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Information Bundling, Disclosure, and Judicial Deference to Market Valuations

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INFORMATION BUNDLING, DISCLOSURE TIMING, AND JUDICIAL DEFERENCE TO MARKET VALUATIONS

CHARLES R. KORSMO

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CHARLES R. KORSMO*

Abstract: This Article examines strategic disclosure behavior in the context of merger announcements. Merger transactions are frequent targets of litigation, including both fiduciary duty class actions and statutory appraisal actions. In either type of litigation, the fair value of the target company as a going concern is at least a part of the measure of damages. In recent years, courts have increasingly looked to market evidence of valuation—including the trading price of the target company's stock prior to the announcement of the merger. This gives managers an incentive to minimize this trading price by strategically timing disclosures such that negative news is released prior to announcement of a merger while positive news is released simultaneously with or following a merger announcement. In many ways, the disclosure incentives managers face in the merger context mirror those they face in the securities fraud context. For years, securities fraud plaintiffs have typically been required to prove loss causation by using an event study to show a market decline upon corrective disclosure—a practice enshrined by the United States Supreme Court in *Dura Pharmaceuticals, Inc. v. Broudo*. Managers can make this task more difficult by bundling corrective disclosures with other potentially material news. Combining the corrective disclosure with additional bad news can make it impossible to determine what portion of any resulting price drop to ascribe to the corrective disclosure. Combining the disclosure with offsetting good news can reduce or eliminate the price reaction altogether. These types of strategic disclosure behaviors have important implications for the design of federal disclosure rules and judicial doctrine. To the extent that courts and regulators ascribe legal significance to the market's reaction to information contained in corporate disclosures, those disclosures should be required to be made in a way that results in an informative market reaction. As such, this Article proposes that the Securities Exchange Commission should require several types of litigation-relevant information to be disclosed in standalone, unbundled fashion. In addition, this Article suggests refinements to judicial doctrine. These refinements are designed to: (1) minimize the incentive for managers to employ opportunistic disclosure strategies; and (2) preserve the flexibility to employ non-market valuation evidence where market evidence has been corrupted or obscured.

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INTRODUCTION

As a general rule, judges hate to perform financial valuations. They avoid it whenever possible. When faced with the need to calculate the value of a company, or of a piece of information relating to a company, judges are typically reluctant to attempt the kind of valuation calculations a securities analyst or investment professional might perform. Most would prefer to defer to the judgment of the market, when possible.

Although this reluctance is partly due in part to the legendary aversion of lawyers (including judges) to mathematics, it also reflects a wise sense of judicial modesty.[1] Few economic propositions are better established than that well-functioning securities markets, on average, perform far better at valuation than even the most sophisticated, motivated, and informed individuals. No doubt the advantages of market judgments are generally even greater vis-à-vis law-trained judges operating on information presented to them by adversarial litigants motivated by something other than the desire to reach an accurate, unbiased valuation.

Over the past several decades, judicial deference to market valuations has become increasingly formalized doctrinally. Perhaps most notably, for many years securities fraud plaintiffs have typically been required to prove loss causation by using an event study to show a market decline upon corrective disclosure of the alleged fraud—a practice enshrined by the United States Supreme Court's 2005 decision in *Dura Pharmaceuticals, Inc. v. Broudo*.[2] Rather than leaving it to a court to determine whether and how much a fraud injured investors by distorting the price of a security, plaintiffs must show that the market price itself reacted to the alleged fraud. The key to successfully doing so is the ability to detect a statistically significant abnormal movement in the relevant firm's stock price and to prove the price change was caused by the corrective disclosure rather than some other cause.[3]

Corporate managers, however, can make securities fraud plaintiffs' task more difficult—if not impossible—by strategic disclosure practices. Most obviously, they can "bundle" the corrective disclosure of a fraud together with other material news. Combining the corrective disclosure with additional bad news can make it impossible to determine what portion of

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[1] *See* Jackson v. Pollion, 733 F.3d 786, 788 (7th Cir. 2013) ("Innumerable are the lawyers who explain that they picked law over a technical field because they have a 'math block' . . . ." (quoting DAVID L. FAIGMAN ET AL., MODERN SCIENTIFIC EVIDENCE: STANDARDS, STATISTICS, AND RESEARCH METHODS, at v (student ed. 2008))).

[2] 544 U.S. 336 (2005).

[3] *See, e.g.*, Sanjai Bhagat & Roberta Romano, *Event Studies and the Law: Part I: Technique and Corporate Litigation*, 4 AM. L. & ECON. REV. 141, 143 (2002).

any resulting price drop to ascribe to the corrective disclosure. Combining the disclosure with offsetting good news can reduce or eliminate the price reaction altogether. In either case, the "signal" of the market reaction to the revelation of the fraud will be obscured by the "noise" of the bundled information. This potential tactic for deterring securities fraud suits has been recognized in the academic literature[4] and subject to a number of empirical investigations.[5]

The literature is silent, however, with respect to the incentives of managers to engage in strategic disclosure practices surrounding merger transactions. Even in the absence of the threat of litigation, managers would have incentives to make an announced merger appear to be as good a deal as possible for the target stockholders. In part, the managers have a simple reputational interest in appearing to have secured a good price for the company. Further, managers must persuade stockholders that the deal price is attrac-

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[4] *See, e.g.*, Allen Ferrell & Atanu Saha, *The Loss Causation Requirement for Rule 10b-5 Causes of Actions: The Implications of* Dura Pharmaceuticals, Inc. v. Broudo, 63 BUS. LAW. 163 (2007); James C. Spindler, *Why Shareholders Want Their CEOs to Lie More After* Dura Pharmaceuticals, 95 GEO. L.J. 653 (2007). Of course, these litigation-related incentives to bundle disclosures operate on top of other incentives—some as simple as the desire to bury bad news. *See, e.g.*, Mary Brooke Billings et al., *On Guidance and Volatility*, J. ACCT. & ECON., Nov.–Dec. 2015, at 161, 161–64, 177–78 (discussing the bundling of earnings forecasts with other announcements); Mary Brooke Billings & Matthew C. Cedergren, *Strategic Silence, Insider Selling and Litigation Risk*, 59 J. ACCT. & ECON. 119, 119–20, 140 (2015) (explaining bundling positive earnings guidance with earnings announcements before insider selling); John R. Graham et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 10 (2005) (reporting that one-third of chief financial officers admit to trying to bundle bad news with other disclosures); S.P. Kothari et al., *Do Managers Withhold Bad News?*, 47 J. ACCT. RSCH. 241, 246 (2009) (discussing delaying the release of bad news to bury it with subsequent news); Jonathan L. Rogers & Andrew Van Buskirk, *Bundled Forecasts in Empirical Accounting Research*, 55 J. ACCT. & ECON. 43, 43 (2013) (examining the bundling of earnings forecasts with other announcements); Charles E. Wasley & Joanna Shuang Wu, *Why Do Managers Voluntarily Issue Cash Flow Forecasts?*, 44 J. ACCT. RSCH. 389, 389–92, 426 (2006) (reviewing certain announcements with the bundling of earnings forecasts); Benjamin N. Lansford, Strategic Coordination of Good and Bad News Disclosures: The Case of Voluntary Patent Disclosures and Negative Earnings Surprises 1 (July 17, 2006) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=830705 [https://perma.cc/Q8DG-CGBX] (discussing the bundling of both good and bad news).

[5] *See, e.g.*, Barbara A. Bliss et al., *Information Bundling and Securities Litigation*, 65 J. ACCT. & ECON. 61, 61 (2018) (finding that the bundling of both positive and negative news with an earnings restatement reduces the incidence of securities fraud litigation and makes courts more likely to dismiss claims); Sebastien Gay, *Strategic News Bundling and Privacy Breach Disclosures*, 3 J. CYBERSEC. 91, 91 (2017) (finding that firms are more likely to release positive news on the same day as disclosure of privacy breaches); Michael Furchtgott & Frank Partnoy, *Disclosure Strategies and Shareholder Litigation Risk: Evidence from Restatements* 26–27 (Univ. San Diego Sch. L., Legal Stud. Rsch. Paper Series, Research Paper No. 15-186, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2585267 [https://perma.cc/222B-FVZD] (observing that managers were more likely to bundle other information with earnings restatements following *Dura Pharmaceuticals, Inc. v. Broudo*).

tive in order to secure the statutorily required stockholder approval.[6] As a result, managers have multiple incentives to have the merger take place at a large premium to the prevailing stock price prior to the announcement of the deal.

The possibility of litigation only heightens these incentives. Merger transactions are frequent targets of litigation, both fiduciary duty actions and statutory appraisal actions. Fiduciary duty actions are generally brought as a class, and these actions typically argue that the directors of the target company breached their duties of care or loyalty, resulting in a deal price that is lower than it otherwise would have been.[7] Appraisal is a statutory remedy allowing a stockholder to dissent from a merger and seek a judicial determination of the "fair value" of their stock.[8] To be successful at the end of the day, either type of claim requires a finding that the merger price was below fair value (though the approach to calculating fair value may be somewhat different in the two types of actions). In either type of litigation, the fair value of the target company as a going concern is at least a part of the measure of damages. Indeed, valuation cannot be avoided in appraisal litigation, where the fair value of the petitioner's stock is the sole merits issue.[9]

Like securities fraud litigation, merger litigation has seen courts increasingly look to market evidence in addition to—or even in lieu of—performing their own valuation calculations. This doctrinal trend is most pronounced in appraisal. In Delaware, the leading corporate law jurisdiction and the venue for the bulk of appraisal activity,[10] the courts have responded

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[6] Management's desire to get stockholder approval is only heightened when the deal will trigger—as many do—valuable side-benefits such as change-of-control payments or golden parachutes. *See* Brian Broughman, *CEO Side Payments in Mergers and Acquisitions*, 2017 BYU L. REV. 67, 71 ("[T]he law already requires that any extra benefits—including side payments—received by senior management in an acquisition be disclosed to shareholders and that the entire transaction be subject to both board *and* shareholder approval.").

[7] *See generally* Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 855–58 (2014) (discussing class actions alleging breach of directors' fiduciary duties in connection with mergers).

[8] *See id.* at 859 ("Appraisal allows a stockholder to dissent from a merger and forego the merger consideration in favor of filing a judicial proceeding to calculate the 'fair value' of the stock cancelled in the merger." (first quoting DEL. CODE ANN. tit. 8, § 262(a) (2013); and then quoting 3 MODEL BUS. CORP. ACT ANN. § 13.02 (2008 & Supp. 2013) (AM. BAR ASS'N, amended 2016))).

[9] *Id.* at 866 (explaining that in appraisal "[t]he only issue at stake is the fair value of the petitioner's shares, and the sole remedy available is cash").

[10] *See* Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1553 (2015) ("Appraisal activity involving public companies is undergoing explosive growth in Delaware, driven by sophisticated parties who specialize in bringing appraisal claims."); Robert B. Thompson, *Exit, Liquidity, and Majority Rule:*

to a spike in appraisal activity by increasingly eschewing traditional valuation methodologies (such as a discounted cash flow (DCF) analysis) in favor of deference to market evidence.

Traditionally, Delaware courts seek to award appraisal petitioners their "proportionate interest in [the] going concern"[11]—that is, their pro rata share of the value of the company as a going concern in the absence of the merger. The pre-announcement trading price of the target company's stock is a natural place to start in determining the company's going-concern value. After all, the stock price represents the market's judgment as to the value of the individual fractionalized equity interests—the shares of stock—in the company. And indeed, the Delaware courts, although thus far eschewing any general presumption, have increasingly looked to the pre-announcement trading price of the target company as persuasive evidence—or even dispositive evidence—of fair value.[12] This litigation dynamic heightens management's incentive to increase the size of the merger premium by pushing down the pre-announcement trading price.

Management has a wide array of potential tools for managing the pre-announcement price. Perhaps the simplest, however, is to simply time the announcement of the merger with the announcement of quarterly earnings. Management generally has ample discretion to time the signing of a merger agreement—and thus the accompanying disclosure. Likewise, the timing of quarterly earnings announcements is flexible.

Where the earnings news is negative—that is, where the news likely will lower the stock price and increase the merger premium—management may prefer to release the earnings news prior to announcing the merger, giving the market time to react to the negative news. Where earnings news is positive—that is, where it will likely raise the stock price and reduce the merger premium—managers may instead choose to either bundle the earnings announcement with the merger announcement, or simply delay the earnings announcement until after the merger is announced. Either way, the

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Appraisal's Role in Corporate Law, 84 GEO. L.J. 1, 10 (1995) (describing Delaware as the "leading corporate law jurisdiction").

[11] Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1144 (Del. 1989) (quoting Tri-Cont'l Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950)). In recent decisions, the Delaware Supreme Court has muddied the waters considerably by suggesting a somewhat different approach to defining "fair value," namely that dissenters are entitled to "what they deserve to receive based on what would fairly be given to them in an arm's-length transaction." DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346, 370–71 (Del. 2017). Elsewhere, Professor Minor Myers and I have argued that this approach to fair value is flawed. *See* Charles R. Korsmo & Minor Myers, *The Flawed Corporate Finance of* Dell *and* DFC Global, 68 EMORY L.J. 221 (2018). The dispute is not vital to my argument here and, in any event, trial courts continue to seek to determine the going-concern value in appraisal actions. *See* discussion *infra* Part I.B.

[12] *See* discussion *infra* Part II.

market will not have a chance to react to the positive earnings before the merger price largely determines the trading price.

In either case, timing the disclosures makes life more difficult for potential plaintiffs and may deter litigation altogether. In the instance of early release of negative news, this is not particularly troubling—it allows the market to value the news prior to announcement of the merger. Delayed release of positive news, however, is potentially problematic. It ensures that the pre-announcement price does not incorporate the value of the positive information, and it thus makes the price less informative as to the standalone value of the company at the time.

In this Article, I extend the existing literature in two ways. First, I expand the prior literature on disclosure bundling in the securities fraud context to the merger context, analyzing how developments in Delaware doctrine have increased the incentive for management to bundle or time disclosures around merger announcements. Much as the early articles on disclosure bundling in the securities fraud context triggered numerous empirical studies, the analysis here identifies several potential targets for empirical investigation in the merger context. In particular, researchers should examine whether negative earnings are more likely to be disclosed prior to a merger announcement than positive earnings and whether this tendency has shifted in response to exogenous changes that make merger-related litigation more or less likely.

