Court of Chancery Continues To Rely on Market-Based Metrics in Appraisal Decisions

Contributors

Jenness E. Parker, Partner

Kaitlin E. Maloney, Associate

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In recent decisions, the Delaware Court of Chancery continued to follow the Delaware Supreme Court's mandate from *Aruba*, *Dell* and *DFC* to rely on market-based metrics, when available, to determine fair value in appraisal cases.

In *In re Appraisal of Panera Bread Company* (Del. Ch. Jan. 31, 2020), the court found that deal price minus synergies was the most reliable indicator of fair value because the deal process exhibited sufficient objective indicia of reliability.[1] This was similar to the court's decisions last year in both *In re Appraisal of Columbia Pipeline Group* (Del. Ch. Aug. 12, 2019) and *In re Appraisal of Stillwater Mining* (Del. Ch. Aug. 21, 2019), in which the court also found that each deal process was characterized by objective indicia of reliability sufficient to make deal price the most reliable metric of fair value. In addition, in *In re Appraisal of Jarden* (Del. Ch. July 19, 2019), the court determined that flaws in the deal process undermined its reliability, but found that the unaffected market price was the best evidence of fair value.[2] *Stillwater* is currently on appeal to the Delaware Supreme Court.

In *Manichaean Capital, LLC v. SourceHOV Holdings, Inc.* (Del. Ch. Jan. 30, 2020), the court appraised SourceHOV, which was a privately held entity prior to a business combination whereby it became a publicly traded company. Only after determining that market-based metrics were unreliable or unavailable, the court resorted to a DCF valuation.

An analysis of the 2020 opinions follows.

Panera

In *Panera*, the court found that the $315 deal price minus $11.56 in synergies was the most reliable indicator of fair value. The court noted that "[t]here is no checklist or set of minimum characteristics for giving weight to the deal price." Instead, the court determined that the following objective indicia (similar to *Columbia Pipeline* and *Stillwater*) outweighed the petitioners' argument that certain aspects of the deal process undermined the reliability of the deal price:

- The merger was an arm's-length transaction with a third party;
- Panera's board, its CEO and primary negotiator, and its advisers were not conflicted;
- Panera's board used its "impeccable knowledge of the market" and its advisers' advice to engage all logical buyers;
- The buyer, JAB Holdings, B.V. (JAB), conducted due diligence and received confidential insights about Panera's value;
- JAB also assessed Panera's value using Panera's extensive public information, which was accessible to other potential bidders;
- Panera negotiated with JAB and extracted multiple price increases;
- Panera's passive post-signing market check offered interested bidders a reasonable chance to bid, where Panera's deal protections (a no-shop provision with a fiduciary

[1] Skadden represented Panera Bread Company.

[2] *See* Jenness E. Parker, Kaitlin E. Maloney and Daniel S. Atlas, "Chancery Relies on Market-Based Metrics in Recent Appraisal Decisions," Delaware Business Courts Insider, October 16, 2019, for an examination of the 2019 decisions.

out, matching rights and a 3% termination fee) fell within what Delaware courts have held to satisfy enhanced scrutiny; and

- No bidders emerged post-signing.

Also, the court agreed with Panera that several factors provided "conclusive evidence" that Panera's stock traded in an efficient market, which supported giving dispositive weight to deal price: Panera had many stockholders; no controlling stockholder; highly active trading; a large market capitalization; substantial public float and trading volume; a low bid-ask spread; a high number of equity analysts; and a rapid response to transaction rumors. In addition, information about the company was widely available and easily disseminated to the market.

The court disregarded the petitioners' three alternative valuation methodologies as unreliable in the face of a reliable market-based deal price. The court rejected the petitioners' proffered DCF valuation because it exceeded the deal price by $39 per share and suggested that over a billion dollars was left on the table. The court found that the petitioners' expert "weaken[ed] his credibility" by shifting his investment rate and failing to adjust his DCF to accommodate that shift. The court also rejected the petitioners' comparable companies and precedent transactions analyses for lack of a suitable peer group.

The court deducted $11.56 in cost savings and tax synergies from the deal price. The court found that a "preponderance of the evidence demonstrate[d] that JAB formed its bid in anticipation of applying its management playbook" for cost and cash savings, including re-leveraging Panera's balance sheet to increase debt and resulting tax savings. The court recognized that JAB had successfully implemented similar working capital changes at other companies it had acquired, noting that several bankers' presentations cited JAB's "long track-record" of delivering expected cost savings. In addition, the court noted that Panera's valuation expert agreed with these synergies and that internal documents reflected that JAB anticipated them and factored them into its valuation of Panera. The court rejected the petitioners' argument that the synergies were not merger-specific because management theoretically could have made the changes. The court found instead that "Panera's management culture and priorities did not support the changes JAB intended to make."

Panera sought a refund of the synergies amount because it had prepaid the full deal price pursuant to the appraisal statute. However, as a matter of first impression, the court denied the request, stating that "Section 262(h) does not explicitly contemplate any refund" and the parties had not stipulated to a clawback provision in their prepayment agreement, even though Panera had reserved all rights to request the refund.

Manichaean Capital

In *Manichaean Capital*, which involved an appraisal of SourceHOV, a privately held company at the time of the business combination, the court noted that "[i]n the wake of recent guidance from our Supreme Court, this Court typically begins its statutory appraisal function by focusing on market-based evidence of fair value." Even though the "parties agree[d] that market evidence is not useful because SourceHOV was privately held and its managers made no real effort to run a 'sale process,'" the court summarily considered the deal process and found that the circumstances surrounding SourceHOV's business combination disqualified market-based evidence as reliable metrics for two reasons.

First, the court agreed with the parties that the deal price was not reliable because SourceHOV did not engage in a sales process prior to the business combination. For example, SourceHOV did not hold a single board meeting to consider the potential business combination, nor did it solicit offers from third parties after it received the initial overture. Second, the court held that it could not look to unaffected market price because as a private company, SourceHOV had no publicly traded stock.

The parties also agreed that there were no sufficiently comparable companies or transactions with which to perform either a trading multiples or a transaction multiples analysis.

Therefore, the court resorted to a DCF analysis to determine SourceHOV's fair value. Noting that the DCF valuations proffered by the parties' experts were "solar systems apart," the court relied solely on the DCF valuation proffered by the petitioners' valuation expert because the inputs were reasonable and supported by credible evidence. Conversely, the court found that the DCF submitted by the respondent was not credible because the respondent disagreed with its own expert and proffered a valuation that came in "well below even its own expert's appraisal," relied on witnesses whose credibility was impeached and employed a novel approach to calculate SourceHOV's equity beta, which was unsupported by the record.

Takeaways

- The Delaware Court of Chancery continues to examine market-based metrics of fair value in the first instance and resorts to a DCF analysis where market-based evidence is unreliable or unavailable.
- Petitioners may have difficulty rebutting the reliability of the deal price where alleged "flaws" in the process do not outweigh the objective indicia of reliability and where no money was left on the table.
- Delaware courts may find that a passive post-signing market check confirms the reliability of the deal price where potential bidders had an opportunity to come forward and where a merger agreement contains reasonable deal protection provisions that would survive enhanced scrutiny.
- Delaware courts may deduct synergies where there is sufficient record evidence that the buyer quantified, anticipated and included those synergies in its valuation of the target company.
- Where synergies comprised a portion of the deal price, companies may consider prepaying an amount lower than the deal price or stipulating to a clawback provision in a prepayment agreement.
- As exemplified by *Panera*, Delaware courts are increasingly skeptical of DCF analyses that result in fair values well above the deal price and are declining to rely on comparable analyses without a suitable peer group.