shell Oil

In *The Matter of Shell Oil Co.*,<sup>117</sup> the Delaware Supreme Court declined to disturb the trial court's decision to award simple interest.<sup>118</sup> The court recognized the trial court's opportunity to weigh the evidence as presented at trial, and therefore declined to intrude upon the lower court's discretion to award simple interest.<sup>119</sup> It is also noteworthy that the trial court arrived at its decision by combining part of the expert testimony given from both sides. The court awarded simple interest at the urging of the dissenters' expert, while at the same time adopting an interest rate more closely resembling that pro-pounded by Shell Oil's expert.<sup>120</sup> The court explained that such a determination was clearly within the discretion of the trial court, notwithstanding the fact that part of the reason for the decision was due to the trial court's perception that Shell's expert testimony was "less credible" than that of the dissenters' expert.<sup>121</sup>

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114. Specifically, it is doubtful that an investor holding shares of common stock would have invested that money in an investment alternative that he or she (1) could not have cashed-out on demand, or (2) did not receive income from at least annually. Therefore, the investor would have had the use of that income after the first period it was received. Consequently, each day interest is not being paid on the use of this income results in *further lost income* that would otherwise have been in the investor's pocket. In other words, that income received from the investment could then itself have been invested to earn more income.

115. See *Rapid-American Corp. v. Harris*, 603 A.2d at 808-09.

116. See *In the Matter of Shell Oil Co.*, 607 A.2d 1213 (Del. 1992). Cf. *TV58 Limited Partnership v. Weigel Broadcasting Co.*, 1993 WL 285850 (Del. Ch. 1993) (although not explicitly relying upon *Rapid-American*, the court awarded simple interest as set out in the "legal rate of interest" statute).

117. 607 A.2d 1213 (Del. 1992).

118. *Matter of Shell Oil*, 607 A.2d at 1222. In *Shell Oil*, minority shareholders brought an appraisal action pursuant to DEL. CODE ANN. tit. 8, § 262. Shell was the target of a short-form merger executed by the majority stockholder of Shell, SPNV Holdings, Inc., which owned 94.6 per cent of the outstanding shares. Although the cash-out price offered to Shell's shareholders was \$58 per share, the Court of Chancery found that the fair value was \$71.20 per share at the time of the merger. See *id.* at 1215.

119. *Id.* at 1222. In recognizing the discretion given to the trial court to award simple interest, the court relied upon both DEL. CODE ANN. tit. 8, § 262(i) and *Rapid-American Corp. v. Harris*, 603 A.2d 796 (Del. 1992). *Matter of Shell Oil*, 607 A.2d at 1221. Although the case at bar was not such a case, the court also noted that an award of interest made in an arbitrary or capricious manner would be an abuse of the discretion afforded the trial court. *Id.*

120. *Id.* at 1222.

121. *Id.*

### 3. TV58

Another recent application of simple interest in an appraisal proceeding occurred in *TV58 Limited Partnership v. Weigel Broadcasting Co.*<sup>122</sup> Here the Delaware Court of Chancery awarded only simple interest to dissenting shareholders in an appraisal proceeding brought under Section 262.<sup>123</sup> In a fashion similar to that of *Rapid-American*, the court in *TV58* buttressed its decision to award simple interest with a sparse amount of reasoning.<sup>124</sup>

After calculating the appropriate rate of interest,<sup>125</sup> the *TV58* court simply stated that "simple interest ... is appropriate here."<sup>126</sup> Interestingly, the court reasoned that simple interest was appropriate because "a) this action has taken a very long time to get to trial; b) there were delays in scheduling the trial and completing discovery, during which time [defendant] argued that the plaintiff's 'interest' would make TV58LP whole; and c) [defendant] had use of TV58LP's funds during this time period."<sup>127</sup> Ironically, it is for these very reasons that compound interest, not simple interest, is necessary. Due to the protracted time the case took to get to trial, the stockholder corporation was without use of its money for a lengthy period of time. Time value of money principles dictate that the further into the future the receipt of money is, the less that money is worth today.<sup>128</sup> Therefore, compound interest is necessary in order to fully compensate the shareholder for the loss of use of money.

Similarly, since the defendant had use of the shareholder's money during this time, economic principles dictate that the shareholder be adequately compensated for this "involuntary loan." In other words, the shareholder quite properly was due some amount of interest, at least at the end of the first year.<sup>129</sup> Therefore, without compounding the interest, this amount due the shareholder was effectively loaned to the defendant free of charge. As this Note has demonstrated, the use of this amount has a cost, and the shareholder can only be fully compensated through the use of compound interest.