Second, earlier work on disclosure bundling was largely content to analyze the phenomenon. Although several authors implicitly suggested that *Dura*'s loss causation rule is sub-optimal and created perverse incentives,[13] they stopped short of specific doctrinal or regulatory prescriptions. In this Article, I more fully explore the significant implications of disclosure bundling and timing for the design of disclosure rules and judicial doctrine.

The guiding principle is straightforward. To the extent courts and regulators ascribe legal significance to market reactions to information contained in corporate disclosures, disclosures should be made in a way that results in a more informative market reaction. In particular, it may make sense to require that certain types of material information clearly relevant to litigation—such as corrective disclosures or merger announcements—be made in isolation, rather than bundled with other material disclosures. At a minimum, defendants who have obscured market signals via disclosure bundling or timing should not be permitted by courts to rely on those market signals (or lack thereof) as a defense. These proposals entail amending the loss causation rules announced in *Dura*, as well as refinements of Dela-

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[13] *See* discussion *infra* Part II.A.

ware's emerging appraisal jurisprudence. These reforms would impose minimal burdens on issuers, while enhancing the quality of market information available to courts adjudicating securities fraud and merger claims and promoting the pricing efficiency of securities markets in general.

This paper proceeds in five parts. Part I briefly traces the doctrinal developments whereby courts have increasingly deferred to markets in valuation-related matters.[14] Part II introduces the prior literature on strategic disclosure bundling in securities fraud cases.[15] Part III extends the analysis to merger litigation, considering the possible forms of strategic disclosure bundling and timing.[16] Part IV suggests potential reforms to disclosure regulation to prevent the harmful disclosure practices that Parts II and III canvass.[17] Part V suggests doctrinal changes and refinements to minimize the incentives for strategic disclosure bundling and timing as well as to minimize the mischief caused when they occur.[18]

I. The Use of Market Reactions in Litigation

Although market-based evidence is potentially relevant in many types of litigation, it is particularly pertinent in securities fraud and merger litigation, and its use in these contexts has been enshrined in judicial doctrine. As such, this Part restricts itself to considering the reliance of courts on market evidence in these two contexts.[19] Specifically, Section A discusses market-based evidence in the context of securities fraud litigation,[20] and Section B examines market-based evidence in the context of merger litigation.[21]

A. Securities Fraud Litigation

The modern securities fraud class action is, as the United States Supreme Court noted long ago, "a judicial oak which has grown from little more than a legislative acorn."[22] Though rooted in Section 10(b)[23] of the Securities Exchange Act of 1934,[24] neither the statute nor the Securities and

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[14] *See* discussion *infra* Part I.
[15] *See* discussion *infra* Part II.
[16] *See* discussion *infra* Part III.
[17] *See* discussion *infra* Part IV.
[18] *See* discussion *infra* Part V.
[19] *See* discussion *infra* Part I.
[20] *See* discussion *infra* Part I.A.
[21] *See* discussion *infra* Part I.B.
[22] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).
[23] 15 U.S.C. § 78j.
[24] Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78qq).

Exchange Commission's (SEC) Rule 10b-5 implementing the statute create an express private cause of action.[25] Instead, starting in the 1940s, federal courts have recognized and shaped an implied cause of action.[26] Both the statute and the implementing rule are brief, catch-all provisions barring manipulation or deceit in connection with the purchase or sale of securities.[27]

Given these circumstances, it is perhaps unsurprising that courts have taken an essentially common law approach to doctrinal development.[28] Likewise, it is natural that courts have drawn on analogy to the common law tort of fraud in crafting the elements of securities fraud: materiality, scienter, reliance, and loss causation.[29] The tort analogy invites courts to assess a fraudulent statement in a securities fraud case in much the same way as in a case involving the sale of ordinary goods, such as a used car. That is, the court could assess materiality of a false statement of fact by ask-

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[25] *See* 17 C.F.R. § 240.10b-5 (2020); *supra* notes 23–24.

[26] The U.S. District Court for the Eastern District of Pennsylvania first recognized a private cause of action under Rule 10b-5 in 1946. *See* Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946). Five years later, the prominent scholar Louis Loss noted that a private cause of action was recognized "in almost two score other cases" and that "[n]o judge has expressed [themselves] to the contrary." LOUIS LOSS, SECURITIES REGULATION 1049–50 (1951). The U.S. Supreme Court recognized the existence of a private cause of action for securities fraud in 1971, without discussion. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 & n.9 (1971).

[27] Rule 10b-5 reads, in its entirety:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

[28] *See, e.g.*, Charles R. Korsmo, *Market Efficiency and Fraud on the Market: The Danger of* Halliburton, 18 LEWIS & CLARK L. REV. 827, 832 (2014) ("Unsurprisingly, this parsimonious statutory and regulatory framework, covering a vast array of potential activities, has yielded an almost common-law style interpretive approach by courts."); Louis Loss, Commentary, *The Assault on Securities Act Section 12(2)*, 105 HARV. L. REV. 908, 910–11 (1992) (noting that, because courts have essentially created a new federal tort from Rule 10b-5, "one should not be shocked to see them invoking *Erie*-resistant federal common law in order to invent appropriate qualifications of the new tort").

[29] *See* Korsmo, *supra* note 28, at 833 ("The elements for 10b-5 securities fraud claims were derived by analogy to the common law tort of fraud."); Jeffrey L. Oldham, Comment, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 1003 (2003) ("Derived primarily from the common law of fraud, the basic elements of a Rule 10b-5 cause of action have become materiality, scienter, reliance, and loss causation." (footnotes omitted)).

ing whether "its existence or nonexistence is a matter to which a reasonable [person] would attach importance in determining [their] choice of action in the transaction in question."[30] The court could then assess reliance and causation by asking whether the plaintiff's "justifiable reliance upon the misrepresentation [was] a substantial factor in determining the course of conduct which result[ed] in [their] loss."[31] "Out-of-pocket" damages could then be calculated.[32]

In theory, these elements would ask the court to make direct judgments as to materiality and reliance. The measure of damages would also require the judge to directly calculate the "value" of the fraudulent information. Indeed, courts have long defined damages in securities fraud actions as "the difference between the price paid and the 'real' value of the security, *i.e.*, the fair market value absent the misrepresentations, at the time of the initial purchase."[33] This would seem to require the court to perform two valuations—the "true value" of the securities and the value of the securities if the fraudulent statements were true.[34]

In practice, these inquiries are both muddied and simplified by the nature of impersonal public securities markets:

> Such markets differ from more familiar markets for consumer goods and services where the common law of fraud developed, in that (1) prices are set by impersonal market mechanisms, rather than by face-to-face bargaining; and (2) securities are typically not being purchased for any form of personal consumption, instead of or in addition to for investment and resale.[35]

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[30] RESTATEMENT (FIRST) OF TORTS § 538(2)(a) (AM. L. INST. 1938).

[31] *Id.* § 546.

[32] *See* Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348, 363 (2007) (noting that the "out-of-pocket measure" of damages in securities fraud actions "originated in tort law").

[33] Robbins v. Koger Props., Inc., 116 F.3d 1441, 1447 n.5 (11th Cir. 1997) (quoting Huddleston v. Herman & MacLean, 640 F.2d 534, 556 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983)); *see also* Burch, *supra* note 32, at 364 n.78 (collecting cases).

[34] *See* Burch, *supra* note 32, at 364 & n.79 (explaining the notion of "true value" in the context of out-of-pocket damages (first citing Mathews v. Kidder, Peabody & Co., 260 F.3d 239, 249 (3d Cir. 2001); and then citing Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1490–91 (1996))).

[35] Korsmo, *supra* note 28, at 868; *see also* Burch, *supra* note 32, at 363–70 (noting the implications of the "disparities between face-to-face and open-market transactions" for calculating damages). Judge Easterbrook made the same general point in pungent fashion in *West v. Prudential Securities, Inc.*, 282 F.3d 935, 939 (7th Cir. 2002), noting there is not "an economic market in 'Jefferson Savings stock' as there is in dill pickles or fluffy towels. . . . [I]nvestors do not want Jefferson Savings *stock* (as if they sought to paper their walls with beautiful certificates); they want monetary returns (at given risk levels) . . . ."

The nature of reliance is somewhat muddied and the distinctions among the elements blurred. At the same time, however, questions of materiality, loss causation, and damages are potentially simplified by the ability to outsource inquiries to the market: Did the market regard the information as material? How did the market calculate the value of the misrepresentation? Indeed, an influential 1982 article argued "that there is no need in a[n open-market] securities fraud case for separate inquiries into materiality, reliance, causation, and damages"—the only "inquiry in open-market transactions should be whether the market price was in fact artificially affected by false information."[36]

Although the courts have not fully embraced a move away from the traditional elements of deceit in favor of a catch-all "market impact" inquiry, they have nonetheless gone a long way in that direction. For each element, courts now look largely, if not exclusively, to market impact as definitive evidence. First, and most famously, in 1988, the Supreme Court in *Basic Inc. v. Levinson* embraced the "fraud-on-the-market" presumption, effectively doing away with the reliance requirement by allowing it to be presumed for stocks traded on well-developed markets.[37] The Court reasoned that investors buying and selling stock "at the price set by the market do[] so in reliance on the integrity of that price"[38] and that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations."[39] This approach necessarily puts the market impact of allegedly fraudulent statements front and center—if the market price was not distorted, the logic of *Basic* does not apply.[40]

Market impact has become the key inquiry for the other elements as well in the wake of *Basic*.[41] Courts have found market tests attractive be-

[36] Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1, 13 (1982); *see also* Jill E. Fisch et al., *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 TEX. L. REV. 553, 559 (2018) ("Fischel argued that the only relevant inquiry in a securities fraud case was the extent to which market prices were distorted by fraudulent information—it was unnecessary for the court to make separate inquiries into materiality, reliance, causation, and damages.").

[37] 485 U.S. 224, 241–42 (1988).

[38] *Id.* at 247.

[39] *Id.* at 246.

[40] *See* Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258, 278 (2014) ("In the absence of price impact, *Basic*'s fraud-on-the-market theory and presumption of reliance collapse."); Fisch et al., *supra* note 36, at 560 ("Price impact is a critical component of [*Basic*'s] approach because absent an impact on stock price, plaintiffs who trade in reliance on the market price are not defrauded.").

[41] *See* Fisch et al., *supra* note 36, at 568 ("[P]roof of price impact is relevant to multiple elements of securities fraud. A single event study may provide evidence relating to materiality, reliance, loss causation, economic loss, and damages.").

cause "they provide a convenient and reliable market test of all the elements of a Rule 10b-5 fraud action: reliance, materiality, causation, and the level of damages are evident in market reaction when the corrective information hits the market."[42] In *Dura Pharmaceuticals, Inc. v. Broudo*, the Supreme Court held that plaintiffs, in order to show loss causation, needed to show not only that the fraudulent information inflated the market price, but also that revelation of the truth caused the price to fall, injuring the plaintiffs.[43] In practice, this means that plaintiffs must allege—and ultimately prove—an impact on market price "both at the time of the misrepresentation and on the alleged corrective disclosure date."[44] In the wake of *Dura*, in 2014, the United States Court of Appeals for the First Circuit has noted that "[t]he usual—it is fair to say 'preferred'—method of proving loss causation in a securities fraud case is through an event study" showing a statistically significant price reaction to a corrective disclosure.[45]

Following *Basic* (and *Dura*), it is difficult to separate clearly the loss causation analysis from the other elements, all of which also turn on market impact. For materiality, rather than engage in the tradition abstract consideration of whether a piece of information is likely to be "viewed by the reasonable investor as having significantly altered the 'total mix' of information made available,"[46] courts now typically defer to the market itself. Changes in market prices are a direct reflection of what investors consider significant. If a fraudulent statement—or the emergence of the truth—has a measurable impact on the market price, courts treat it as strong evidence the fraudulent statement was material.[47] Conversely, the absence of any measurable price reaction is strong evidence of immateriality.[48]

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[42] Spindler, *supra* note 4, at 676; *see also id.* at 664 (noting that a market impact requirement "largely automate[s] the trier of fact's tests of materiality and damages, whereas '[j]uries generally do not have a clue' about *ex ante* valuations of fraudulent information" (second alteration in original) (quoting John C. Coffee, Jr., *Causation by Presumption? Why the Supreme Court Should Reject Phantom Losses and Reverse* Broudo, 60 BUS. LAW. 533, 538 (2005))).

[43] 544 U.S. 336, 339–40 (2005).

[44] Fisch et al., *supra* note 36, at 561 (footnote omitted).

[45] Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC, 752 F.3d 82, 86 (1st Cir. 2014).

[46] Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

[47] *See, e.g.*, *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997) ("In the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock."); *In re* Sadia, S.A. Sec. Litig., 269 F.R.D. 298, 302, 311 & n.104, 316 (S.D.N.Y. 2010) (relying on evidence of market impact in finding materiality); Fisch et al., *supra* note 36, at 562 ("Event studies can be used to demonstrate the impact of fraudulent statements on stock price, providing evidence that the statements are material.").

[48] *See, e.g.*, *In re* Merck & Co. Sec. Litig., 432 F.3d 261, 269 (3d Cir. 2005) (holding that a false disclosure was not material where it had "no negative effect" on the stock price); Oran v.

Courts also rely on market impact to establish economic loss and calculate damages. If the plaintiffs are unable to show any impact of the fraud on market prices, they will be unable to show they suffered an economic loss. Where plaintiffs can show such an impact, the extent of the change in market price will generally be the measure of damages. Courts routinely reject attempts to establish damages by valuing information directly, rather than by conducting an event study to determine market impact.[49]

In sum, if plaintiffs are ultimately unable to prove that a fraudulent statement had an impact on the market price, their claims will inevitably fail. Modern judicial practice requires plaintiffs to tie a price impact to the alleged fraud to establish materiality, loss causation, economic loss and damages, and even a presumption of reliance.

