

AN ANALYSIS OF WHEN THE MERGER PRICE IS THE BEST REPRESENTATION OF FAIR VALUE IN AN APPRAISAL ACTION

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Abstract

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Delaware's statutorily afforded right of appraisal is once again a hot topic. In an appraisal action, the Delaware Court of Chancery is charged with the task of determining the fair value of recently acquired Delaware corporations. However, the appraisal process is not an easy one, in no small part, to the inflexible statute guiding the appraisal procedure. The process is further complicated by the Delaware Supreme Court's mandate that the Court of Chancery not to employ a bright line test in determining the fair value even for those transactions that were the result of a free and open market process. As a result, the courts are often left second-guessing a merger value that was the product of a fair merger process. I propose that in an arms-length third-party cash-out merger, the entire fairness standard of review is the appropriate standard to determine fair value within an appraisal action. A statutory safe harbor allowing the judiciary the opportunity to examine the process by which the target company and acquiring company arrived at the final merger value versus questioning the substance of the merger would serve the M&A and shareholder community well. In the absence of a legislative fix, the Court of Chancery has, at the least, provided buyers, sellers, and arbitrageurs alike, with scenarios that will likely result in the court determining that the merger price is in fact the best representation of fair value. Essentially, when the inputs typically used by the court for determining fair value are in some way flawed, the court will likely conclude that the merger price is the best representation of fair value.

Keywords: Appraisal, Fair Value, Market Value, Merger Price

1. INTRODUCTION

In an arms-length third-party cash-out merger, the entire fairness standard of review is the appropriate standard to determine fair value within an appraisal action.¹ The courts for more than a decade have, in a less than subtle manor, questioned the wisdom of a

judge second guessing the results of a transaction born of a free and open marketplace.² Although the court is given much flexibility to execute an inflexible statute, the Delaware Supreme Court has made it abundantly clear that a bright-line rule is contrary to the statute that governs the determination of fair value in an appraisal proceeding.³ The appraisal statute does clearly state

¹ *Union Illinois 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 359 (Del. Ch. 2004) ("For me (as a law-trained judge) to second-guess the price that resulted from that process involves an exercise in hubris and, at best, reasoned guess-work.")

² *In re Appraisal of Ancestry.com, Inc.*, No. CV 8173-VCG, 2015 WL 399726, at *15 (Del. Ch. Jan. 30, 2015).

³ *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214, 218 (Del. 2010) ("Requiring the Court of Chancery to defer—

that the court is to use all relevant factors in determining fair value.⁴ With the clear direction from the Delaware Supreme Court and the unambiguous language of the statute, the Court of Chancery is left with little choice but to consider all factors when determining fair value.⁵

However, the courts continue to second guess their ability to beat Wall Street. Vice Chancellor Glasscock writes, “I have commented elsewhere on the difficulties, if not outright incongruities, of a law-trained judge determining the fair value of a company in light of an auction sale. . . .”⁶ It would appear that the Delaware courts are asking for nothing less than an amendment to the Delaware corporate appraisal statute. Adding a safe harbor to the statute for a third-party cash-out merger that applies the stringent entire fairness standard of review would make sense.⁷

Yet, the latest legislative session of the Delaware General Assembly offered no such remedy to the Court of Chancery’s conundrum of their requirement to second-guessing an open and fair auction process.⁸ The Executive Committee of the Delaware Bar did address the recent concern of appraisal arbitrage by approving a change to §262 of the DGCL.⁹ These changes, to be approved by the Delaware General Assembly, surround creating a floor for the percentage of ownership a shareholder must have prior to filing an appraisal action (in theory to reduce *de minimus* claims), and allowing the targeted company to tender the value of the outstanding shares at the final merger price (to limit interest owed).¹⁰ This “fix” to the recent surge of appraisal arbitrage activity does not, though, address the issue of marketplace valuation. Therefore, the holding in *Golden Telecom*, stating that the court performing the appraisal is not permitted to utilize a bright-line test, rules the day.¹¹ Why then, knowing that there is no indication that a legislative fix is in the works, and that the Delaware Supreme Court will not favor a judicial remedy to a burdensome statute, do those charged with resolving these appraisal actions continue to rely

upon market price as fair value?¹² It has been recently noted that these market value appraisal decisions provide a nice arsenal for the targeted company to use when defending merger price (Halper, 2015). The reality, more likely, is that the court is signaling to those sophisticated arbitrageurs that appraisal, although statutorily afforded, is not appropriate in a third-party merger where a fair and open auction was undertaken.¹³

Moving back to third-party transactions, to appreciate why the market value is an appropriate measure of fair value in these third-party appraisal cases, an examination of appraisal is necessary. Part II below briefly explains the background of appraisal and the mechanics of the appraisal statute. Part III explores the methods used by the courts to determine fair value as well as when those methods are not appropriate. Part IV argues that, at times, the process is more important than substance when determining fair value in the context of appraisal.

2. APPRAISAL GENERALLY

2.1 The purpose of appraisal

The appraisal statute is primarily designed to protect the interests of the minority shareholders in a merger transaction.¹⁴ This right is generally afforded in all cash out transactions.¹⁵ A properly perfected appraisal action not only protects the dissenting shareholder, but it also affords compensation to the shareholder for economic losses suffered from the merger.¹⁶ The ultimate goal of the appraisal action is to determine “fair value.”¹⁷ In the world of appraisal, fair value is equated to the going concern of the target corporation.¹⁸ The court is tasked with the not so simple directive of determining the value of the targeted company on the date of the merger less synergies derived from the merger.¹⁹

The area of the Delaware General Corporation Law statute that controls the process of determining

conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute and the reasoned holdings of our precedent.”).

⁴ See DEL. CODE ANN. tit. 8, § 262h (2013).

⁵ *Golden Telecom, Inc.*, 11 A.3d at 218.