The court in *TV58* explained that compound interest is not encouraged when computing the legal rate of interest.<sup>130</sup> Although recognizing that some

122. Del. Ch., 1993 WL 285850 (July 22, 1993).

123. *Id.* at 8.

124. The court first pondered the provision in DEL. CODE ANN. tit. 8, § 262(h), which provides for the consideration of "all relevant factors, including the rate of interest which the surviving or resulting corporation would have to pay to borrow money during the pendency of the proceeding." *TV58 Limited Partnership v. Weigel Broadcasting Co.*, 1993 WL 285850, at 8. The court went on to explain that DEL. CODE ANN. tit. 8, § 262(i) allows the court to award either simple or compound interest. *Id.*

125. The court in *TV58* calculated the "legal rate of interest" pursuant to DEL. CODE ANN. tit. 6, § 2301, which provides for computation by adding 5% to the Federal Reserve discount rate. *TV58 Limited Partnership v. Weigel Broadcasting Co.*, 1993 WL 285850 at 8. Since the discount rate was 6.5 per cent at the time of the merger, the court determined that the correct rate to be applied was 11.5 per cent. *Id.*

126. *TV58 Limited Partnership v. Weigel Broadcasting Co.*, 1993 WL 285850, at 8.

127. *Id.* (emphasis added).

128. See *supra* notes 64 - 68 and accompanying text for a discussion of the time value of money.

129. See *supra* note 43 and accompanying text for a discussion of earning interest on money due.

130. *TV58 Limited Partnership v. Weigel Broadcasting Co.*, 1993 WL 285850, at 8.

Delaware courts have awarded compound interest in appraisal valuations,<sup>131</sup> the trial judge merely stated "I do not find that this case warrants compound interest."<sup>132</sup> The court further attempted to strengthen its conclusion to award only simple interest by noting that the parties had failed to address the "prudent investor factor."<sup>133</sup> Specifically, the court explained that "the volatility and risk associated with an investment of a start-up television station such as MTV58 reduces a reasonable investor's expectation of regular returns on investment."<sup>134</sup> However, this conclusion does not necessarily follow from the court's reasoning.

Investors understand that start-up companies are inherently risky. Young companies have a high failure rate, and as such are not recommended for the conservative investor. However, this risk is built into the expected return that the investor seeks, and the investor understands that in compensation for accepting a higher level of risk, there will be a correspondingly higher total expected return.

While the conclusion that reduced expectation of *regular* returns may be correct, this does not mean that the expected *total* return is lower. To the contrary, by accepting more risk, the investor is entitled to a correspondingly higher expected *overall* return. This means simply that although some of the investments may result in little return, no return, or even negative return, the investor can expect a greater *total* return due to the acceptance of increased levels of risk.

This reasoning necessarily leads to the conclusion that the only way to fully compensate the investor is to award compound interest. Otherwise, simple interest not only fails to account for the higher expected total return of the investor, but it leaves the investor in an even worse position than if the investor would have simply spent the income, since the value at the time the interest was due would clearly have been greater than the value sometime in the distant future.

## ***B. Compound Interest in Appraisal Proceedings***

### ***1. McCloon Oil***

Fortunately, not all courts have adhered to the view that simple interest is sufficient to compensate a dissenting shareholder in an appraisal proceeding. In *In re Valuation of Common Stock of McCloon Oil Co.*,<sup>135</sup> the Supreme Court of Maine held that compound interest was the only way to compensate dissenting shareholders for the loss of use of their money for almost thirteen years.<sup>136</sup> This was a modification of the trial court's decision, which had

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131. The court made reference to *Cede & Co. v. Technicolor, Inc.*, Del. Ch., C.A. No. 7129, Allen, C. (Oct. 19, 1990), for an appraisal action in which compound interest was awarded. *TV58 Limited Partnership v. Weigel Broadcasting Co.*, 1993 WL 285850, at 8.

132. *Id.*

133. *Id.* See *supra* notes 81 - 84 and accompanying text for a discussion of the "prudent investor approach."

134. *TV58 Limited Partnership v. Weigler Broadcasting Co.*, 1993 WL 285850 at 8.

135. 565 A.2d 997 (Me. 1989).