B. Merger Litigation

Market evidence of value also plays an increasingly large role in merger litigation. Stockholders seeking to challenge a merger transaction have two primary options for doing so. The first is the traditional fiduciary duty class action, wherein the plaintiffs allege that the officers and/or directors breached one or more of their fiduciary duties in the course of entering into the merger transaction.[50] The second is an appraisal action. Appraisal is a statutory action[51] allowing a stockholder to dissent from a merger, forgoing the merger consideration and instead filing a judicial proceeding to calculate the "fair value" of the dissenter's stock.[52]

Stafford, 226 F.3d 275, 282 (3d Cir. 2000) ("[I]n an efficient market 'the concept of materiality translates into information that alters the price of the firm's stock . . . .'" (quoting *Burlington Coat Factory*, 114 F.3d at 1425)).

[49] *See, e.g.*, *In re* Imperial Credit Indus., Inc. Sec. Litig., 252 F. Supp. 2d 1005, 1015 (C.D. Cal. 2003) (noting that "a number of courts have rejected or refused to admit into evidence damages reports or testimony by damages experts in securities cases which fail to include event studies or something similar"), *aff'd sub nom.* Mortensen v. Snavely, 145 F. App'x 218 (9th Cir. 2005); *In re* N. Telecom Ltd. Sec. Litig., 116 F. Supp. 2d 446, 460 (S.D.N.Y. 2000) (finding an expert's testimony "fatally deficient in that he did not perform an event study or similar analysis"); *In re* Exec. Telecard, Ltd. Sec. Litig., 979 F. Supp. 1021, 1025 (S.D.N.Y. 1997) ("The reliability of the Expert Witness'[s] proposed testimony is called into question by his failure to indicate . . . whether he conducted an 'event study' . . . .").

[50] *See* Korsmo & Myers, *supra* note 7, at 855–58 (tracing the logic and structure of merger class actions).

[51] *See generally* DEL. CODE ANN. tit. 8, § 262 (2020); MODEL BUS. CORP. ACT ANN. § 13.02 (AM. BAR ASS'N 2016).

[52] *See generally* Korsmo & Myers, *supra* note 7, at 859–68 (first quoting DEL. CODE ANN. tit. 8, § 262(a) (2013); and then quoting 3 MODEL BUS. CORP. ACT ANN. § 13.02 (2008 & Supp. 2013) (AM. BAR ASS'N, amended 2016) (tracing the history and structure of the appraisal remedy). Appraisal rights of some kind have been available in some states since the mid-nineteenth century and became widely available in their modern form in the early twentieth century.

In both types of action, the fair value of the target company is generally the key variable in determining damages. Although courts in fiduciary duty class actions have broad equitable powers to craft appropriate remedies, the starting point is out-of-pocket loss as measured by the difference between the "fair value" of the plaintiffs' shares and the deal price.[53] Thus, at the damages stage, a fiduciary duty class action becomes largely indistinguishable from an appraisal action, where the fair value of the target company is the *only* merits issue.[54] Indeed, Delaware courts often refer to cash damages in a merger class action as a "quasi-appraisal" remedy.[55] The ques-

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[53] *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 714 (Del. 1983) (describing the notion of "fair value," while noting that "the Chancellor's powers are complete to fashion any form of equitable and monetary relief as may be appropriate" (quoting DEL. CODE ANN. tit. 8, § 262(h) (1983))); *In re* Orchard Enters., Inc. S'holder Litig., 88 A.3d 1, 38–42 (Del. Ch. 2014) (evaluating the damages available in a merger class action). Calculation of damages in merger class actions is a somewhat theoretical question, as the number of cases proceeding through trial is vanishingly small. *See* STEFAN BOETTRICH & SVETLANA STARYKH, NERA ECON. CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2016 FULL-YEAR REVIEW 41 (2017), https://www.nera.com/content/dam/nera/publications/2017/PUB_2016_Securities_Year-End_Trends_Report_0117.pdf [https://perma.cc/5SSW-R7BE] ("Very few securities class actions reach the trial stage and even fewer reach a verdict.").

[54] *See, e.g.*, *Weinberger*, 457 A.2d at 713–14 (equating "fair price" in a merger class action with "fair value" in appraisal (quoting DEL. CODE ANN. tit. 8, § 262(h) (1983))); Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 114 (Del. 1952) (adopting for a fiduciary duty case the valuation standard for appraisal); *see also* Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987) (stating that the "fair price" measure in a class action "flow[s] from the statutory provisions permitting mergers and those designed to ensure fair value by an appraisal" (citation omitted)); Poole v. N.V. Deli Maatschappij, 243 A.2d 67, 69 (Del. 1968) (affirming the trial court's conclusion that, for damages purposes, "the stock is to be evaluated on a going-concern basis and not on a liquidation basis; that the actual or true value of the stock is to be determined by considering the various factors . . . deemed relevant in a stock evaluation problem arising under . . . 8 Del. C. § 262"); Del. Open MRI Radiology Assocs., P.A. v. Kessler, 898 A.2d 290, 342–44 (Del. Ch. 2006) (determining fair value and using it as the measure of damages in a breach of fiduciary duty case); *In re* Emerging Commc'ns, Inc. S'holders Litig., C.A. No. 16415, 2004 WL 1305745, at *9 (Del. Ch. June 4, 2004) (deciding monetary damages after determining fair value). It is worth noting that, conceptually, it might make sense to have a different measure of fair value in a fiduciary duty action than in an appraisal action. In particular, in a fiduciary duty action, it would be reasonable to award plaintiffs the amount they would have gotten in the merger absent the breach of duty. Sometimes—perhaps most of the time—this will be equivalent to fair value as a going concern. But sometimes it may be something else, such as the value they would have fairly gotten in an unconflicted, arm's-length transaction, which may be substantially different where there are significant synergies. Elsewhere, Professor Myers and I have criticized the Delaware Supreme Court's recent decisions for eliding the differences between the fiduciary duty and appraisal contexts. *See* Korsmo & Myers, *supra* note 11, at 269–73.

[55] *See, e.g.*, *Weinberger*, 457 A.2d at 714 (using the term "quasi-appraisal" first to describe the measure of damages for a breach of fiduciary duty in connection with a merger); *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d 205, 224–25 (Del. Ch. 2014) ("The 'fair value' or 'intrinsic value' of the shares held by the class is determined by using the same methodologies employed in an appraisal, and this form of damages is sometimes colloquially called a 'quasi-appraisal' remedy." (footnote omitted) (first quoting *Weinberger*, 457 A.2d at 713–14; and then

tion of how to define "fair value" in appraisal is thus significant in both types of merger litigation.

Delaware courts have long held that appraisal petitioners are entitled to receive the "true or intrinsic value of [their] stock which has been taken by the merger," which is found by calculating the petitioners' "proportionate interest in a going concern."[56] That is, an appraisal petitioner holding 1% of the outstanding shares would be entitled to 1% of the value of company as a standalone entity as of the closing date of the merger, excluding any gain in value—such as potential synergies—from the merger itself.[57] As a result, the fair value of the target company on a standalone basis is the key issue in appraisal.

Because so few merger class actions reach the damages phase, it is primarily in appraisal that Delaware courts have developed their approach to calculating fair value.[58] Until the 1980s, Delaware had long employed

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quoting *Sterling*, 93 A.2d at 114)); Arnold v. Soc'y for Sav. Bancorp, Inc., No. 12883, 1995 WL 376919, at *4 (Del. Ch. June 15, 1995) (holding that damages for breach of fiduciary duty could be calculated through a "quasi-appraisal" remedy), *aff'd*, 678 A.2d 533 (Del. 1996); *see also In re* Ocean Drilling & Expl. Co. S'holders Litig., No. 11898, 1991 WL 70028, at *7 (Del. Ch. Apr. 30, 1991) (concluding that alleged breaches of fiduciary duty did not threaten irreparable harm because of the availability of "quasi-appraisal" damages); Steiner v. Sizzler Rests. Int'l, Inc., No. 11994, 1991 WL 40872, at *2 (Del. Ch. Mar. 19, 1991) (same).

[56] Tri-Cont'l Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950); *see also* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 132–33 (Del. 2019) (en banc) (per curiam) ("[F]air value 'is . . . the value of the company to the stockholder as a going concern," i.e., the stockholder's "proportionate interest in a going concern." (first quoting M.P.M. Enters., Inc. v. Gilbert, 731 A.2d 790, 795 (Del. 1999); and then quoting Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1144 (Del. 1989))); Montgomery Cellular Holding Co. v. Dobler, 880 A.2d 206, 222 (Del. 2005); *Cavalier Oil Corp.*, 564 A.2d at 1144.

[57] *See, e.g.*, *Cavalier Oil Corp.*, 564 A.2d at 1144 (noting that the company must be valued "without regard to post-merger events"); *Weinberger*, 457 A.2d at 714 (directing the Delaware Court of Chancery not to "take speculative effects of the merger into account" in calculating "fair value" (quoting DEL. CODE ANN. tit. 8, § 262(h) (1983))); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 74 (Del. Ch. 2013) (noting that valuations in appraisal must "back out any synergies"); Gearreald v. Just Care, Inc., C.A. No. 5233-VCP, 2012 WL 1569818, at *3 (Del. Ch. Apr. 30, 2012) ("Determining the value of a 'going concern' requires the Court to exclude any synergistic value . . . ." (quoting Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd., 847 A.2d 340, 356 (Del. Ch. 2004))); *Union Ill. 1995 Inv. Ltd. P'ship*, 847 A.2d at 356 ("[T]his court must endeavor to exclude from any appraisal award the amount of any value that the selling company's shareholders would receive because a buyer intends to operate the subject company, not as a standalone going concern, but as a part of a larger enterprise, from which synergistic gains can be extracted.").

[58] Although appraisal is available in one form or another in almost every state, the bulk of the decisional law is in Delaware, with many other state courts taking their doctrinal cues from Delaware. *See* Thompson, *supra* note 10, at 10 (describing Delaware as the "leading corporate law jurisdiction").

what came to be known as the "Delaware block method"[59] (DBM), which entailed a fairly robotic calculation with three inputs: (1) the value of the company's assets, (2) the capitalized value of the company's average earnings over the past five years, and (3) the company's market value.[60] Although the court could weigh the three inputs as it saw fit, the method came to be seen as too restrictive with the rise of modern finance. Ultimately the Delaware Supreme Court moved away from the method in 1983 in the landmark case *Weinberger v. UOP, Inc.*, holding that, to the extent it "excludes other generally accepted techniques used in the financial community and the courts, it is now clearly outmoded."[61]

In particular, the DBM had precluded the use of the forward-looking DCF methodology—one of the most common and theoretically sound valuation methodologies employed by actual investment professionals.[62] The DCF methodology entails projecting the future cash flows of the company and discounting them back to present value.[63] In the wake of *Weinberger*, the DCF methodology quickly became the preferred valuation tool in Delaware and other courts.[64]

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[59] *See generally* William S. Allred, *Corporate Law—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, 193 (1986) ("For roughly forty years, courts have commonly invoked the Delaware block approach to valuation . . . .").

[60] *See id.* at 204–09 (describing the elements of the "Delaware block method").

[61] *Weinberger*, 457 A.2d at 712.

[62] *See, e.g.*, *In re* PetSmart, Inc., C.A. No. 10782, 2017 WL 2303599, at *23 (Del. Ch. May 26, 2017) (noting "that DCF [discounted cash flow] is considered by many to be the 'gold standard' of valuation tools" (quoting Trial Transcript at 1241:3–:17, 1244:14–45:8, *id.* (No. 10782)); Samuel C. Thompson, Jr., *A Lawyer's Guide to Modern Valuation Techniques in Mergers and Acquisitions*, 21 J. CORP. L. 457, 461 (1996) (stating that prominent scholars "emphasize the importance of the DCF method of valuation"); Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 625–26 n.68 (1998) ("Despite its preeminent role in valuation, there was no place for discounted cash flow analysis under the Delaware block method; its use did not become permissible in Delaware until *Weinberger* discarded the block method as the exclusive means of valuation.").

[63] *See In re* Radiology Assocs., Inc. Litig., 611 A.2d 485, 490 (Del. Ch. 1991) ("The DCF model entails three basic components: an estimation of net cash flows that the firm will generate and when, over some period; a terminal or residual value equal to the future value, as of the end of the projection period, of the firm's cash flows beyond the projection period; and finally a cost of capital with which to discount to a present value both the projected net cash flows and the estimated terminal or residual value." (quoting Cede & Co. Technicolor, Inc., C.A. No. 7129, 1990 WL 161084, at *7 (Del. Ch. Oct. 19, 1990))).

[64] *See, e.g.*, Questrom v. Federated Dep't Stores, Inc., 84 F. Supp. 2d 483, 488 (S.D.N.Y. 2000) (concluding that the DCF is the "preeminent valuation methodology" (quoting Neal v. Ala. By-Products Corp., C.A. No. 8282, 1990 WL 109243, at *7 (Del. Ch. Aug. 1, 1990))), *aff'd*, 2 F. App'x 81 (2d Cir. 2001); Lippe v. Bairnco Corp., 288 B.R. 678, 689 (S.D.N.Y. 2003) (finding the DCF to be "the most reliable method for determining the value of a business"), *aff'd*, 99 F. App'x 274 (2d Cir. 2004); *In re* Bond, No. 11-bk-33849, 2012 WL 3867427, at *4 (Bankr. D. Ariz. Sept. 5, 2012) (noting that the valuation "method preferred in the Second and Seventh Cir-

The past few years have seen a shift in the Delaware courts' approach to valuation in appraisal. This shift has come, at least in part, in reaction to a dramatic increase in the level of appraisal activity and, in particular, in appraisal cases involving publicly traded target companies.[65] Although the Delaware courts had occasionally expressed trepidation about the reliability of their valuation calculations,[66] this self-doubt waxed as the volume of appraisal litigation spiked.[67]

Burdened by these doubts, and often facing competing expert DCF valuations reaching wildly different conclusions,[68] judges looked for a way

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cuits is discounted cash flow"); Andaloro v. PFPC Worldwide, Inc., C.A. Nos. 20289, 20336, 2005 WL 2045640, at *9 (Del. Ch. Aug. 19, 2005) ("The DCF model of valuation is a standard one that gives life to the finance principle that firms should be valued based on the expected value of their future cash flows, discounted to present value in a manner that accounts for risk. The DCF method is frequently used in this court and, I, like many others, prefer to give it great, and sometimes even exclusive, weight when it may be used responsibly."); Dobler v. Montgomery Cellular Holding Co., C.A. No. 19211, 2004 WL 2271592, at *8 (Del. Ch. Oct. 4, 2004) (noting that DCFs are "routinely utilized by this court in appraisal actions"), *aff'd in part, rev'd in part on other grounds*, 880 A.2d 206 (Del. 2005); *see also* 1 DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 9-11[d]-[1] (2020) ("Since *Weinberger*, some type of [DCF] methodology has been considered in nearly all appraisals . . . .").