⁶ See *In re Appraisal of Ancestry.com, Inc.*, WL 399726, at *1.

⁷ Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. page 1551 (“In our view, a genuine market test of the target company will necessarily provide a superior valuation of the stockholders’ interest, and in such circumstances an appraisal proceeding can only cause mischief. For this reason, we would support the development of a safe harbor to eliminate appraisal where the transaction has undergone a true auction.”).

⁸ Practical Law, *DGCL Amendments Proposed on Fee-shifting, Forum Selection and Appraisal Rights*, (March 12, 2015), <http://us.practicallaw.com/8-603-7526>.

⁹ See generally *2015 Amendments to the General Corporation Law of the State of Delaware*, (Apr 13, 2015), <https://www.rlf.com/Publications/6017>.

¹⁰ See generally *supra* note 9.

¹¹ *Golden Telecom, Inc.*, 11 A.3d at 218.

¹² For e.g. *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. at 49 (The Chancery Court does though exhaust all likely fair value methods prior to relying on market price).

¹³ *Huff Fund Inv. P’ship v. CKx, Inc.*, No. CV 6844-VCG, 2013 WL 5878807 at 13.

¹⁴ Wertheimer (1998). “Minority shareholders are granted limited statutory rights as a check against rampant majority rule. One such right is the ability of shareholders to dissent from certain corporate actions, primarily mergers and other fundamental corporate changes and to receive the appraised fair value of their shares”.

¹⁵ See generally DEL. CODE ANN. tit. 8, § 262 (2013).

¹⁶ *Id.*

¹⁷ *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298 (Del. 1996), (“[T]his Court has explained that the dissenter in an appraisal action is entitled to receive a proportionate share of fair value in the going concern on the date of the merger, rather than value that is determined on a liquidated basis.”).

¹⁸ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983) (“Clearly, there is a legislative intent to fully compensate shareholders for whatever their loss may be, subject only to the narrow limitation that one cannot take speculative effects of the merger into account.”); See generally Del. Code Ann. tit. 8, § 262 (2013).

¹⁹ *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d at 507.

fair value is §262(h).²⁰ Unfortunately, like many statutes, the courts are left with the task of discerning legislative intent. In the case of a Delaware appraisal that is subject to the Delaware General Corporation Law the court looks to the following:

[T]he Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.²¹

Prior to 1983, the Delaware courts utilized the “Delaware block” method to determine fair value.²² The block method, in attempting to interpret what “all relevant factors” in the statute meant, applied a weighted average of the elements typically used to define value in the equities market, such as market value and total assets.²³ The decision in *Weinberger v. UOP, Inc.* moved the courts from the reliance on the block method to a method that allowed the courts to use essentially any method generally accepted by the financial community.²⁴ The basic methods utilized by the courts post-*Weinberg* are discounted cash flow, comparable companies analysis, comparable transactions analysis, and a market value analysis.²⁵

2.2 The four methods of valuation

The most common method employed by the court is discounted cash flow (DCF).²⁶ DCF uses the following:

[a]n estimation of net cash flows that the firm will generate and when, over some period; a terminal 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.²⁷

The DCF exercise produces a value of a company that is equal to the value of its projected future cash flows, discounted to the present value. This solves the going concern issue by excluding synergies derived from a merger.²⁸

The comparable company analysis involves the examination of similarly situated publicly traded companies that have reviewable financials.²⁹ A trading price ratio is derived by using financially acceptable methods that aid in the determination of income. Next, the derived ratios are corrected and applied to the target company.³⁰

A comparative transactions analysis involves identifying similar transactions, “quantifying those transactions through financial metrics, and then applying the metrics to the company at issue to ascertain a value.”³¹ The comparable transactions method is heavily reliant upon to the similarity between the target company and the companies used for comparison.³² Like the previous methods of valuation discussed, a comparable transaction evaluation relies upon an expert to choose the comparables.³³ The burden is therefore placed upon the expert to persuade the court of the viability of the comparables.³⁴

Lastly, the court can look to the merger price as a strong indication of fair value.³⁵ This method is often criticized because it encompasses the post-merger synergies that are not to be included when calculating fair value in an appraisal action.³⁶ To remedy that concern, the court has simply adopted a process of soliciting from the parties an analysis of what they believe to be the post-merger synergies.³⁷

²⁷ *Id.* at 917.

²⁸ *Merion Capital, L.P. v. 3M Cogent, Inc.*, No. CV 6247-VCP, 2013 WL 3793896, at *10 (Del. Ch. July 8, 2013) *judgment entered sub nom.* *Merion Capital, L.P. v. 3M Cogent, Inc.* (Del. Ch. July 23, 2013).

²⁹ *Id.* at *6.

³⁰ *Id.* (“The comparable companies method of valuing a company's equity involves several steps including: (1) finding comparable, publicly traded companies that have reviewable financial information; (2) calculating the ratio between the trading price of the stocks of each of those companies and some recognized measure reflecting their income such as revenue, EBIT, or EBITDA; (3) correcting these derived ratios to account for differences, such as in capital structure, between the public companies and the target company being valued; and, finally, (4) applying the average multiple of the comparable companies to the relevant income measurement of the target company....”).

³¹ *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 54 (Del. Ch. 2007) *judgment entered*, (Del. Ch. Aug. 31, 2007).

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Merlin Partners LP v. AutoInfo, Inc.*, No. CV 8509-VCN, 2015 WL 2069417, at *7 (Del. Ch. Apr. 30, 2015) quoting *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 507 (Del. Ch.2010), *aff'd*, 11 A.3d 214 (Del.2010). (“[A]n arms-length merger price resulting from an effective market check” is a strong indicator of actual value.”).

³⁶ See *supra* note 16 at 133.