136. *Id.* at 1007-08.

awarded only simple interest.<sup>137</sup> The court further stated that the compounding should be done at least annually.<sup>138</sup> The court explained that as a matter of law, interest received pursuant to an appraisal proceeding is a substantive right designed to compensate for the loss of use of money, and is not merely a "procedural incentive."<sup>139</sup>

It is noteworthy that the court in *McCloon* did not remand the case, but instead simply held that, given the nature of the evidence, the trial judge should not have denied compound interest.<sup>140</sup> The evidence introduced included savings accounts at the low end of the risk spectrum and commercial paper at the high end, all of which paid interest in a regular periodic manner, usually quarterly or even more frequently.<sup>141</sup> The *McCloon* court explained that "as the payee received each payment of interest, that amount became available to the payee to produce interest income thereafter."<sup>142</sup> As such, the court reasoned that compounding was necessary in order to fully compensate the dissenting shareholders.<sup>143</sup> *McCloon* clearly demonstrates the necessity of compound interest in appraisal proceedings by correctly focusing on the ability of the shareholder to receive income on the interest due. As this Note has demonstrated, this interest due but not paid has a cost that can only be paid through compound interest.

## 2. Sarrouf

Another case recognizing the necessity of awarding compound interest is *Sarrouf v. New England Patriots Football Club, Inc.*,<sup>144</sup> in which the Massachusetts Supreme Court held that the trial judge should consider whether "[t]he amount selected fairly compensated the plaintiffs for their inability to use the money during the period in question, . . . [and whether the rate] reflected

137. See *id.* at 1000. The applicable statute in *McCloon*, ME. REV. STAT. ANN. tit. 13-A, § 909(9)(G), provided that the Superior Court's judgment "shall include an allowance for interest at such rate as the court may find to be fair and equitable in all the circumstances, from the date on which the vote was taken on the proposed corporate action to the date of payment." ME. REV. STAT. ANN. tit. 13-A, § 909(9)(G). Other courts have also recognized the applicability of compound interest. See, e.g., *Hernando Bank v. Huff*, 609 F.Supp. 1124, 1129 (N.D. Miss. 1985) (awarding interest based upon the rate available on a one-year CD, to be compounded annually); *Francis I. duPont*, 343 A.2d 629, 635 n.\*\*\* (Del. Ch. 1975) ("I do not mean to imply that the Court is bound to award simple interest, as opposed to compound interest, in every [appraisal] case.... I only decide that, absent an express exercise of the Court's discretion for purposes of administrative convenience, there is little significance in the date of the order for interest purposes and compounding effect. But, since interest in an appraisal case is not paid annually or periodically, there is a good argument for compound interest.").

138. In re *Valuation of McCloon Oil Co.*, 565 A.2d 997, 1008 (Me. 1989).

139. *Id.* at 1007. See also *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 222 (Del. 1975) ("the purpose of interest is to fairly compensate [dissenting shareholders] for their inability to use [their] money during the period in question."); In re *Glosser Bros., Inc.*, 555 A.2d 129, 146 (Pa. 1989) ("[the interest is to be] fair compensation to the dissenters for the deprivation of the fair value of their stock from the effective date of the merger.").

140. In re *Valuation of McCloon Oil Co.*, 565 A.2d at 1008.

141. *Id.*

142. *Id.*

143. *Id.*

144. 492 N.E.2d 1122 (Mass. 1986). In *Sarrouf*, dissenting stockholders brought an appraisal valuation pursuant to MASS. GEN. LAWS ANN. ch. 156B, §§ 86-98 (West 1983) in order to contest the offering price of \$15 per share by an acquiring company. Along with this litigation, the merger at issue also produced judicial proceedings designed to thwart the merger. See *Coggins v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1112 (Mass. 1986).

'the rate of interest at which a prudent investor could have invested money.'"<sup>145</sup> Further, the court held that the awarding of compound interest by the trial court was not an abuse of discretion.<sup>146</sup> The court explained that the applicable statute<sup>147</sup> does not require nor prohibit compound interest.<sup>148</sup> Therefore, this statute vests the court with discretion to award either simple or compound interest.<sup>149</sup> The court further explained that the trial judge is empowered to "consider the inability of the plaintiffs to use the money tied up in the appraisal property."<sup>150</sup>

The decision to award compound interest in a judicial appraisal proceeding flows fairly from common sense. The one necessary assumption is that interest is being awarded by the court in an effort to fully compensate the dissenting shareholder for the loss of use of money.<sup>151</sup> With this assumption as the underpinning, compound interest becomes necessary, not simply discretionary, to ensure full compensation for loss of use of money greater than one year. As this Note has demonstrated, the most accurate way to accomplish such compensation is through use of the future value method described in Part IV, subsection B of this Note.