[65] *See generally* Korsmo & Myers, *supra* note 10 (documenting a dramatic increase in public company appraisal beginning in 2011).

[66] *See, e.g.*, *Andaloro*, 2005 WL 2045640, at *9 n.34 ("I stress [that DCFs should be] 'used responsibly,' for there are situations when the available data will not support the use of the DCF model."); Finkelstein v. Liberty Dig., Inc., C.A. No. 19598, 2005 WL 1074364, at *12 (Del. Ch. Apr. 25, 2005) ("The judges of this court are unremittingly mindful of the fact that a judicially selected determination of fair value is just that, a law-trained judge's estimate that bears little resemblance to a scientific measurement of a physical reality.").

[67] *See, e.g.*, Blueblade Cap. Opportunities LLC v. Norcraft Cos., No. 11184, 2018 WL 3602940, at *22 n.251 (Del. Ch. July 27, 2018) (noting that "'the judges of this Court' have lamented the challenges posed by the appraisal statute for many years"); Laidler v. Hesco Bastion Env't, Inc., C.A. No. 7561, 2014 WL 1877536, at *1 (Del. Ch. May 12, 2014) ("This case presents a demand for a statutory appraisal, response to which should be a daunting task for a law-trained judge . . . ." (footnote omitted)); Glob. GT LP v. Golden Telecom, Inc., 993 A.2d 497, 518 n.126 (Del. Ch.) (explaining that "academics and professionals throw around . . . ranges of value [that] are used by a law-trained judge to come to a single point estimate of value" and that "[t]he law-trained judges who must perform such analyses are more conscious than anyone of the inherent risk of error in such an endeavor"), *aff'd*, 11 A.3d 214 (Del. 2010).

[68] *See, e.g.*, Kruse v. Synapse Wireless, Inc., C.A. No. 12392, 2020 WL 3969386, at *7 (Del. Ch. July 14, 2020) (noting that two experts "utilized the same three valuation techniques . . . but reached very different conclusions"); *In re* Appraisal of Jarden Corp., C.A. No. 12456, 2019 WL 3244085, at *3 (Del. Ch. July 19, 2019) ("[B]oth parties proffered expert evidence regarding Jarden's fair value based on DCF and, not surprisingly, the experts' DCF analyses yielded results that were solar systems apart."), *aff'd sub nom.* Fir Tree Value Master Fund, LP v. Jarden Corp., 236 A.3d 313 (Del. 2020); Huff Fund Inv. P'ship v. CKx, Inc., C.A. No. 6844, 2013 WL 5878807, at *1 (Del. Ch. Nov. 1, 2013) ("The parties have submitted expert valuations of the company, ranging from an amount below the sales price (submitted by the Respondents) to more than twice

out. One appealing way out was to look to the deal price itself as the best evidence of fair value. After all, for most kinds of assets, the best measure of financial value is simply the price that a willing buyer and willing seller would agree upon in the absence of compulsion.[69] As one frustrated Vice Chancellor concluded, "A law-trained judge . . . would have no reason to second-guess the market price absent demonstration of self-dealing or a flawed sales process."[70] In a string of opinions, the Delaware Court of Chancery found fair value to be equal to the negotiated deal price, where petitioners were unable to show that the deal process was sufficiently flawed.[71]

Ultimately, three recent Delaware Supreme Court decisions—involving Dell, DFC Global, and Aruba Networks—endorsed reliance on the deal price in the presence of an adequate sales process.[72] In 2017, in *DFC Global Corp. v. Muirfield Value Partners, L.P.*, the Delaware Supreme Court noted that "an economist would find that the fair market value of a company is what it would sell for when there is a willing buyer and willing seller without any compulsion to buy."[73] It went on to note that it had "little

the sales price (submitted by the Petitioners)."), *aff'd*, No. 348, 2014, 2015 WL 631586 (Del. Feb. 12, 2015) (en banc).

[69] *See Huff Fund Inv. P'ship*, 2013 WL 5878807, at *1 ("What is the fair value of an asset? For a simple asset—a piece of real property, for instance—it is the market value. If a trustee were to sell property held in trust, such a sale could be challenged by the beneficiary on a number of grounds. It would be odd, however, if the sale were an arms-length, disinterested transaction after an adequate market canvas and auction, yet the challenge was that the price received did not represent 'fair' value.").

[70] *Id.*

[71] *See, e.g.*, Merion Cap. LP v. BMC Software, Inc., C.A. No. 8900, 2015 WL 6164771, at *14–15, *18 n.168 (Del. Ch. Oct. 21, 2015); Merlin Partners LP v. AutoInfo, Inc., C.A. No. 8509, 2015 WL 2069417, at *10 (Del. Ch. Apr. 30, 2015); *In re* Appraisal of Ancestry.com, Inc., C.A. No. 8173, 2015 WL 399726, at *17 (Del. Ch. Jan. 30, 2015); *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *1.

[72] *See* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 135 (Del. 2019) (en banc) (per curiam); Dell, Inc., v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 23–24 (Del. 2017); DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346, 362 (Del. 2017).

[73] *DFC Glob.*, 172 A.3d at 369. Professor Myers and I have cautioned elsewhere that the "willing buyer and willing seller" analogy should not be taken too far:

> This might be true if the company were sold by a single owner into a thick market of potential buyers. But any analogy between a merger and a transaction between "a willing buyer and a willing seller" is virtually useless. In a public company merger, the firm will be sold by a board of directors with varying incentives, advised and assisted by inside managers and outside professionals with still different incentives, and then put to a stockholder plebiscite on a take-it-or-leave-it basis.

Korsmo & Myers, *supra* note 11, at 268. We go on to agree, however, that "under certain conditions—conditions that . . . will likely be met in most arm's-length deals—the outcome of that process will be a price that serves as an adequate proxy for what the willing seller and buyer might have reached." *Id.*

quibble with the economic argument that the price of a merger that results from a robust market check, against the back drop of a rich information base and a welcoming environment for potential buyers, is probative of the company's fair value."[74] It further cautioned that "second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous."[75] In the face of statutory language requiring the courts to consider "all relevant factors" in determining fair value, the Delaware Supreme Court declined to create a judicial presumption that deal price equals fair value.[76] Nonetheless, in all three cases, the court found the deal price to deserve heavy or exclusive weight in determining fair value.[77]

In none of the three cases did the Delaware Supreme Court attempt to craft a general definition of when a process would lead to a deal price sufficiently reliable to justify judicial deference as to fair value.[78] In 2017, in both *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.* and *DFC Global Corp. v. Muirfield Value Partners, L.P.*, however, the Delaware Supreme Court overruled trial court opinions that found the sales process was too flawed to generate a reliable deal price.[79] The strong message to the trial judges was that they courted reversal if they failed to sufficiently consider market valuation evidence.[80]

In the wake of these opinions from the Delaware Supreme Court, the Delaware Court of Chancery has, unsurprisingly, continued to defer to the

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[74] *DFC Glob.*, 172 A.3d at 366.

[75] *Id.*; *see also id.* at 369–70 (observing that "[m]arket prices are typically viewed [as] superior to other valuation techniques because, unlike, e.g., a single person's [DCF] . . . model, the market price should distill the collective judgment of the many based on all the publicly available information about a given company and the value of its shares").

[76] DEL. CODE ANN. tit. 8, § 262(h) (2020); *see Dell*, 177 A.3d at 21; *DFC Glob.*, 172 A.3d at 366–67.

[77] *See Aruba Networks*, 210 A.3d at 135 (using the deal price as the exclusive basis for its determination of fair value); *Dell*, 177 A.3d at 30 ("Overall, the weight of evidence shows that Dell's deal price has heavy, if not overriding, probative value."); *DFC Glob.*, 172 A.3d at 349 (finding that deal price was "the best evidence of fair value").

[78] *See In re* Stillwater Mining Co., C.A. No. 2017-0385, 2019 WL 3943851, at *22 (Del. Ch. Aug. 21, 2019) ("As with *Dell* and *DFC*, the *Aruba* decision did not have to address when a sale process was sufficiently bad that a trial court should decline to rely on the deal price."), *aff'd sub nom.* Brigade Leveraged Cap. Structures Fund Ltd. v. Stillwater Mining Co., 240 A.3d 3 (Del. 2020).

[79] *Dell*, 177 A.3d at 19; *DFC Glob.*, 172 A.3d at 388; *see* Korsmo & Myers, *supra* note 11, at 223.

[80] As the Delaware Court of Chancery put it in a recent 2019 decision, *In re Appraisal of Jarden Corp.*, "I begin my fair value analysis where I believe I must—with the market evidence." C.A. No. 12456, 2019 WL 3244085, at *2 (Del. Ch. July 19, 2019), *aff'd sub nom.* Fir Tree Value Master Fund, LP v. Jarden Corp., 236 A.3d 313 (Del. 2020).

negotiated deal price in many appraisal cases.[81] In a handful of cases, the trial courts have gone further. As noted above, fair value is to exclude prospective values associated with the merger, including synergies.[82] Reasoning that the negotiated deal price may itself reflect the value of expected synergies, the Delaware Supreme Court noted that the pre-announcement market trading price may be probative evidence of fair value.[83] Even in 2019, *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, where the Delaware Supreme Court overruled a trial court decision deferring to the pre-announcement price, it did so due to evidentiary concerns, suggesting that, in the right case, deference to pre-announcement prices may be appropriate.[84] So far, one trial court has taken up the invitation, awarding the pre-announcement market trading price to petitioners.[85] Others have acknowledged the evidentiary value of the pre-announcement price, even as they ultimately deferred to the deal price instead.[86]

Though the Delaware courts have not had recent occasion to opine on the relevance of market data in fiduciary duty class actions, in light of recent appraisal decisions it is reasonable to surmise that, all else being equal, a deal price is more likely to be considered "fair" if it is substantially above the pre-announcement trading price.

II. Disclosure Bundling in the Securities Fraud Context

In the wake of *Dura Pharmaceuticals, Inc. v. Broudo*, commentators quickly noted that the United States Supreme Court's loss causation rules would give unscrupulous managers an incentive to engage in strategic disclosure practices to obscure market reactions to corrective disclosures—in particular, bundling corrective disclosures with other material information. More recently, several empirical investigations have sought to investigate the prevalence of strategic disclosure bundling, and its effectiveness at deterring litigation. This Part provides a brief overview of this literature.[87] Section A discusses scholarship pertaining to the incentive effects of *Du-*

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[81] *Stillwater Mining Co.*, 2019 WL 3943851, at *19–20; *In re* Appraisal of Columbia Pipeline Grp., C.A. No. 12736, 2019 WL 3778370, at *13–20 (Del. Ch. Aug. 12, 2019).

[82] *See supra* note 57 and accompanying text.

[83] *See Dell*, 177 A.3d at 5–7, 24–27, 35 (concluding that both the trading price and the deal price were reliable indicators of value).

[84] *See* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 132 (Del. 2019) (en banc) (per curiam), *rev'g* No. 11448, 2018 WL 922139 (Del. Ch. Feb. 15, 2018).

[85] *See, e.g.*, *In re Jarden Corp.*, 2019 WL 3244085, at *2 (awarding "the unaffected market price").

[86] *See, e.g.*, *Stillwater Mining Co.*, 2019 WL 3943851, at *54–55; *In re Columbia Pipeline Grp.*, 2019 WL 3778370, at *38–39.

[87] *See* discussion *infra* Part II.

ra.[88] Section B explores empirical studies pertaining to disclosure bundling.[89]

A. The Incentive Effects of Dura

Following *Dura*, Professor James Spindler pointed out that, under many plausible circumstances, *Dura*'s requirement of an ex post market decline will under-deter fraud:

> [T]he *ex post* rule excludes from recovery three cases of fraud: (1) when the lie is about a contingency that resolves favorably; (2) the contingency resolves unfavorably, but is bundled with positive news of projects that make up for it; and (3) the contingency resolves unfavorably, but is bundled with negative news of exogenous events that would have caused the loss anyhow.[90]

Because this Article's concern is strategic disclosure bundling and timing, I pass over the first scenario[91] and focus on the second and third.[92] As an example of the second, consider a firm where management had fraudulently claimed that a given project—worth $1 billion if successful—had a 50% chance of success when in fact they knew it really only had a 25% chance of success. The lie inflates the market price by $250 million. When the project fails, however, the fraud is revealed. If management, however, bundles disclosure of the failure and fraud together with news that another project has been unexpectedly successful to the tune of $500 million, the market price will actually go up. The offsetting positive news obscures the

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[88] *See* discussion *infra* Part II.A.

[89] *See* discussion *infra* Part II.B.

[90] Spindler, *supra* note 4, at 674.

[91] An example of the first problem would be management falsely claiming that a project—worth $1 billion if it is successful—has a 50% chance of success, when in fact they know that it really has only a 25% chance of success. In theory, this lie would inflate the market price by $250 million. If the project, however, ended up succeeding, there would be no market decline upon revelation of the fraud. Nonetheless, allowing a suit in such a case would involve the court in estimating both the probabilities and payoffs associated with the success and failure of the project in question, neither of which they are particularly well-equipped to do. *See id.* at 676–77 (noting that "there is a greater chance that courts will get things horribly wrong with an *ex ante* rule"). Thus, *Dura Pharmaceuticals, Inc. v. Broudo*'s requirement of an ex post market drop is arguably justified in such a case, despite the resulting under-deterrence. *See, e.g.*, Coffee, *supra* note 42, at 538 (explaining the danger of frivolous litigation alleging "phantom loss").