³⁷ *Union Ill. 1995 Inv. Ltd. P'ship*, 847 A.2d at 343 (“In this post-trial opinion, I conclude that the fair value of a UFG share as of the Merger date is the value of the Merger Price

²⁰ See generally DEL. CODE ANN. tit. 8, § 262 (2013).

²¹ DEL. CODE ANN. tit. 8, § 262(h) (2013).

²² *Weinberger*, 457 A.2d at 712 (“This means that the so-called ‘Delaware block’ or weighted average method was employed wherein the elements of value, i.e., assets, market price, earnings, etc., were assigned a particular weight and the resulting amounts added to determine the value per share. This procedure has been in use for decades.”).

²³ *Id.*

²⁴ *Id.* (“However, to the extent [the Delaware block method] excludes other generally accepted techniques used in the financial community and the courts, it is now clearly outmoded. It is time we recognize this in appraisal and other stock valuation proceedings and bring our law current on the subject.”).

²⁵ Franklin Balotti and Jesse A. Finkelstein, Blake Rohrbacher, ContributorVolume 1Chapter 9: Merger or Consolidation Del. L. of Corp. and Bus. Org. § 9.45R. Valuation in a Delaware Appraisal Proceeding, 2006 WL 2454231.

²⁶ *ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 925 (Del. Ch. 1999), *as revised* (July 1, 1999) (“As I stated above, this Court favors the discounted cash flow approach, based in large part on its wide acceptance.”).

3. MERGER PRICE AS FAIR VALUE

The Delaware Court of Chancery has served notice to minority shareholders that when there is a third-party merger free from a questionable process, merger price is a strong indication of fair value.³⁸ Four recent Court of Chancery appraisal decisions highlight the aforementioned sentiment. *Huff Fund Investment Partnership v. CKx, Inc.*,³⁹ *In re Appraisal of Ancestry.com, Inc.*,⁴⁰ *Merlin Partners LP v. AutoInfo, Inc.*,⁴¹ and *LongPath Capital, LLC v. Ramtron International Corp.*⁴² provide insight into not only how the court currently views merger price relative to fair value, but also why the court, in many cases, is unwilling to rely on the valuations provided by experts.

3.1 Huff Fund Investment Partnership v. CKx, Inc., (a third-party transaction)

As a brief background to *Huff*, the company owned multiple unique and successful entertainment streams of which the most significant were: 19 Entertainment, which owned rights to the number-one-rated television show, the singing competition American Idol as well as the successful competitive dance show So You Think You Can Dance; Elvis Presley Enterprises, which owned the rights to the name, image, and likeness of entertainer Elvis Presley, as well as some rights to Presley's recorded music catalog; and Muhammad Ali Enterprises, which owned the name, likeness, and image of the boxing champion.⁴³

In *Huff*, Vice Chancellor Glasscock proceeded to describe a vigorous sales process that occurred over a six-year period.⁴⁴ More importantly, the Court's exhaustive analyses of the traditional fair value calculation techniques lead it to a conclusion that merger price was the fair value not simply *de facto*, but by comparing the effectiveness of DCF, comparative companies, and comparative transactions to the results of the process type market value analysis.⁴⁵

minus synergies. The appraisal award excludes synergies in accordance with the mandate of Delaware jurisprudence that the subject company in an appraisal proceeding be valued as a going concern.”)

³⁸ *Merlin Partners LP*, WL 2069417, at *7.

³⁹ See generally *Huff Fund Inv. P'ship v. CKx, Inc.*, No. CV 6844-VCG, 2013 WL 5878807 (Del. Ch. Nov. 1, 2013), *adhered to*, No. CIV.A. 6844-VCG, 2014 WL 2042797 (Del. Ch. May 19, 2014), *judgment entered sub nom.* *Huff Fund Inv. P'ship v. CKX, Inc.* (Del. Ch. June 17, 2014), *aff'd sub nom.* *Huff Fund Inv. P'ship v. CKx, Inc.*, No. 348, 2014, 2015 WL 631586 (Del. Feb. 12, 2015).

⁴⁰ See generally *In re Appraisal of Ancestry.com, Inc.*, No. CV 8173-VCG, 2015 WL 399726 (Del. Ch. Jan. 30, 2015).

⁴¹ See generally *Merlin Partners LP*, 2015 WL 2069417.

⁴² See generally *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. (Del. Ch. June 30, 2015).

⁴³ *Huff Fund Inv. P'ship*, WL 5878807, at *2.

⁴⁴ *Id.* at *1. (“The company was sold after a full market canvas and auction.”)

⁴⁵ *Id.* at *15 (“Other relevant factors typically include DCF analyses, comparable companies analyses and comparable transaction analyses. For the reasons explained above, the latter are either unreliable or unavailable here.”)

When looking at DCF in *Huff*, the reliability of the inputs was questioned.⁴⁶ When specifically looking at the inputs, the court considered why the numbers were prepared, who prepared the numbers, how competent the preparer was in the process, and whether or not there were economic outliers in the projections.⁴⁷

The Vice Chancellor found that the five-year projections used by Petitioner were created for the purpose of selling the company.⁴⁸ Additionally, the inputs used by the Petitioner included a highly speculative number that was included to either entice a sale or better position financing.⁴⁹ Furthermore, the highly speculative numbers were not produced in the ordinary course of business.⁵⁰ Ultimately, the Vice Chancellor could not rely upon management's five-year projection, the projection that Petitioner relied upon in its DCF calculation.⁵¹

Petitioner also used, as part of its fair value analysis, a comparison company and transaction analysis.⁵² The effectiveness of a comparative company analysis relies upon the similarity of the target company and the guideline company.⁵³ Although the Petitioner agreed that the companies he used in his company comparison analysis and the transactions relied upon were not truly comparable to the target, CKx, he nonetheless, relied on this analysis to the tune of 40% of his final fair value calculation.⁵⁴ The Court, based upon Petitioner's expert's own testimony, refused to rely on Petitioner's analysis.⁵⁵

Huff is instructive in that it not only begins to reveal when merger price is the appropriate number for fair value, but it also illustrates factors a court will look to discredit traditional DCF and comparison analyses. The Vice Chancellor made it

⁴⁶ *Id.* at *9 (The reliability of a DCF analysis therefore depends, critically, “on the reliability of the inputs to the model.”)