In the most basic sense, a dissenting stockholder has given the corporation what effectively amounts to an involuntary loan. The shareholder is operatively without the rights of equity ownership, and instead of receiving immediate compensation for this loss of ownership, the shareholder does not receive payment until the conclusion of the appraisal proceeding. Although such a "forced loan" is concededly rare in other situations, there appear to be no sufficiently compelling reasons for treating such an involuntary loan any differently than a voluntary loan.<sup>152</sup> Regardless of the period upon which interest is calculated, this Note has demonstrated that at the end of the first year, the borrower owes the lender *some* amount of interest for the use of the money.<sup>153</sup> Consequently, if that interest is not paid at the end of the year, the lender is worse off simply because the lender will now be without the use of money rightfully belonging to the lender, i.e., the interest earned but not yet received.

Obviously, there is an opportunity cost to this money in that if it were in the lender's pocket, the lender would have the choice as to how to use it. This interest income could be spent, loaned, or consumed in some other beneficial

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145. *Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d at 1129 (citing *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 222 (Del. 1975)).

146. *Id.*

147. The statute to which the court was referring to was MASS. GEN. LAWS ch. 156B, §§ 92 and 95.

148. *Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d. at 1129.

149. This is the same discretion conferred upon Delaware courts in appraisal proceedings. See DEL. CODE ANN. tit. 8, § 262(i).

150. *Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1122, 1129 (Mass. 1986).

151. See *supra* note 36 and accompanying text, stating that interest is a reimbursement for the use of money.

152. Specifically, an individual looking to borrow money, for whatever legitimate purpose, would be hard pressed to find a lender to make a loan in which that lender would be paid interest less frequently than annually. In practice, most mortgages and other loans require the borrower to pay interest calculated on a monthly or even a daily basis.

153. See *supra* Part III for a discussion of interest and the fact that the use of interest owed to the shareholder has a cost.

way. The fundamental point is that the lender misses out on some valuable use due solely to the fact that he or she has not received money properly due and payable. Although the problem may not seem too severe at this juncture, when a longer time horizon is brought into play the deficiency in awarding only simple interest becomes startling.

If, for example, the interest was not paid for ten years, then the lender has lost use of the interest owed him or her at the end of the first year (Year 1) for nine years. Therefore, by not giving the lender the amount due at the end of Year 1 until the end of Year 10, the lender has effectively made another free loan of that interest for nine years. Thus, the basic principles of the financial marketplace and the logical conclusion of this explanation require that the borrower pay *something* for the use of this money. This something can only come from compounding the interest from the day it was due. At the very least, this due date is at the end of Year 1.

## VII. CONCLUSION

*Rapid-American* and its predecessors represent the application of a traditional rule completely for tradition's sake. Oliver Wendell Holmes has adequately and eloquently exposed the faultiness of such historic application.<sup>154</sup> Given the wide-reaching influence of the Delaware Supreme Court on the corporate law of other states, the court's recent decisions relating to simple interest in appraisal proceedings are unsettling indeed. However, this judicial reluctance to fully compensate aggrieved shareholders is understandable given the law's historic distaste for compound interest.

This Note has demonstrated that compound interest is not simply helpful to dissenting shareholders, but rather it is mandatory to achieve full compensation for the loss of use of money. Fortunately, the Delaware appraisal statute was drafted with the foresight to provide the courts with discretion to award compound interest. Therefore, judicial utilization of the future value concepts proposed by this Note will have a constructive effect on ensuring adequate compensation of dissenting shareholders in appraisal proceedings. By focusing on the fact that dissenting shareholders have been deprived of the use of their money during the appraisal litigation, the courts should be able to achieve this necessary compensation. Perhaps the easiest way to promote the adoption of compound interest in judicial valuation proceedings is simply to remove the offensive word "compound" and replace it with "compensating." Thus, as its name implies, "compensating interest" may provide the euphemistic prodding necessary to begin fully compensating injured shareholders subjected to providing involuntary loans to corporations. Not only will this more adequately reimburse the shareholders, it will give corporations the monetary incentive necessary to reevaluate both their offering prices in proposed mergers and their potential use of delay tactics in appraisal proceedings.

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154. See *supra* note 110 and accompanying text.