[92] Of course, in addition to the difficulties canvassed here, a host of other confounding factors can make it difficult or impossible to isolate the market impact of a fraud. *See, e.g.*, Ferrell & Saha, *supra* note 4, at 168 (discussing, among other issues, the problem of gradual or partial leakage of the truth, projects that succeed despite a fraud, market over- and under-reactions, and collateral damage from revelation of a fraud).

market reaction to revelation of the fraud, making it impossible for plaintiffs to show an ex post market decline.[93]

The third scenario also involves obscuring the market reaction, this time by bundling the corrective disclosure with other negative news. Consider again the same example of management fraudulently claiming a 50% chance of success for a $1 billion project that in reality has only a 25% chance of success. Again, the project fails and the fraud is on the cusp of being revealed. This time, however, management bundles the disclosure with news that another $1 billion project, which management had *truthfully* claimed had a 15% chance of success, has also failed. In this scenario, the corrective disclosure will be accompanied by a market drop, but it will be difficult or impossible for a plaintiff to prove what portion of the drop to ascribe to the fraudulent project as opposed to the honest failure.[94]

The difficulty in both scenarios is that the event study methodology favored post-*Dura* is generally unable to discern the independent price impacts of bundled news.[95] Although tools exist for attempting to tease apart the price impacts of simultaneous events,[96] "[w]hen multiple sources of news are released at exactly the same time . . . no event study can by itself separate out the effects of the different news."[97] As a result, "judicial reliance on event studies creates an incentive for issuers and corporate officials to bundle corrective disclosures with other information in a single press re-

[93] For similar examples, see Spindler, *supra* note 4, at 677–80.

[94] *See, e.g.*, Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 02-CV-1152, 2008 WL 4791492, at *11 (N.D. Tex. Nov. 4, 2008) (denying class certification because the relevant disclosure contained "two distinct components," a corrective disclosure of prior misstatements and new negative information, and the plaintiffs were unable to demonstrate that the former caused the stock price decline), *aff'd*, 597 F.3d 330 (5th Cir. 2010), *vacated sub nom.* Erica P. John Fund, Inc. v. Halliburton Co., 563 U.S. 804 (2011); Fener v. Belo Corp., 560 F. Supp. 2d 502, 505 (N.D. Tex. 2008) (denying class certification because the plaintiff was unable to untangle the effects of the fraudulent information and "other unrelated negative statements" (quoting Oscar Priv. Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261, 266 (5th Cir. 2007), *abrogated by Erica P. John Fund*, 563 U.S. 804)), *aff'd sub nom.* Fener v. Operating Eng'rs Constr. Indus. & Miscellaneous Pension Fund (LOCAL 66), 579 F.3d 401 (5th Cir. 2009). For similar examples, see Spindler, *supra* note 4, at 680–82.

[95] *See* Fisch et al., *supra* note 36, at 556 ("[I]n cases involving multiple 'bundled' disclosures, event studies have limited capacity to identify the particular contribution of each piece of information or the degree to which the effects of multiple disclosures may offset each other.")

[96] *See, e.g.*, Esther Bruegger & Frederick C. Dunbar, *Estimating Financial Fraud Damages with Response Coefficients*, 35 J. CORP. L. 11, 25 (2009) (explaining that "'content analysis' is now part of the tool kit for determining which among a number of simultaneous news events had effects on the stock price" (quoting DAVID TABAK, NERA ECON. CONSULTING, MAKING ASSESSMENTS ABOUT MATERIALITY LESS SUBJECTIVE THROUGH THE USE OF CONTENT ANALYSIS 13 (2007), https://www.nera.com/content/dam/nera/publications/archive1/PUB_Tabak_Content_Analysis_SEC 1646-FINAL.pdf [https://perma.cc/768L-FPGQ])).

[97] Fisch et al., *supra* note 36, at 614.

lease or filing."[98] Of course, the greater management's discretion to time disclosures, the greater their ability to engage in such bundling.

B. Empirical Evidence of Disclosure Bundling

Recently, empirical studies have found evidence that managers have indeed responded to doctrinal developments by more often engaging in strategic disclosure bundling. As predicted, the evidence also suggests that bundling is often effective at deterring securities fraud litigation and makes it easier to get claims dismissed when they are brought.[99]

A 2016 study by Barbara A. Bliss, Frank Partnoy, and Michael Furchtgott examined bundling of both positive and negative information when a firm releases a restatement.[100] As discussed above, bundling in positive information can offset any decline associated with the restatement, making it impossible to satisfy *Dura*'s loss causation requirement. Bundling in additional negative information, meanwhile, will magnify the resulting market impact, but make it impossible to determine how much of the impact to ascribe to the restatement.[101] The study used the *Dura* decision as an exogenous shock. Prior to *Dura*, the United States Courts of Appeals for the Eighth and Ninth Circuits allowed plaintiffs to survive a motion to dismiss by simply asserting that alleged misstatements inflated the stock price. *Dura* forced these circuits into alignment with the rest of the country.[102] The authors found that positive and negative bundling were both effective at avoiding litigation pre- and post-*Dura* in most circuits[103] and became dra-

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[98] *Id.*; *see also id.* ("If the presence of overlapping news makes it difficult or impossible for plaintiffs to marshal admissible and useful event study evidence, defendants may strategically structure their disclosures to impede plaintiffs' ability to establish price effect.").

[99] The phenomenon is not limited to securities fraud litigation. For example, a 2015 study by Sebastien Gay examined bundling in the context of firms that had experienced customer privacy breaches—another situation likely to lead to litigation. Gay, *supra* note 5, at 99 (finding that firms make a larger than usual number of positive disclosures on the same day they disclose a privacy breach).

[100] *See generally* Bliss et al., *supra* note 5.

[101] *See id.* at 63 ("Piling bad or confounding news on top of bad news might seem counterproductive to the extent it amplifies the magnitude of a stock price decline . . . . However, noise bundling may generate countervailing benefits by making it difficult or impossible to unravel how much of the stock price decline is attributable to each piece of bad news . . . ." (citation omitted)).

[102] *See id.* at 62, 63 ("The *Dura* ruling effectively raised the standard for the Eighth and Ninth Circuits to the same level that other courts previously imposed. . . . [W]e exploit an exogenous shock from the 2005 U.S. Supreme Court ruling on loss causation standards to achieve identification in our tests.").

[103] *Id.* at 64 ("[O]ur matching estimator indicates that positive and noise bundling were associated with lower litigation occurrence for firms outside the Eighth and Ninth Circuits during both time periods.").

matically more effective in the Eighth and Ninth Circuits following *Dura*.[104] Moreover, they found that when restatements led to a lawsuit, cases involving bundled restatements were more likely to be dismissed and led to lower average settlement values.[105]

A 2015 study by two of the same authors, Michael Furchtgott and Frank Partnoy, examined whether firms were more likely to engage in bundling post-*Dura*.[106] Again, the authors used the Eighth and Ninth Circuits—where the *Dura* decision had worked a sudden change in the law—as their testing ground. In sum, they found that large firms—those most likely to be targeted in securities fraud actions—"were more likely to bundle news [with restatements] than they were before" *Dura*."[107] Moreover, "firms based in the jurisdictions of the Eighth and Ninth Circuits (whose loss causation standards were overturned in *Dura*) changed their disclosure behaviors more than firms in other locations."[108]

III. DISCLOSURE BUNDLING IN THE MERGER CONTEXT

Whereas the literature on disclosure bundling has focused on the securities fraud context, bundling and strategic timing are perhaps even more likely in the merger context. Section A of this Part describes management's incentives and ability to engage in strategic disclosure practices surrounding a merger.[109] Section B provides preliminary empirical evidence that managers do, in fact, engage in such practices.[110]

A. Disclosure Incentives in the Merger Context

Even if the pre-announcement market price and the size of the merger premium were irrelevant in litigation, managers would still have an incentive to make the merger premium look as large as possible. A merger must be approved by a majority vote of the target company's stockholders.[111] Managers may, quite sensibly, believe that a larger premium will make stockholder ap-

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[104] *Id.* at 63 (finding that in the U.S. Courts of Appeals for the Eighth and Ninth Circuits "the occurrence of litigation dropped from 6.7% to 0% for positive bundled restatements, and from 20.3% to 5.6% for noise bundled restatements after the tightening of loss causation standards").

[105] *Id.* at 61 (noting that, among restatements that lead to lawsuits, "[b]undled restatements have 8.17 times higher dismissal rates and $21.17 to $23.45 million lower settlement amounts").

[106] Furchtgott & Partnoy, *supra* note 5, at 1.

[107] *Id.* at 34.

[108] *Id.*

[109] *See* discussion *infra* Part III.A.

[110] *See* discussion *infra* Part III.B.

[111] DEL. CODE ANN. tit. 8, § 251 (2020).

proval more likely and a smaller premium may make stockholder approval more challenging.[112]

Litigation risk only heightens these incentives. As detailed in Part I, judges in merger litigation increasingly look to market pricing as evidence of fair value, or as a "reality check" on valuations arrived at by other methodologies, such as a DCF analysis.[113] This is especially so in appraisal litigation. In recent cases, this has commonly resulted in courts deferring to the prices set by the deal market—the merger price itself. Occasionally, however, courts have also looked to the pre-announcement market trading price, particularly where there may be substantial synergistic value incorporated in the merger price.[114]

As a result, a large merger premium—the amount by which the merger consideration exceeds the pre-announcement price—can make it more difficult to establish a fair value above the deal price, thus serving as a deterrent to litigation. Indeed, in fiduciary duty litigation, Delaware courts, although they have repeatedly noted both that the *lack* of a substantial merger premium does not necessarily mean a deal price is unfair[115] and that the presence of a large premium does not necessarily establish fairness,[116] nonetheless

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[112] *See, e.g.*, Malcolm Baker et al., *The Effect of Reference Point Prices on Mergers and Acquisitions*, 106 J. FIN. ECON. 49, 64–65 (2012) (observing that deals with higher merger premiums tend to close more often); Sangwon Lee & Vijay Yerramilli, Relative Values, Announcement Timing, and Shareholder Returns in Mergers and Acquisitions 2 (May 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2714572 [https://perma.cc/SW8Z-LGAZ] (adopting Malcolm Baker, Xin Pan, and Jeffrey Wurgler's finding that "key decision makers in the bidding and target firms and investors are known to use recent prices as reference points"); *see also* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., C.A. No. 11448, 2018 WL 922139, at *33 (Del. Ch. Feb. 15, 2018) (noting that "Aruba management believed that an increase in the [pre-announcement] stock price would hurt their chances of getting the deal approved"), *rev'd*, 210 A.3d 128 (Del. 2019) (en banc) (per curiam). *See generally* GUHAN SUBRAMANIAN, NEGOTIAUCTIONS: NEW DEALMAKING STRATEGIES FOR A COMPETITIVE MARKETPLACE 16–18 (2010) (explaining the anchoring dynamics in the merger context).

[113] *See* discussion *supra* Part I.B.

[114] *See* discussion *supra* Part I.B.

[115] *See, e.g.*, *In re* MeadWestvaco S'holders Litig., 168 A.3d 675, 687 (Del. Ch. 2017) ("Even if it were true that the premium was low, '[t]here is no rule that a low premium represents a bad deal, much less bad faith.'" (alteration in original) (quoting *In re* Crimson Expl. Inc. S'holder Litig., C.A. No. 8541, 2014 WL 5449419, at *23 (Del. Ch. Oct. 24, 2014))); *In re* BJ's Wholesale Club, Inc. S'holders Litig., C.A. No. 6623, 2013 WL 396202, at *11–12 (Del. Ch. Jan. 31, 2013) (granting a motion to dismiss in a case with a 6.6% merger premium); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 619 (Del. Ch. 2010) (denying a preliminary injunction in a case with a 5.5% merger premium); *In re* CompuCom Sys., Inc. S'holders Litig., C.A. No. 499, 2005 WL 2481325, at *8 (Del. Ch. Sept. 29, 2005) (granting a motion to dismiss where the deal price was at a discount to the pre-announcement trading price).

[116] *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 875 (Del. 1985) ("[T]he fact of a premium alone does not provide an adequate basis upon which to assess the fairness of an offering price."), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009); *In re* Del Monte Foods Co. S'holders

frequently point to the presence of a substantial merger premium as *suggestive* of fairness.[117] As the Delaware Court of Chancery summarized, "Delaware law recognizes that, although market price should be considered in an appraisal, the market price of shares is not always indicative of fair value."[118] Even where courts do not explicitly place weight upon the market price, it may—consciously or otherwise—serve as a reference point anchoring the ultimate valuation.[119] In general, a larger merger premium will make a plaintiff's success at trial more difficult and may deter litigation altogether.[120]

If managers are afraid that a soon-to-be-announced merger is at an inadequate premium to the merger price, perhaps the most straightforward way to increase the premium is to release bad news prior to the announcement of the merger, driving the stock price lower. Similarly, the managers would want to delay release of any good news until after (or simultaneous with) the merger announcement, avoiding the risk of the stock price rising to near or above the merger price.

Litig., 25 A.3d 813, 818–19 (Del. Ch. 2019) (same, despite a 40% premium); *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 434–45 (Del. Ch. 2012) (noting a reasonable probability of success on the merits of a breach of fiduciary duty claim, despite a 47.8% merger premium); *In re* Telecommcn's, Inc. S'holders Litig., C.A. No. 16470, 2005 WL 3642727, at *1–2 (Del. Ch. Jan. 10, 2006) (explaining that the defendants had not demonstrated entire fairness at the summary judgment stage, despite a 37% merger premium); Gholl v. eMachines, Inc., C.A. No. 19444, 2004 WL 2847865, at *15 (Del. Ch. Nov. 24, 2004) (giving "little weight" to the "control premium argument," despite a merger premium of 96%), *aff'd*, 875 A.2d 632 (Del. 2005).

[117] *See, e.g.*, Cinerama, Inc., v. Technicolor, Inc., 663 A.2d 1156, 1176–77 (Del. 1995) (pointing to the size of the merger premium as the first "reliable source[] . . . indicat[ing] that the $23 per share received" constituted a fair price (quoting Cinerama, Inc., v. Technicolor, Inc., 663 A.2d 1134, 1142 (Del. Ch. 1994), *aff'd*, *id.*)); *In re* Stillwater Mining Co., No. 2017-0385, 2019 WL 3943851, at *44 (Del. Ch. Aug. 21, 2019) (noting "the premium over market" as a reason for finding that the deal price represented fair value), *aff'd sub nom.* Brigade Leveraged Cap. Structures Fund Ltd. v. Stillwater Mining Co., 240 A.3d 3 (Del. 2020); *In re* Morton's Rest. Grp. S'holders Litig., 74 A.3d 656, 662–63, 676 (Del. Ch. 2013) (explaining a merger's status as a "premium-generating transaction" and "a premium sale of a company" in dismissing a fiduciary duty claim); *Gholl*, 2004 WL 2847865, at *15 ("In many cases market indicia of value such as control premiums . . . can provide informative checks on the reasonableness of financial valuation techniques.").