⁴⁷ *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *9 (“But this Court has disregarded management projections where the company's use of such projections was unprecedented, where the projections were created in anticipation of litigation, or where the projections were created for the purpose of obtaining benefits outside the company's ordinary course of business.”)

⁴⁸ *Id.* at *5 (“It was in connection with expressions of interest from potential acquirers that CKx management created its five-year projections (the “Management Projections.”))

⁴⁹ *Id.* at *10.

⁵⁰ See generally *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010).

⁵¹ *Huff Fund Inv. P'ship*, WL 5878807, at *9.

⁵² See *id.*, at *8 where Petitioner presented a weighted analysis relying on DCF, comparison company, and comparison transaction.

⁵³ *Merion Capital, L.P. v. 3M Cogent, Inc.*, No. CV 6247-VCP, 2013 WL 3793896, at *6 (Del. Ch. July 8, 2013).

⁵⁴ *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *9. (“Reilly admitted at trial that he found no companies he could describe as “comparable” to CKx, which was why he labeled his analyses as consisting of “guideline” public companies and acquisitions. Reilly's trial testimony confirmed important differences between the “guideline” companies and CKx: none of the guideline companies were of comparable size; none owned assets resembling the assets of CKx; and none competed with CKx or utilized a comparable business model.”)

⁵⁵ *Id.*

clear that in the absence of reliable DCF numbers, sound comparable companies, or a legitimate comparable transactions analysis, the court can default to the merger price.⁵⁶ However, before concluding that the merger price was the appropriate representation of fair value, Vice Chancellor Glasscock carefully addressed the concern that *Global* presents.⁵⁷ In order to conclude that the merger price is an appropriate measure of fair value, the court must examine all relevant factors.⁵⁸ The Vice Chancellor began to pick away at the various analysis provided by the litigants.⁵⁹ When a target company does not typically produce projections as part of its ordinary course of business or when the projections are made in anticipation of a sale or litigation, the court may not rely upon the DCF numbers.⁶⁰ This was the case in *Huff*.⁶¹ As noted, the Petitioners' expert's own testimony leveled the comparison (company and transaction) analysis ineffective.⁶²

Even though, the Vice-Chancellor has precedent that by default,⁶³ allowing him the option to utilize the merger price as fair value, he still describes a process that CKx followed in the sales process which resulted in a fair value merger price.⁶⁴ The Vice-Chancellor stated:

The record and the trial testimony support a conclusion that the process by which CKx was marketed to potential buyers was thorough, effective, and free from any spectre of self-interest or disloyalty. This is not a case where a controlling stockholder froze out a minority stockholder. Nor is this a case where the only evidence that a merger price was the result of "market" forces was a post-signing go-shop period (which failed to produce competing bids) relied on to demonstrate that the transaction represented market price, and thus fair value.⁶⁵

The processes that the Vice Chancellor relied upon to conclude merger price equated to fair value were, for example, that CKx engaged the assistance of a reputable financial advisor to maximize price, and the Board successfully instigated a bidding war.⁶⁶ There were also multiple unsolicited and credible bids; all the while CKx canvassed the market for additional bidders.⁶⁷

Although an appraisal action is not a fiduciary analysis, the Vice Chancellor provides a sound process to follow to determine fair value in the absence of other acceptable means.⁶⁸

3.2 In re Appraisal of Ancestry.com, Inc. (a private equity transaction)

Ancestry.com was a publicly traded company specializing in online family research.⁶⁹ Their business model was fairly unique and competition was found mostly in startups.⁷⁰ In addition to providing subscriptions for online family research, Ancestry.com backed the show *Who Do You Think You Are?*⁷¹ This show was a "massive catalyst for growth."⁷² Between 2009 and 2011 in particular, Ancestry.com experienced a record increase of new subscribers.⁷³

In early 2012 Ancestry was approached by a number of private equity firms.⁷⁴ Once the solicitation activity began, Ancestry's board undertook the task of preparing the company for sale.⁷⁵ The board engaged Qatalyst, an investment bank, to begin auction process.⁷⁶ In short order, there were fourteen bidders, six strategic buyers, and eight financial sponsors.⁷⁷ By October 18, 2012, Ancestry's board approved a merger with Permira, a private equity entity.⁷⁸

Approximately 80 days post-merger, two minority shareholders filed for appraisal.⁷⁹ Once

⁵⁶ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *11.

⁵⁷ *Id.* at 12 ("The Court of Chancery has a statutory mandate to consider "all relevant factors" in conducting an appraisal proceeding, and, accordingly, the Supreme Court declined to impose a presumption systematically favoring one of those factors—merger price—over the others.").

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. at 49.

⁶¹ See *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *10 (discussing that the projections were made for the purpose of the sale and were not made in the ordinary course of business).

⁶² *LongPath Capital, LLC*, C.A. No. 8094-VCP, memo. op. at 49.

⁶³ *Merlin Partners LP*, WL 2069417, at *11,

⁶⁴ *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *1 ("In particular, the unpredictable nature of the income stream from the company's primary asset renders the apparent precision of the expert witnesses' cash flow valuation illusory. Because neither party has presented a reasonable alternative valuation method, and because I find the sales price here a reliable indicator of value, I find that a use of the merger price to determine fair value is appropriate in this matter.").