[118] *In re* Emerging Commc'ns, Inc. S'holders Litig., C.A. No. 16415, 2004 WL 1305745, at *23 (Del. Ch. June 4, 2004).

[119] *See* Colin Miller, *Anchors Away: Why the Anchoring Effect Suggests That Judges Should Be Able to Participate in Plea Discussions*, 54 B.C. L. REV. 1667, 1693 (2013) ("The 'anchoring effect' is a cognitive bias by which individuals evaluate numbers in relation to a reference point—the anchor—and then modify those numbers based on that 'anchor.' The bias manifests itself in three particular ways: (1) the selection of an anchor; (2) underadjustment; and (3) the fact that even arbitrary, random, or irrelevant numbers can serve as anchors and distort calculations." (footnote omitted) (quoting Stephanos Bibas, *Plea Bargaining Outside the Shadow of Trial*, 117 HARV. L. REV. 2463, 2516 (2004))).

[120] *See, e.g.*, Korsmo & Myers, *supra* note 7, at 835 (finding that appraisal litigation becomes less likely as the size of the merger premium increases).

Managers have a great deal of flexibility to time their disclosures in this fashion, particularly with respect to one of the most common types of good or bad news: quarterly earnings announcements. Quarterly earnings need not be released on a fixed schedule. Instead, most companies have a forty-day window from the end of their fiscal quarter during which to report their quarterly earnings on Form 10-Q.[121] Even this loose deadline can be extended by filing an NT 10-Q untimely filing form.[122] Similarly, depending on the dynamics of the merger process, the parties may have substantial flexibility in deciding when to announce the deal publicly. In fact, it is extremely common for the parties to a merger to bundle together the deal announcement with an earnings release, making it difficult or impossible to disentangle the market's reaction to the two pieces of material information.[123]

The recent 2019 *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.* appraisal case provides a nice example of how managers might respond to this mix of litigation and non-litigation incentives by using their ability to strategically time and bundle disclosures. In early 2015, Hewlett-

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[121] *See* Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports, Securities Act Release No. 8644, Exchange Act Release No. 52,989, 70 Fed. Reg. 76,626 (Dec. 27, 2005).

[122] *See* Adam Hayes, *SEC Form NT 10-Q*, INVESTOPEDIA, https://www.investopedia.com/terms/s/sec-form-nt-10-q.asp [https://perma.cc/G5BN-FH7D] (last updated July 5, 2020) ("SEC Form NT 10-Q is a Securities and Exchange Commission (SEC) filing required for companies that will not be able to submit their 10-Q filing (for quarterly financial results) by the SEC deadline or in a timely manner.").

[123] *See, e.g.*, Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., C.A. No. 11448, 2018 WL 922139, at *33 n.316 (Del. Ch. Feb. 15, 2018) ("[I]t's very customary, very, very customary, if you're pursuing an M & A transaction and it's close to being done, . . . and you have an earnings release, to make the two concurrent, because these are two material events that will impact the stock price, and the last thing you want to do is release material information piecemeal to your shareholders." (alteration in original) (quoting Boutros Dep. at 203, *id.* (No. 11448))), *rev'd*, 210 A.3d 128 (Del. 2019) (en banc) (per curiam); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 591 (Del. Ch. 2010) (noting the "normal desire to announce the deal in conjunction with an earnings release"); *In re* Trans World Airlines, Inc. S'holders Litig., C.A. No. 9844, 1988 WL 111271, at *4 (Del. Ch. Oct. 21, 1988) ("The proposal now under consideration was announced . . . the same day on which the [c]ompany announced very favorable financial results for the first quarter of 1988."), *abrogated by* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110 (Del. 1994). Similarly, if management believes the merger premium is already adequate, they may be tempted to bury bad news by bundling it together with a merger announcement. *See, e.g.*, *In re* Appraisal of DFC Glob. Corp., C.A. No. 10107, 2016 WL 3753123, at *13 (Del. Ch. July 8, 2016) ("[D]iscouraging financial results [were] issued on April 2, 2014, the same day the transaction was announced."), *rev'd sub nom.* DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017); *see also Dollar Thrifty*, 14 A.3d at 591 ("Dollar Thrifty's advisors were suspicious that Hertz wanted to use the deal to cover up what would be an otherwise disappointing earnings announcement . . . ."). In particular, a merger announcement may be the "good news" to offset a restatement in the securities fraud context. *See* discussion *supra* Part I.

Packard was in confidential negotiations to acquire Aruba Networks and made an offer of $23.25 per share.[124] While the offer was pending, analyst opinion of Aruba was largely negative, expecting reduced earnings going forward, and the stock price languished around sixteen dollars per share.[125] Internally, however, Aruba management knew that the company was "having an excellent quarter and would beat its guidance."[126] Nonetheless, Aruba management was determined to delay release of the positive earnings news until announcement of the merger.[127] Ultimately, the earnings and merger announcement were bundled together, and HP apparently leaked news of the merger a day early to further muddy the market reaction to Aruba's positive earnings.[128]

Aruba's management was apparently motivated both by litigation and non-litigation factors. As for non-litigation factors, "Aruba management believed that an increase in the stock price would hurt their chances of getting the deal approved."[129] At the same time, Aruba and Hewlett-Packard's management hoped to "blur the market's reaction to Aruba's strong quarterly results"[130] in a way the Delaware Supreme Court noted "might make it difficult for an expert to disentangle . . . for purposes of an event study."[131] Indeed, bankers at Qatalyst—one of Aruba's deal advisors—"speculated internally that HP had leaked the news [of the deal] so that Aruba's 'results and subsequent stock price reaction won't be easy to measure.'"[132]

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[124] *See Aruba Networks*, 2018 WL 922139, at *33 ("At the end of January 2015, HP offered to acquire Aruba for $23.25 per share.").

[125] *Id.* ("During the first week of February, while Aruba was considering its response, another analyst report criticized [Aruba], and the stock price fell again, closing around $16.07 the day after the report.").

[126] *Id.*

[127] *See id.* ("[R]ather than correcting the market's perception, Aruba management proposed to time the announcement of the merger to coincide with the announcement of Aruba's February 2015 earnings."); *id.* at *33 n.315 (noting that "[t]he idea of announcing the merger along with Aruba's strong quarterly results came from Aruba management" and that management wanted to "get[] a deal announced by [Aruba's] earnings on Feb. 26" (third alteration in original) (quoting JX 454, internal Barclays email summarizing Johansson's relay of the call)).

[128] *See id.* at *33 n.317 ("HP also may have leaked news of the deal to further mask the significance of Aruba's strong earnings. On February 25, 2015, one day before Aruba was scheduled to announce its earnings, Bloomberg News ran a story on the merger.").

[129] *Id.* at *33; *see also id.* *33 n.315 (stating that Aruba's bankers "'emphasized that [Aruba would] like to announce [the] deal before the [Aruba] earnings announcement' because Aruba was 'afraid stock runs like Ubiquiti's did which could make the deal more challenging from the [Aruba] perspective'" (alterations in original) (quoting JX 491, email from Barclays to HP recounting exchange)).

[130] *Id.* at *33.

[131] *Id.* at *34.

[132] *Id.* at *33 n.317 (quoting JX 510, internal Qatalyst email).

B. Potential Empirical Evidence

It would be a relatively straightforward matter to test empirically whether parties to a merger engage in strategic bundling or timing of disclosures. One simple test would be to examine the timing of merger and earnings announcements. As noted above, the folk wisdom is that management often like to announce earnings in concert with a merger. One potential motivation for such bundling would be to bury especially bad earnings news by combining it with the (typically) good news of a merger. The incentives discussed above, however, point in the opposite direction. All else being equal, managers would like the merger to be as large a premium as possible to the pre-announcement trading price. The more likely the merger is to be the subject of either litigation or a contested stockholder vote, the stronger these countervailing incentives.

As a result, I would expect that the more likely litigation or a contested stockholder vote are, the less likely that negative earnings news would be bundled, and the more likely it would be released prior to the earnings announcement. The release of the negative earnings news in advance of the merger announcement would drive down the market price and maximize the apparent attractiveness of the merger premium. At the same time, I would expect that the more likely litigation or a contested stockholder vote are, the more likely positive earnings news would be released simultaneously with or after the merger announcement. Doing so would avoid an inconvenient increase in the trading price and correspondingly smaller merger premium.

Testing these propositions should be relatively simple. The hypothesis would be that the higher the litigation/approval risk, the greater the likelihood that negative earnings results are released before, and positive earnings simultaneously or after, a merger announcement. Testing this hypothesis would require an investigator to examine merger announcements and the nearest earnings announcement by the target company. The investigator would then need to characterize the earnings announcement as positive or negative by assessing whether it exceeded or fell short of analyst expectations. The investigator would also need to quantify the level of litigation/stockholder approval risk.[133] Finally, the investigator would calculate the relationship between this risk and the timing of earnings announcements.

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[133] Quantifying litigation/stockholder approval risk would likely be the most difficult step. Nonetheless, a number of potential proxies are available. Among them are: (1) the size of the merger premium; (2) P/E ratios at the merger price; (3) Tobin's Q at the merger price; (4) the actual results of the eventual stockholder vote; and (5) the actual incidence of merger class actions or appraisal actions targeting the merger.

IV. POTENTIAL REGULATORY RESPONSES

Earlier scholarship on disclosure bundling has been largely content to describe the issue. To the extent reforms are proposed, they have mostly been restricted to the tacit implication that *Dura Pharmaceuticals, Inc. v. Broudo*'s loss causation rules ought to be reconsidered.[134] In Parts IV and V, I provide more concrete proposals.[135] This Part considers potential regulatory responses to disclosure bundling and strategic disclosure timing—in particular, whether the SEC could and should require "unbundled" disclosures in certain contexts.[136] It consists of three sections. Section A considers the extent to which private ordering can be expected to ameliorate strategic disclosure practices.[137] Section B reviews whether an unbundling requirement would conflict with the traditional design of SEC disclosure requirements.[138] Section C examines the potential design of unbundling rules.[139]

In short, I conclude (1) that private ordering is unlikely to be effective; (2) that unbundling rules would be a somewhat awkward fit with traditional SEC disclosure rules; and (3) that, nonetheless, there may be a role for disclosure unbundling rules. The limited potential for unbundling rules, however, means they will need to be supplemented by doctrinal modifications, which Part V discusses.[140]

A. Private Ordering

Regulatory action would be unnecessary if private ordering could be expected to provide efficient incentives for management to refrain from strategic disclosure practices. It is theoretically possible that market incentives would encourage management to credibly commit to unbundled disclosures. As Parts II and III discuss, strategic disclosure practices appear to effectively allow managers to escape liability for securities fraud or a breach of a fiduciary duty.[141] The market may, therefore, discount the price

[134] *See, e.g.*, Spindler, *supra* note 4, at 691 (concluding that *Dura Pharmaceuticals v. Broudo*'s rule "does not adequately internalize fraud losses when firms can bundle projects, when firms can wait before disclosing bad news, or when other factors may overlap with the fraud in causing a plaintiff's loss"); Furchtgott & Partnoy, *supra* note 5, at 34 ("Our results may have the normative implication that the courts should consider relaxing the *Dura* loss causation pleading requirements if there are multiple pieces of firm-specific news occurring simultaneously or if there is evidence of a pre-announcement downward drift in the share price.").

[135] *See* discussion *infra* Parts IV, V.

[136] *See* discussion *infra* Part IV.

[137] *See* discussion *infra* Part IV.A.

[138] *See* discussion *infra* Part IV.B.

[139] *See* discussion *infra* Part IV.C.

[140] *See* discussion *infra* Part V.

[141] *See* discussion *supra* Parts II, III.

of shares in firms that retain the ability to engage in such practices. Conversely, if a firm's managers can credibly commit that they will not engage in such practices, that firm's shares should be able to command a premium relative to other firms.[142] Because managers, in general, benefit from higher market valuations of the firms they manage, this dynamic could give them an incentive to commit to forbearing from abusive disclosure practices.[143]

The questions, then, are whether it is easy to credibly commit to unbundled disclosures and how powerful the incentives are to do so. Unfortunately, the answers to these two questions are intertwined and appear to be "no" and "not very," respectively. Taking the securities fraud context first, the main difficulty is that management itself will generally be the only party that knows when a material corrective disclosure is warranted. But at the time that happens, the possibility of avoiding securities fraud liability—which typically entails direct, personal liability for the managers—will almost always significantly outweigh any indirect, theoretical benefits from maintaining a credible commitment to unbundled disclosures.[144] Any suit for a breach of the promise to maintain unbundled disclosures would face the same evidentiary problems as the underlying securities fraud suit.

Management's incentives are even worse in the merger context. Mergers are, in game-theoretic terms, a "final period" decision.[145] Following a merger, the target company's stock will no longer trade and the managers will be cashed out along with the stockholders. As a result, market disci-

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[142] *See* Spindler, *supra* note 4, at 658 ("[I]f a firm values transparency or values the confidence that shareholders have when a firm is subject to strict antifraud penalties, firms can choose to unbundle their projects and disclosures."); *id.* at 685 ("We may suppose that, at equilibrium, a rational marketplace would discount securities of firms that have bundled projects and disclosures. A firm that can commit to disaggregating itself and its disclosures could therefore command a premium relative to aggregated firms.").

[143] *See id.* at 685 ("Market incentives may therefore drive voluntary disaggregation.").

[144] *See id.* at 658 ("The extent to which firms can unbundle themselves and their disclosures may, however, be limited, and the costs of doing so may be significant even where possible."); *id.* at 687 ("Is there any way for a firm to commit credibly beforehand not to bundle negative information with other information? This seems to be a significant problem, because the firm itself will likely be the only party that knows when it has come into new material information.").

[145] *See generally* Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3292 (2013) ("[S]tructural decisions—such as corporate takeovers—present a final period problem entailing an especially severe conflict of interest."); Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1945 (2003) ("Another corporate law last period problem occurs when a company is sold . . . ."); Charles R. Korsmo, *Delaware's Retreat from Judicial Scrutiny of Mergers*, 10 U.C. IRVINE L. REV. 55, 90 (2019) ("[W]hile most managerial decisions take place in the context of on ongoing series of repeat transactions, the decision to approve a merger is, in game theoretic terms, a 'final period' transaction." (quoting Bainbridge, *supra*, at 3292)).

pline of managerial opportunism melts away in the merger context.[146] By the time a merger agreement is in hand, the value to management of maintaining a credible commitment to wholesome disclosure practices is effectively zero. As a result, private ordering is unlikely to be effective.[147]

B. The Traditional Role of Disclosure

"[F]ederal securities regulation has three principal components: (1) mandatory disclosure [requirements]; (2) prohibitions on securities fraud; and (3) restrictions on insider trading."[148] The key source of disclosure requirements is Regulation S-K, which has been promulgated by the SEC under the authority of the Securities Act of 1933.[149] Regulation S-K requires regular disclosure of numerous types of information, including both quantitative financial metrics and qualitative descriptions of the firm's business and assets. Other disclosure requirements are continuous. In particular, Form 8-K requires firms to promptly disclose—within four business days—certain types of material events.[150]

Historically, disclosure requirements have often been spoken of in terms of investor protection. The emerging consensus, however, is that investors can best protect themselves by simply ensuring the market has the information it needs to value securities accurately.[151] As a result, the primary goal of disclosure regulation is making sure the disclosures provide the market with the necessary information in as close to real time as possible. Sophisticated investors can then use that information to value the relevant securities, simultaneously protecting ordinary investors and promoting effi-

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[146] *See* Korsmo, *supra* note 145, at 90 ("For most decisions, managerial discretion is heavily constrained by a large number of legal and extra-legal constraints, including annual director elections, regular reports under securities law, product markets, capital markets, and labor markets, among others. Managers who behave foolishly or dishonestly in one period face the possibility of being found out, punished, or shamed in the next. Such constraints do not operate in the context of a final period transaction like a merger." (footnote omitted)).

[147] *See* Spindler, *supra* note 4, at 685 (concluding that committing to disaggregated disclosure is "likely to be imperfect or costly").

[148] Charles R. Korsmo, *The Audience for Corporate Disclosure*, 102 IOWA L. REV. 1581, 1590 (2017); *see, e.g.*, Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 716 (2006) ("The law of securities regulation may be divided into three broad categories: disclosure duties, restrictions on fraud and manipulation, and restrictions on insider trading."); Kevin S. Haeberle & M. Todd Henderson, *Information-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed*, 101 CORNELL L. REV. 1373, 1377 (2016) (describing "mandatory-disclosure, securities-fraud, and insider-trading law" as "the core of modern securities regulation").

[149] *See generally* 17 C.F.R. § 229 (2020).

[150] *See Form 8-K*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/form8-k.pdf [https://perma.cc/79X2-J84Q].

[151] *See* Korsmo, *supra* note 148, at 1586.

cient allocation of capital.[152] Any rule requiring unbundled disclosure would be at least somewhat in tension with the goal of prompt disclosure of material information. Often, a firm will come into possession of multiple pieces of material information simultaneously. In such circumstances, unbundled disclosure would require deliberately delaying disclosure of some information. The result is an inevitable trade-off of a requirement of unbundled disclosures and a requirement of prompt disclosure of new information.

Nonetheless, the conflict should not be overstated. Form 8-K already provides firms with the flexibility to delay the release of new material information by four days, and earnings releases—chock-full of material information—may be made at any time within a multi-week window.[153] Deterring securities fraud is also one of the core functions of securities regulation. A narrowly drawn unbundling rule may help to do so without unduly delaying the market's receipt of material information. Similarly, although the corporate governance concerns surrounding mergers are not a traditional focus of federal securities law, as Section C discusses, the necessary alterations to existing disclosure requirements would be minimal.

C. Requiring Unbundled Disclosure

A rule that all material disclosures be unbundled is manifestly unworkable and would likely generate more problems than it solves. What is required to prevent opportunistic bundling of information, however, is much more limited. The guiding principle is straightforward: if market evidence is to be determinative at trial, measures should be taken to ensure that the market evidence is as clear and reliable as possible. As such, ideally, issuers would be required to make all corrective disclosures individually, disaggregated from other material information, such that the market reaction can provide a clear measure of the revealed fraud, unmuddied by bundled disclosures. The difficulty with such a requirement is two-fold: (1) that it would often require release of material information to be delayed; and (2) that it is difficult to clearly define "corrective disclosure."

The first difficulty is not so serious. It is certainly the case that where a firm comes into possession of multiple pieces of material information simultaneously, some corrective of earlier misstatements and some not, disclosure of one or more pieces of information would have to be delayed to release the corrective disclosure on its own. Yet, this is not out of the ordinary. As noted above, even the 8-K continuous disclosure obligations only require new information to be disclosed within four business days. This win-

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[152] *Id.*

[153] *See supra* note 121 and accompanying text.

dow provides ample room to separate corrective from non-corrective disclosures. Indeed, even for relatively complex information, the market reaction is often almost immediate, with prices reaching a new equilibrium in a matter of seconds or minutes.[154] As long as the corrective disclosure is made separately, it would rarely be problematic to release other information even later in the same day.

The second difficulty is more serious. The problem is two-fold. First, managers are rarely able and willing to simply admit that earlier misstatements are fraudulent. Second, the truth will often emerge in drips and drabs, with the market gradually decreasing the probability it attributes to the truth of a misstatement, thus muting the ultimate market impact of any eventual corrective disclosure. As a result, even though *Dura* ties the loss causation requirement to market impact upon a corrective disclosure, the lower courts have struggled to determine what exactly constitutes a corrective disclosure.[155] Indeed, during oral argument in *Dura* itself, Justice Stephen Breyer noted that the truth as to an earlier misstatement "might come out in many different ways," and not only "because [an executive] announces I'm a liar."[156]

Grabbing hold of Justice Breyer's suggestion, lower courts have—despite a lack of consensus as to what *does* constitute a corrective disclosure—consistently rejected the notion that it must be a "mirror image" of the fraudulent statements being corrected.[157] Although a "classic" corrective

[154] *See* Grace Xing Hu et al., *Early Peek Advantage? Efficient Price Discovery with Tiered Information Disclosure*, J. FIN. ECON. 399, 402 (2017); Charles R. Korsmo, *High-Frequency Trading: A Regulatory Strategy*, 48 U. RICH. L. REV. 523, 524–25 (2014).

[155] *See generally* Matthew L. Mustokoff & Margaret E. Mazzeo, *Loss Causation on Trial in Rule 10b-5 Litigation a Decade After* Dura, 70 RUTGERS U. L. REV. 175, 196–99 (2017) (discussing circuit court attempts to define "corrective disclosure" and concluding that "[t]he line delineating what type of information is and is not corrective is far from clear").

[156] Transcript of Oral Argument at 38–39, Dura Pharms., Inc., v. Broudo, 544 U.S. 336 (2005) (No. 03-932).

[157] *See, e.g.*, Alaska Elec. Pension Fund v. Flowserve Corp., 572 F.3d 221, 230 (5th Cir. 2009) ("To be corrective, [a] disclosure need not precisely mirror [an] earlier misrepresentation." (alterations in original) (quoting *In re* Williams Sec. Litig.—WCG Subclass, 558 F.3d 1130, 1140 (10th Cir. 2009))); Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 202 (S.D.N.Y. 2010) ("[N]either the Supreme Court in *Dura*, nor any other court addressing the loss causation pleading standard require a corrective disclosure to be a 'mirror image' tantamount to a confession of fraud."); *In re* Bristol-Myers Squibb Sec. Litig., C.A. No. 00-1990, 2005 WL 2007004, at *20 (D.N.J. Aug. 17, 2005) (rejecting the "proposition that an alleged corrective disclosure must be the linguistic mirror image of the alleged fraud"). *See generally* Mustokoff & Mazzeo, *supra* note 155, at 196–99 ("Notwithstanding divergence among the circuit courts on the question of what constitutes a corrective disclosure, there appears to be general agreement that to be corrective, a disclosure need not be a defendant's express admission or acknowledgement of the fraud; in other words, it need not be a 'mirror image' of the fraudulent statement(s) being 'corrected.'" (first

disclosure might be a frank admission of earlier misstatement accompanied by the truth, the whole truth, and nothing but the truth, in practice fraudulent misstatements will often be corrected in a piecemeal, haphazard fashion that defies easy definition.[158] As a result, any rule requiring unbundling of "corrective disclosures" will inevitably be underinclusive in its definition of "corrective disclosure."

Nonetheless, the perfect need not be the enemy of the good. Even a narrow, underinclusive unbundling rule—requiring unbundling of only clearly corrective disclosures—is better than no rule at all. It would impose few costs and be helpful in at least some cases, particularly the worst ones involving clear and uncontroversial fraud. As Part V details, less straightforward cases can be addressed by doctrinal adjustments to *Dura* that would allow plaintiffs to use alternative methods of showing loss causation in appropriate cases.[159]

Two types of disclosures are particularly well-suited to an unbundling requirement. The first is a financial restatement. A financial restatement is defined by the Financial Accounting Standards Board as a revision of a previously issued financial statement to correct an error.[160] Less serious errors can be corrected in a firm's periodic financial disclosures, but an error so serious that earlier statements can no longer be relied upon must be disclosed in a 4.02-8K disclosure within four days of its discovery.[161] Such restatements often signal that earlier disclosures were potentially fraudulent, and they are frequently the trigger for securities fraud class actions.[162] To make the market reaction to the restatement as informative as possible, the SEC should

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quoting *Freudenberg*, 712 F. Supp. 2d at 202; and then quoting *Bristol-Myers Squibb*, 2005 WL 2007004, at *20)).

[158] *See, e.g.*, *In re* Vivendi Universal, S.A. Sec. Litig., 634 F. Supp. 2d 352, 363–65 (S.D.N.Y. 2009) (noting that a "corrective disclosure is traditionally an admission by the company that one or more of its previous statements were false or misleading followed by a corrected, truthful and complete version of those statements" but "[t]he [disclosure] event need not take this form" .in order "to prove loss causation").

[159] *See* discussion *infra* Part V.

[160] *See* ACCT. STANDARDS CODIFICATION § 250-10-50-7 (FIN. ACCT. STANDARDS BD. 2020).

[161] *See* Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Securities Act Release No. 33-8400, Exchange Act Release No. 49,424, 69 Fed. Reg. 15,594 (Mar. 25, 2004); Philip Keunho Chung & Ronnie Cohen, *Hiding in Plain Sight: Stealth Restatements and Their Implication for Litigation Risk*, 15 N.Y.U. J.L. & BUS. 257, 266 (2019) ("After the SEC Final Rule mandating additional Form 8-K disclosures, firms must decide whether the past financial statements which contain material errors can still *be relied upon*; if not, the firm must disclose the errors and restatements using 4.02–8K disclosure within four business days of this decision.").

[162] *See* Chung & Cohen, *supra* note 161, at 283 (finding that a 4.02-8K disclosure "is associated with higher securities class action suits risk"); Furchtgott & Partnoy, *supra* note 5, at 6 (noting that "nearly half" of their sample of securities fraud class actions were filed within two weeks of an accounting restatement).

require that 4.02-8K disclosures be made individually, unbundled with other disclosures. This should be easily achieved, given the four-day window within which the restatement may be announced.

The attraction of such a requirement is that, instead of needing to define the information it applies to, it would piggy-back on an existing disclosure requirement involving a defined set of obviously securities fraud-related information. Although the definitions of what must be required via 4.02-8K may not be as clear as we would like,[163] they are a good start. If combined with clearer definitions of the type of accounting errors that must be disclosed via a 4.02-8K disclosure, such an unbundling requirement would go a long way toward providing more reliable market evidence of the magnitude of an important class of securities fraud.

The second type of disclosure that could productively be subjected to an unbundling requirement is announcement of a government investigation or subpoena. Such an announcement, although not "corrective" in and of itself, can be a signal to the market that a corrective announcement is likely to follow, and it can produce a more dramatic market impact than the eventual corrective disclosure.[164] An unbundling rule for government investigations will undoubtedly be overinclusive—the opening of an investigation does not always portend liability. But the cost and difficulty of unbundling this limited universe of disclosures are minimal, and doing so will lead to a more reliably informative market reaction in that subset of cases where fraud is ultimately uncovered.

Unbundling in the merger context is at once simpler than in the securities fraud context, but less likely to be effective in ensuring accurate market evidence for courts. It is simpler because the disclosure to be unbundled is easy to define—the announcement that the target company's board has approved a merger agreement. It is less effective because it would still provide little assurance that the market price is fully informative in a future judicial proceeding. In addition to the problem of leaks and publicity prior to the merger announcement—factors that may also be present in the securities fraud context—any information that comes out *after* the merger announcement will not generate a meaningful market reaction. It is not uncommon

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[163] *See generally* Chung & Cohen, *supra* note 161, at 284 (calling on the SEC to provide "more guidance as to the types of errors that warrant a non-reliance judgment and the attendant 4.02-8K disclosure" to "curb firms' opportunistic choices" to avoid making a 4.02-8K disclosure).

[164] *See, e.g.*, Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1210–11 (9th Cir. 2016) (noting that the announcement of an SEC subpoena regarding potential misstatements caused the company's stock to "drop precipitously" although "the market reacted hardly at all" to the firm's eventual admission of its misstatements); Pub. Emps.' Ret. Sys. of Miss. v. Amedisys, Inc., 769 F.3d 313, 324–25 (5th Cir. 2014) (recognizing the sharp stock drops accompanying the announcement of government investigations into allegedly fraudulent practices).

for many months to pass between the announcement of a merger and its actual consummation. During this time, the market price is typically pegged more to the value of the merger consideration rather than the value of the underlying business as a standalone concern. Valuation for litigation purposes is generally as of the time of the closing—by explicit statutory command in the case of appraisal.[165] Thus, it is not enough that disclosure be unbundled. Even in the face of an unbundling rule, managers may simply wait to disclose earnings information until after the merger announcement, thus obscuring any market reaction.