⁶⁵ *Id.* at *13.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *13 ("I come to the same conclusion that the Court did in *Union Illinois*: '[f]or me (as a law-trained judge) to second-guess the price that resulted from that process involves an exercise in hubris and, at best, reasoned guess-work.' My conclusion that merger price must be the primary factor in determining fair value is justified in light of the absence of any other reliable valuation analysis.").

⁶⁹ *In re Appraisal of Ancestry.com, Inc.*, No. CV 8173-VCG, 2015 WL 399726, at *2 (Del. Ch. Jan. 30, 2015). Ancestry.com is an internet-based, subscription-driven company.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Huff Fund Inv. P'ship*, 2013 WL 5878807, at *13

⁷³ *In re Appraisal of Ancestry.com, Inc.*, WL 399726, at *2.

⁷⁴ *Id.* at *3

⁷⁵ *Id.* After receiving these unsolicited overtures, Ancestry's board began exploring strategic options for the Company.

⁷⁶ *Id.*

⁷⁷ *In re Appraisal of Ancestry.com, Inc.*, WL 399726d at *3.

⁷⁸ *Id.* ("The \$32 price represented a 41% premium on the unaffected trading price of Company stock.").

⁷⁹ *Id.* at *15 ("On January 3, 2013, Merion filed a Verified Petition for Appraisal pursuant to 8 Del. C. § 262. Also on January 3, the Merlin Petitioners filed a Petition for Appraisal of Stock. On June 24, these actions were consolidated. Collectively, the Petitioners owned 1,415,000 shares of common stock as of the Merger Date.").

again, Vice Chancellor Glasscock was tasked with determining the fair value of a publicly traded company that underwent a vigorous auction process. Unlike *Huff* though, neither the petitioner, nor the respondent offered data relating to comparable companies or transactions analysis due to the unique nature of Ancestry's business.⁸⁰ Petitioner's and Respondent's experts relied exclusively on DCF to calculate fair value.⁸¹

The DCF provided by both sides used disparate inputs throughout the entire analysis.⁸² To illustrate the problem with pitting two hired guns (experts) against each other in a DCF battle, the Vice Chancellor stated:

The Respondent's expert candidly suggested that, if he had reached a valuation that departed from the merger price by as much as the Petitioners' expert, he "would have to tried to find out a way to reconcile those two numbers," in other words, he would have tailored his analysis to fit the merger price. Neither of these approaches gives great confidence in the DCF analysis of either expert, since both appear to be result-oriented riffs on the market price.⁸³

Without confidence in the DCF provided by the experts or in the numbers available for the Court to conduct its own DCF analysis, and without other acceptable methods available to calculate fair value, the Court has the option to defer to the market price.⁸⁴ Like in *Huff*, the Vice Chancellor did not simply defer, he provided a detailed account of why the auction and sale was a fair representation of fair value.⁸⁵

Ancestry engaged in a reasonable sales process that produced a motivated buyer; the market was segmented carefully, good investment bankers were involved, and the process was one "that had a lot of vibrancy and integrity."⁸⁶ Given the vigorous auction and sale, it was likely that all value was accounted for in the merger price.⁸⁷

In a third-party-take-private merger, the merger price is the appropriate representation of fair value when the comparison data is either unreliable or unavailable, and when DCF inputs suffer the burden that they were produced for litigation, a sale, or outside of the course of normal business activity.⁸⁸ Therefore, merger price is a reliable representation of fair value when the sale of the target occurred

under the watchful eyes of the free and open market place.⁸⁹

3.3 Merlin Partners LP, and AAMAF, LP v. AutoInfo, Inc. (thinly traded)

A brief look into the target company's business reveals that at the time of the merger, AutoInfo was a public non-asset based transportation services company operating through two wholly-owned subsidiaries.⁹⁰ AutoInfo's board, from its own analysis, as well as from pressure from large shareholders, concluded that the stock was undervalued and a sale was a fair way to extract full value.⁹¹

AutoInfo contacted an experienced advisor in the transportation field to shop the company.⁹² The auction process ultimately yielded a suitor, Comvest.⁹³ A sale was completed at a merger price of \$1.05 per share.⁹⁴ Soon thereafter an appraisal action was filed by Merlin Partners LP and AAMAF, LP.⁹⁵

Not unlike the appraisal problems found in *Huff* and *Ancestry*, the Court deemed the Petitioner's DCF inputs unreliable.⁹⁶ Petitioners' expert's comparable companies analysis too was rejected⁹⁷ due to the use of dissimilar guideline companies.⁹⁸

⁸⁹ *Id.*

⁹⁰ *Id.* at *1.

⁹¹ *Merlin Partners LP.*, 2015 WL 2069417, at *1.

⁹² *Id.* at *3 ("In the spring of 2012, Stephens contacted 164 potential strategic and financial acquirers, focusing on those most interested in the transportation space.38 Approximately seventy bidders signed non-disclosure agreements ("NDAs") and received a Confidential Information Memorandum ("CIM"). Those interested were provided several weeks for due diligence before a deadline to submit an indication of interest ("IOI"). By the end of May, ten bidders had presented IOIs, with bids ranging from \$0.90-\$1.36 per share.41 Nine moved on to a second round of the sales process, at which point they attended Management presentations and received access to an electronic data room.").

⁹³ *Id.*

⁹⁴ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *6.

⁹⁵ *Id.* at *1

⁹⁶ *Id.* at *8 ("Petitioner utilized a DCF and comparable companies analysis to represent fair value. Here, Petitioners have failed to establish that the Management Projections can be relied upon. Management prepared them at Stephens's request and with the guidance that they "need[ed] to be optimistic" to maximize the effort to market the Company. Management had never prepared anything resembling the Management Projections before and "hadn't analyzed the business historically in a way that would allow [it] to predict the future." Stephens had advised, "You're trying to sell the business. You need to paint the most optimistic and bright current and future condition of the company that you can. All positive. Let's get the most interest by painting the most positive picture of this business.").

⁹⁷ *Merion Capital, L.P.*, WL 3793896, at *6.

⁹⁸ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *11. ("Because the weight of the evidence suggests that size and business model affect the multiples at which companies trade in the freight brokerage industry, Puglisi's comparable companies analyses are not reliable indicators of value. The Court's confidence in this conclusion is bolstered by the facts that (i) all of the bids

⁸⁰ *Id.* at *8 ("The experts of both the Petitioners and Respondent relied exclusively on a discounted cash flow ("DCF") analysis to value Ancestry as of the Merger Date, as opposed to comparable companies and comparable transactions analyses, recognizing that the latter would be irrelevant or unhelpful here, given Ancestry's unique business and the concomitant difficulty of finding comparable companies or transactions.").

⁸¹ *In re Appraisal of Ancestry.com, Inc.*, WL 399726, at *8.

⁸² *Id.*

⁸³ *Id.* at *9.

⁸⁴ See generally Section II Analysis.

⁸⁵ See generally Section II Analysis; *In re Appraisal of Ancestry.com, Inc.*, WL 399726.

⁸⁶ *In re Appraisal of Ancestry.com, Inc.*, WL 399726, at *16.

⁸⁷ *Id.*

⁸⁸ *Merlin Partners LP.*, 2015 WL 2069417, at *11.

Vice Chancellor Noble, following the holding of the Delaware Supreme Court in *Golden*,⁹⁹ did consider the multiple methods typically used by the court to determine fair value.¹⁰⁰ In addition to analyses provided by the litigants, the Court performed its own DCF analysis using inputs generated by the acquiring company during the sales process.¹⁰¹ With a Petitioner's DCF analysis, a Petitioner's comparable company analysis, and a court-driven DCF, the Court still concluded that merger price was in fact fair value.¹⁰²

Respondent did not provide the Court with a traditional analysis.¹⁰³ They instead, offered merger price as the representation of fair value.¹⁰⁴ The sales process was strong, and the final merger price less synergies was fair value.¹⁰⁵

Vice Chancellor Noble agreed, and much like the method used by Vice Chancellor Glasscock in *Huff* and *Ancestry*, the Vice Chancellor painstakingly provided a fiduciary duty-like analysis to show that the sound auction and sales process followed by the target and the acquirer yielded a fair value.¹⁰⁶

It is fair to conclude that even if the target company is thinly traded,¹⁰⁷ merger price can, in

received by AutoInfo during the sales process implied market multiples well below Puglisi's, and (ii) AutoInfo ultimately sold, through a thorough sales process, at a price less than half of Puglisi's comparable companies valuations.¹⁴⁰ The Court was unable independently to derive in any reasoned manner a valuation multiple from the purported comparables. Accordingly, the Court gives no weight to any comparable companies analysis.").

⁹⁹ *Golden Telecom, Inc.*, 11 A.3d at 218.

¹⁰⁰ See *supra* Section II.

¹⁰¹ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *14 ("Before placing full weight on the Merger price, the Court performed its own DCF analysis. Having rejected the Management Projections, the Court relied on financial projections that Comvest had prepared for internal use in evaluating the AutoInfo deal.")

¹⁰² See generally *Merlin Partners LP.*, 2015 WL 2069417.

¹⁰³ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *11.

¹⁰⁴ *Id.* Zmijewski, AutoInfo's expert, relies on the Merger price as a reliable indication of AutoInfo's fair value at the time of the Merger. ("[W]here no comparable companies, comparable transactions, or reliable cash flow projections exist, ... the merger price [may be] the most reliable indicator of value. Nonetheless, the Court will give little weight to a merger price unless the record supports its reliability.")

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at *14 ("AutoInfo's process was comprehensive and nothing in the record suggests that the outcome would have been a merger price drastically below fair value, as Petitioners' expert suggests. Placing heavy weight on the Merger price "is justified in light of the absence of any other reliable valuation analysis." Not only are other credible valuations unavailable, but the record also contains evidence corroborating the Merger price's reliability. Even Petitioners' expert agrees that AutoInfo was "shopped quite a bit" and that the sales process was arm's length. The Merger was the result of "an adequate process." The Merger price is thus a strong indicator of value.")

¹⁰⁷ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *12. ("AutoInfo was thinly traded and lacked financial analyst coverage. Petitioners contend that the market underpriced the Company because it was ignorant of its potential. While "[t]he court cannot defer to market price

fact, be the best indicator of fair value. Ultimately, the methodology utilized in *AutoInfo* to determine that merger price equated to fair value was one of process, not substance.

3.4 LongPath Capital, LLC v. Ramtron International Corporation (A Single Bidder)

A final look at recent Delaware appraisal decisions illustrates that the Court of Chancery is comfortable with equating merger price to fair value in a third-party transaction.¹⁰⁸ Like the Vice Chancellors in *Huff*, *Ancestry*, and *AutoInfo*, Vice Chancellor Parsons exactly dissected why the traditional financial based methods of computing fair value are not always appropriate.¹⁰⁹ Additionally, the Vice Chancellor provided a detailed analysis of why the merger price, for reasons other than simply defaulting to the merger price, was the appropriate number for a fair value.¹¹⁰

The target company, Ramtron International Corporation, was a fabless semiconductor company that produced complex user specific semiconductors.¹¹¹ A fabless semiconductor company is one that does not manufacture the silicon wafers used in its products.¹¹² The business is a complicated one, requiring sound commitments from foundry partners.¹¹³ In 2012, a hostile takeover of Ramtron was commenced by the eventual acquirer, Cypress.¹¹⁴

The appraisal action request was filed soon after a contentious merger.¹¹⁵ Petitioner provided the

as a measure of fair value if the stock has not been traded actively in a liquid market," the Merger price does not reflect the value that a potentially uninformed market attributed to AutoInfo. The Merger price represented a 22% premium to AutoInfo's average stock price during the six months before February 28, 2013, the last trading day before public announcement of the Merger. At no time in the two years before the Merger's announcement had the market price for the Company's stock reached \$1.00. Further, the Merger price exceeded the highest price that AutoInfo stock had reached during the previous five years.")