For the market price to be as informative as possible, all material information known as of the *closing* of the merger would have to be disclosed prior to the *announcement* of the merger—an obvious impossibility absent substantial advances in time-travel technology (where progress has been notoriously slow). As a result, an unbundling requirement is merely an obstacle to the most blatantly opportunistic disclosure practices. The real work in the merger context must be done by doctrinal refinements, which Part V discusses.[166]

V. Potential Doctrinal Refinements

As Part IV explains, regulatory unbundling requirements can only go so far in preventing opportunistic disclosure practices.[167] In the securities fraud context, any unbundling rule will inevitably be underinclusive. And in the merger context, management can achieve the same result—obscuring the market reaction to new information—by simply waiting to disclose until after the announcement of the merger. If opportunistic disclosure practices are to be discouraged, courts must have the doctrinal flexibility to use non-market valuation evidence in appropriate circumstances.

Section A sketches the doctrinal refinements to *Dura Pharmaceuticals, Inc. v. Broudo*'s loss causation requirement.[168] Section B discusses the implications of market evidence in the context of merger litigation valuation.[169] The guiding principles are, again, straightforward. Market evidence is, as current doctrine reflects, generally the best valuation evidence in securities fraud and merger litigation. Where market evidence is obscured, however, it may be necessary and appropriate to rely on other valuation evidence. Indeed, to the extent courts are unable or unwilling to look to non-

[165] *See* Del. Code Ann. tit. 8, § 262 (2020).
[166] *See* discussion *infra* Part V.
[167] *See* discussion *supra* Part IV.
[168] *See* discussion *infra* Part V.A.
[169] *See* discussion *infra* Part V.B.

market valuation evidence, managers will have a strong incentive to deliberately obscure market evidence through the opportunistic disclosure practices discussed above. Thus, courts should maintain the ability to use non-market valuation evidence: both (1) to serve as a second-best solution in the absence of reliable market evidence; and (2) to discourage managers from avoiding the creation of reliable market evidence in the first place.

A. Refining Dura*'s Loss Causation Requirement*

The great advantage of *Dura Pharmaceuticals, Inc. v. Broudo*'s requirement of a market impact to show loss causation is that it will often provide a reliable measurement of damages, in the form of an event study showing the existence and magnitude of an abnormal price reaction to a corrective disclosure.[170] Where a corrective disclosure is bundled with other material information, however, this advantage is destroyed. As Professors Jill E. Fisch, Jonah B. Gelbach, and Jonathan Klick (Fisch et al.) note:

> When multiple sources of news are released at exactly the same time, however, no event study can by itself separate out the effects of the different news. The event study can only tell us whether the net effect of all the news was associated with an unusually large drop or rise.[171]

Although Fisch et al. state that "[t]he possibility of such strategic behavior raises important questions about the admissibility of non-event study evidence,"[172] they do not go on to address those questions.

When faced with multiple bundled disclosures, such that an event study cannot isolate the impact of the corrective disclosure, courts have two basic choices. First, they could simply dismiss any securities fraud claim. Whereas this would systematically under-deter fraud, it may nonetheless be justified by concerns over false positives and ease of administration.[173] As argued above, however, this approach creates incentives for unfaithful managers to engage in strategic bundling behavior. In order to avoid creating these incentives, the approach must turn on the defendant-managers' behavior. Where the bundling was unintentional or unavoidable, trading off deterrence for reliability and ease of administration is likely appropriate.

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[170] *See, e.g.*, Spindler, *supra* note 4, at 687 ("Recall that, with a single project, fraud is perfectly internalized under both *ex post* and *ex ante* [loss causation] rules, the difference being that the *ex post* approach also provides a ready measurement of damages.").

[171] Fisch et al., *supra* note 36, at 614.

[172] *Id.* at 614–15.

[173] *See* Spindler, *supra* note 4, at 688 ("Even taking into account the systemic underdeterrence of the *ex post* rule, one might think the ease of administration makes for a worthwhile tradeoff.").

Where, however, plaintiffs are able to show that the bundling was intentional and/or avoidable, a different approach is necessary, and a court should allow plaintiffs to introduce non-event study evidence. The plaintiff's goal would remain the same: to value the fraudulent information. The first thing to note, however, is that this could be done in two ways. It could be done directly, by valuing the fraudulent information itself. Or, it could be done indirectly, by valuing the non-fraud-related information, and then subtracting it from the market reaction to the bundled disclosures. In any given case, one or the other might be more susceptible to valuation by non-event study means.

The form the non-market evidence could take would depend on the nature of the corrective disclosure and the type of the bundled non-fraud-related information. Fisch et al. give the example of earnings news, a common type of information bundled with a corrective disclosure. They note that "[e]xperts might be able to use historical price and earnings data for the firm to estimate the relationship between earnings news and the firm's stock price."[174] They then suggest that:

> If th[e] study controlled appropriately for market expectations concerning the firm's earnings (say, using analysts' predictions), it might provide a plausible way to separate out the component of the event date's estimated [abnormal] excess return that could reasonably be attributed to the earnings news, with the rest being due to the alleged corrective disclosure . . . .[175]

If, on the other hand, the information concerns the success or failure of a particular project, an expert might attempt to value it using a classic DCF methodology, or by any other methodology generally accepted in the financial community. More crudely, an expert could attempt to assess the relative importance of multiple pieces of bundled information by measuring the relative frequencies with which news stories or headlines refer to them in the wake of the disclosures.[176]

The allocation of the burden of proof can do useful work in this context. The United States Court of Appeals for the Seventh Circuit's approach in the *Glickenhaus & Co. v. Household International, Inc.* securities fraud 2015 case is instructive.[177] In *Glickenhaus & Co.*, the plaintiffs argued at

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[174] Fisch et al., *supra* note 36, at 614.

[175] *Id.*

[176] *See id.* ("Alternatively, experts might use quantitative content analysis, e.g., measuring the relative frequencies of two types of news in headlines of articles published following the news."). *See generally* TABAK, *supra* note 96, at 13.

[177] Glickenhaus & Co. v. Household Int'l, Inc., 787 F.3d 408 (7th Cir. 2015).

trial that at least some of the price inflation due to the underlying fraud gradually "leaked out" as the market gradually learned the truth, as opposed to the price impact coming entirely from specific corrective disclosures.[178] The difficulty, of course, is that numerous non-fraud-related factors undoubtedly affected the stock price during the same period. On appeal, the defendants argued that the plaintiff's "loss-causation model must *itself* account for, and perfectly exclude, any firm-specific, nonfraud related factors that may have contributed to the decline in a stock price."[179] Just as with bundled disclosures, however, the appeals court pointed out that "[i]t may be very difficult, if not impossible, for any statistical model to do this."[180]

As a result, the court required the plaintiffs to first explain "in nonconclusory terms" how its valuation methodology excluded non-fraud-related information.[181] If they could do so, the burden would then shift to the defendant to identify "some significant, firm-specific, nonfraud related information that could have affected the stock price."[182] The burden would then shift back to the plaintiff to "account for that specific information or provide a loss-causation model that doesn't suffer from the same problem."[183]

In a case of disclosure bundling, where the defendants themselves *caused* the problem of confounding information—or, at the very least, could have avoided it—some degree of burden shifting is even more appropriate. Where the plaintiffs can provide nonconclusory evidence that the corrective disclosure had a discernible market impact—or *would have had* a discernable market impact absent the bundled disclosure—the burden should shift to the defendant to account for the bundled information. If they are unable to do so, then, in the case of bundled negative information, the plaintiffs should benefit from a presumption that the entire abnormal price reaction was due to the corrective disclosure. In the case of bundled positive (confounding) information, the defendants should not be able to use the lack of market impact as a defense.

B. Using (and Rejecting) Market Evidence in Merger Litigation Valuation

The doctrinal lesson in merger litigation is at once more direct and more difficult for a judge to navigate. Any attempt to use unaffected market prices to measure the standalone value of a firm must reckon with infor-

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[178] *See* Report of Daniel R. Fischel at 24–25, Jaffe Pension Plan v. Household Int'l, Inc., 756 F. Supp. 2d 928 (N.D. Ill. 2010) (No. 02-C-5893), 2007 WL 3192033.

[179] *Glickenhaus & Co.*, 787 F.3d at 422.

[180] *Id.*

[181] *Id.*

[182] *Id.*

[183] *Id.*

mation that was unavailable to the market prior to the announcement of the merger. Earnings or other material information bundled with the merger announcement—or deliberately released after the announcement—is only one particularly salient subset of such information. Where the plaintiff is able to show the existence of material information that was not available to the market, the court must either adjust the market price to take the information into account or determine whether another valuation methodology would be more reliable.

In its most recent pronouncement on appraisal litigation, the Delaware Supreme Court implicitly gave trial courts the discretion to do so. In its *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.* 2019 decision, the Delaware Supreme Court reversed the trial court's decision to rely on the pre-announcement price as the sole evidence of fair value.[184] In part, it reversed because the pre-announcement price did not reflect information that may have emerged between the announcement and the valuation date. In Delaware appraisal, the valuation is performed as of the date of the merger closing, which in *Aruba* was several months after the announcement of the merger agreement.[185] In addition, the court noted that the market lacked material information even as of the date of the announcement.[186] Of particular relevance here, as noted above, the parties had bundled Aruba's positive quarterly earnings with the merger announcement, a factor the Delaware Supreme Court suggested called into question the reliability of the pre-announcement market price.[187] The strong—and sensible—implication was that a court must either find a way to adjust the unaffected market price to reflect such information, or eschew reliance on the market price altogether.

One remaining wrinkle is whether deliberately bundled or delayed information should be treated any differently than any other type of information not available to the market pre-announcement. Arguably, the Delaware Supreme Court implied that it should be in its opinion in Dell's appraisal case. In 2017, in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, the court suggested that the market price was reliable because the trial court had "found no evidence that information failed to flow freely

[184] *See* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., 210 A.3d 128, 130, 132 (Del. 2019) (en banc) (per curiam), *rev'g* C.A. No. 11448, 2018 WL 922139 (Del. Ch. Feb. 15, 2018).

[185] *Id.* at 139 ("For starters, the unaffected market price was a measurement from three to four months prior to the valuation date, a time period during which it is possible for new, material information relevant to a company's future earnings to emerge.").

[186] *See id.* ("Even more important, HP . . . also had material, nonpublic information that, by definition, could not have been baked into the public trading price.").

[187] *Id.* (noting that "HP knew about Aruba's strong quarterly earnings before the market did, and likely took that information into account when pricing the deal").

or that management purposefully tempered investors' expectations for the [c]ompany so that it could eventually take over the [c]ompany at a fire-sale price."[188] The implication is that management's deliberate withholding of information should be taken as especially strong evidence that the market price is not reliable.

The trial court in *Aruba* found surprising the apparent significance that the *Dell* court placed on management's intent.[189] Yet, the emphasis on managerial intent may be appropriate for two reasons. First, one purpose of the merger class action and the appraisal remedy—perhaps the primary purpose—is to deter managerial opportunism in the merger context.[190] Strategic disclosure practices such as those catalogued above are themselves a species of destructive managerial opportunism that should be deterred. Second, managerial intent can serve as a red flag: powerful circumstantial evidence that management—who have a considerable informational advantage over the court—believed that the withheld information was material and would undermine their argument that the market price (or even the merger price) was fair. Thus, bundling or delaying of material disclosures should trigger a presumption that the market price is not a reliable indicator of fair value. Furthermore, where the deal price was itself anchored on the merger price, strategic disclosure practices call into question the fairness of the deal price as well.[191]

CONCLUSION

It is natural for courts to want to defer to market evidence of valuation. In most cases, they are right to do so. Market prices represent a consensus generated by the buying and selling decisions of thousands of market partic-

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[188] Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 25–26 (Del. 2017).

[189] *See* Verition Partners Master Fund Ltd. v. Aruba Networks, Inc., C.A. No. 11448, 2018 WL 922139, at *34 (Del. Ch. Feb. 15, 2018) ("My prediction of the law before the Delaware Supreme Court's decision in *Dell* would have been that scienter did not matter for an appraisal case where the sole litigable question is valuation rather than culpability."), *rev'd*, 210 A.3d 128 (Del. 2019) (en banc) (per curiam).

[190] *See generally* Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 282 (2017) (noting that "[a]ppraisal now stands as a formidable mechanism of deterrence to opportunistic mergers").

[191] In 2019, in *In re Appraisal of Columbia Pipeline Group*, the Delaware Court of Chancery recognized the possibility that "the reliability of the trading price" may reflect on the reliability of the negotiated "deal price." *See In re* Appraisal of Columbia Pipeline Grp., C.A. No. 12736, 2019 WL 3778370, at *49 (Del. Ch. Aug. 12, 2019) ("Based on these authorities, this decision does not have to make a finding regarding the reliability of the trading price as a condition to relying on the deal price. It remains conceivable that there could be a case where the parties anchored deal negotiations off the trading price, but this is not that case.").

ipants competing to identify any information relevant to the value of a security. In most circumstances, courts are correct to conclude that this price-forming process will generate a more reliable estimate of value than a judge struggling to reconcile the testimony of competing experts in an adversarial trial.

Market pricing, however, is only as good as the information available to the market. Courts must be cognizant of the information asymmetry between managers and the market. Furthermore, managers at least partly control the flow of information to the market. Where courts rely on market prices, managers can use this control strategically to gain an advantage in litigation. Where they are successful, the deterrence value of litigation is weakened. In particular, managers can—and do—use their ability to bundle or delay disclosure of material information to undermine the deterrence value of securities fraud and merger litigation.

To combat this possibility, the SEC should require that certain types of litigation-relevant information be disclosed to the market in as informative a form as possible—unbundled and before the price reaction is distorted by a pending merger. In addition, courts should be cautious to avoid creating incentives for strategic disclosure behavior. Where strategic disclosure behavior is possible, courts must preserve the flexibility to resort to non-market valuation evidence. Where it appears strategic disclosure behavior may have occurred, courts should not hesitate to use this flexibility. In sum, if courts are to defer to market valuation evidence, they must ensure that the market has received the relevant information in a fashion that makes market valuation evidence reliable.