¹⁰⁸ See generally *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. (Del. Ch. June 30, 2015).

¹⁰⁹ *Id.* at 2

¹¹⁰ See Section III Analysis, *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. (Del. Ch. June 30, 2015).

¹¹¹ *Id.* at 4.

¹¹² See *id.* at 4 (Fabless semiconductor companies do not have their own foundries that manufacturer the chips).

¹¹³ *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. at 4 (Del. Ch. June 30, 2015). ("As a fabless semiconductor company, Ramtron's relationships with its foundries were vitally important. Indeed, Ramtron depended on its foundry to manufacture its products.")

¹¹⁴ *Id.* at 3. ("Nonparty Cypress Semiconductor Corporation (-Cypress)) issued a bear hug letter to Ramtron on June 12, 2012, offering to buy all of its shares for \$2.48 per share. After Ramtron's board rejected the offer as inadequate, Cypress initiated a hostile tender offer on June 21, 2012, at \$2.68 per share.")

¹¹⁵ *Id.* at 18. ("Meanwhile, Cypress' hostile offer continued. On June 21, 2012, Cypress commenced a hostile tender offer for Ramtron at \$2.68 per share. Ramtron's Board rejected

court with a DCF analysis and a comparable transactions analysis that produced a fair value, not surprisingly, far afield from that of Respondent's.¹¹⁶

Petitioner's numbers were wrought with the classic appraisal deficiencies.¹¹⁷ There was a combination of unreliable inputs resulting in an unreliable DCF analysis, and the number of comparable transactions provided was inadequate.¹¹⁸ Given the unreliable analysis provided by Petitioner,¹¹⁹ Vice Chancellor Parsons was left with the conclusion that the transaction price was the best representation of fair value.¹²⁰

To bolster the decision of relying on the transaction price, there was a thorough vetting of the sales process by the Vice Chancellor.¹²¹ Ramtron desperately did not want to sell to Cypress, so they engaged in an all-out sales process.¹²² Although not one other company made an offer, the process impressed the Vice Chancellor.¹²³ This third-party hostile takeover went through a sales process that yielded a fair value.¹²⁴

3.5 An Inappropriate Application of Merger Price in Appraisal

Even with the recent string of market value based appraisal decisions, a simple deferral to a market value approach is in no way the appropriate appraisal methodology in many appraisal actions. In addition to appraisal in a closely-held corporation where there is no public market value, deferral to

the \$2.68 price as inadequate and not in the best interests of the Company's stockholders. Accordingly, the Board recommended that the stockholders not tender their shares.").

¹¹⁶ *Id.* at 22.

¹¹⁷ *LongPath Capital, LLC, C.A. No. 8094-VCP, memo. op.*

¹¹⁸ *LongPath Capital, LLC v. Ramtron International Corp., C.A. No. 8094-VCP, memo. op. at 49 (Del. Ch. June 30, 2015).*

¹¹⁹ *LongPath Capital, LLC, C.A. No. 8094-VCP, memo. op.* ("In summary, the Management Projections suffer from numerous flaws. Specifically, they: (1) were prepared by a new management team, (2) in anticipation of future disputes and of shopping the Company to potential white knights, (3) using a new methodology, and (4) were for a significantly longer period of time than previous forecasts. In addition, I note the following problems: (5) management's track record at forecasting was questionable even under their standard method of forecasting; (6) the final projections incorporate speculative elements relating to ROHM, (7) rely on distorted base year figures that resulted from customer allocation issues and channel stuffing, and (8) predict growth out of line with historical trends; and, finally, (9) management itself was providing other, more accurate projections to the Company's bank.").

¹²⁰ *See id.* at 68. (Vice Chancellor Parsons did remove \$.03 per share to account for synergies gained from the merger).

¹²¹ *See generally, LongPath Capital, LLC, C.A. No. 8094-VCP, memo. op.*

¹²² *LongPath Capital, LLC v. Ramtron International Corp., C.A. No. 8094-VCP, memo. op. at 21 (Del. Ch. June 30, 2015)* (Ramtron was actively seeking a white knight).

¹²³ *Id.* at 1.

¹²⁴ *Id.* at 57 ("At the outset, I note that I am not aware of any case holding that a multi-bidder auction of a company is a prerequisite to finding that the merger price is a reliable indicator of fair value.").

merger price may not be an appropriate outcome in take-private transactions involving insiders and short form mergers.¹²⁵

With a take-private or squeeze-out merger there is a concern that the controlling shareholders can depress the value of the company to reduce the purchase price.¹²⁶ Market value as fair value would of course fail in these instances.¹²⁷ Similarly, the final market value in a short-form merger is no guarantee of fair value.¹²⁸ Unlike the take-private transaction that may involve a true auction, there is no such mechanism in the short-form merger.¹²⁹

It is then reasonable to conclude that the much maligned appraisal arbitrage is a welcomed check to various types of mergers.¹³⁰ Essentially, a well-funded sophisticated hedge fund is often in the best position to question the results of either the squeeze-out or the short-form merger.¹³¹

4. ENTIRE FAIRNESS AND FAIR VALUE

4.1 The entire fairness doctrine

It is well understood that Delaware courts utilize the methodology of determining fair value in an appraisal action to determine fair price in a fiduciary duty entire fairness test.¹³² However, when it comes

¹²⁵ *Supra* note 19.

¹²⁶ *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. CORP. L. 119, 129 (2005).

¹²⁷ *Id.* ("The problem is exacerbated precisely when there is a controlling shareholder because the company is not subject to the market for corporate control, which provides one of the major barriers to directors taking excessive private benefits. The result is that minority shares can remain indefinitely below their true or "fair" value, since claims of managerial breach of fiduciary duty are by no means a thoroughly effective and cost-free check.").

¹²⁸ *Id.*

¹²⁹ *See id.* ("In the case of a short-form merger, however, an entirely unfair low-ball price in itself gives rise to no fiduciary duty-based remedy. Moreover, if the company's shares still publicly trade, the market price is even less likely to be an accurate measure of fundamental value than in the prior case.").

¹³⁰ *LongPath Capital, LLC v. Ramtron International Corp., C.A. No. 8094-VCP, memo. op. (Del. Ch. June 30, 2015)* ("A merger price does not necessarily represent the fair value of a company, as the term —fair value‖ is interpreted under 8 Del. C. § 262. For example, in a short-form merger under Section 253, the merger price is set unilaterally by the controlling stockholder; the minority stockholders are forced out of the company and left with appraisal as their sole remedy. To presume that the merger price represented fair value in such a situation would leave the minority stockholders effectively without the remedy offered by Section 262 of an independent analysis of a company's fair value.").

¹³¹ *Supra* note 7 at 41.

¹³² *In re Orchard Enterprises, Inc. Stockholder Litig.*, 88 A.3d 1, 30 (Del. Ch. 2014), ("Delaware Supreme Court precedent establishes that the fair price and fair value standards call for equivalent economic inquiries."); *see also* Lawrence A. Hamermesh & Michael L. Wachter, *Rationalizing Appraisal Standards in Compulsory Buyouts*, 50 B.C. L.REV. 1021, 1030 (2009) ("[I]t is generally accepted in the Delaware case law and the major treatises on Delaware corporate law that in evaluating the 'entire fairness' of a squeeze-out merger,

to fair dealing, the appraisal statute does not reciprocate by requiring the Court of Chancery to review the process that was followed by the target and acquirer to come to the final merger price.¹³³

A fair dealing analysis looks to the process followed by the board of the target during the auction and sales process.¹³⁴ There are times, though, that a transaction which satisfies the fair dealing element of the entire fairness test can fail the fair price analysis.¹³⁵ It is certainly possible that where a merger is free from the classic self-dealing or process problems, the court will have adequate data to confidently conduct a type of analysis that is generally accepted in the financial community, DCF for example, and arrive at a fair value that is different from the merger price.¹³⁶

Even so, in modern appraisal cases, the Court of Chancery is actually performing a reverse quasi-entire fairness test by first looking at fair price instead of fair dealing. If the court is unable to confidently conclude that the methodology typically employed by the Courts to determine fair value within an appraisal action is either available or reliable, a fair dealing type of review is employed to vet the reliability of the merger price.¹³⁷ The appraisal statute mandates that the Court of Chancery take into account all relevant factors when determining fair value.¹³⁸ *Weinberger* allows the court to employ methods that are generally acceptable in the financial community to calculate fair value.¹³⁹ However, when the only relevant factor is the merger price, and the balance of the generally accepted methods are flawed, the court should perform a quasi-fair dealing test to determine if the merger price is the best available representation of fair value.

5. CONCLUSION

The Court of Chancery has provided minority shareholders with the sound guidance of when merger price is, in fact, the best representation of fair value.¹⁴⁰ Therefore, short of some type of statutory safe harbor allowing for a market value exception when the merger is a third-party

transaction,¹⁴¹ minority shareholders should heed the results of recent third-party appraisal actions.

When the inputs for a DCF analysis are not projections generated in the ordinary course of business, such as projections for the purpose of litigation or a sale, they are likely unreliable.¹⁴² When the guidelines companies used by either respondent or petitioner are differing, the court will likely ignore the results.¹⁴³ When the sample size of comparable transactions is too small, the court will likely conclude that the analysis is ineffective.¹⁴⁴ However, when the auction and sales process is free from self-interest, the process itself is likely to generate a price that is a fair value.¹⁴⁵

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the courts generally utilize the same valuation analysis for both the fair price prong of the fiduciary duty action and the appraisal action." (internal quotation marks omitted); Guhan Subramanian, Fixing Freezeouts, 115 YALE L.J. 2, 43 (2005) ("As a starting point, courts in entire fairness proceedings generally look to the appraisal remedy. . .").

¹³³ See Del. Code Ann. tit. 8, § 262h (2013).

¹³⁴ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) ("[Fair dealing] embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.").

¹³⁵ *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 466 (Del. Ch. 2011).

¹³⁶ See generally *Cede & Co. v. Technicolor, Inc.*, 884 A.2d 26 (Del. 2005).

¹³⁷ *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *11.

¹³⁸ See DEL. CODE ANN. tit. 8, § 262h (2013).

¹³⁹ *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214, 218 (Del. 2010).

¹⁴⁰ See *supra* Section III-Merger Price as Fair Value.

¹⁴¹ Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613, 706 (1998) ("In other words, the market exception would apply to bona fide third-party transactions, but would be inapplicable to transactions where an insider had a conflict of interest, including the typical cash-out merger initiated by a majority shareholder.").

¹⁴² *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. at 49 (Del. Ch. June 30, 2015).

¹⁴³ E.g., *Huff Fund Inv. P'ship*, 2013 WL 5878807, at* 9.

¹⁴⁴ *LongPath Capital, LLC v. Ramtron International Corp.*, C.A. No. 8094-VCP, memo. op. at 53 (Del. Ch. June 30, 2015) ("In the past, —[t]his Court has found comparable transactions analyses that used as few as five transactions and two transactions to be unreliable.").

¹⁴⁵ *Union Illinois 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 359 (Del. Ch. 2004).

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