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Plaintiffs strike out in two recent Delaware appraisal actions

Contributed by **Ropes & Gray LLP**

September 02 2015

The Delaware Chancery Court has twice in the past few months ruled in statutory appraisal actions that the negotiated transaction price was the most reliable indicator of value.

First decision

In an April 30 2015 Delaware Chancery Court decision deciding a statutory appraisal action,(1) the court found that the price paid for the buy-out of AutoInfo by funds affiliated with private equity firm Comvest Partners was fair to AutoInfo's stockholders.

The court found that the $1.05 per share price, negotiated through a special committee of independent directors after an extensive sale process involving multiple competing bidders, was the best estimate of AutoInfo's value at the time of the transaction. The court was unpersuaded by the plaintiffs' reliance on a discounted cash-flow (DCF) analysis and multiple forms of comparable company analysis, each of which led to higher valuations. The court found that the companies used in the plaintiffs' comparable company analysis were not sufficiently comparable, and that the plaintiffs' DCF analysis was not credible given the reliance on management projections which the court found to be unreliable. While weight is often given in appraisal proceedings to management projections prepared in the ordinary course of business, management projections may be disregarded when:

- their use was unprecedented;
- they were produced in anticipation of litigation;
- they differed in form or duration from those customarily prepared; or
- they were produced in order to obtain benefits outside the ordinary course of business.

Second decision

Similarly, on June 30 2015, the Delaware Chancery Court relied primarily on the negotiated purchase price when determining fair value in the statutory appraisal proceeding of *LongPath Capital LLC v Ramtron Int'l Corp.*(2) In this case a hedge fund plaintiff acquired shares after announcement of the deal in order to pursue the appraisal claim. This plaintiff advocated following a DCF analysis that supported a significantly higher valuation. In a context where the $3.10 per share merger price represented a significant (71%) premium to the pre-announcement trading price, and the record demonstrated substantial price negotiations with the purchaser and extensive (albeit ultimately unsuccessful) sales efforts in an attempt to solicit potential alternative buyers to try to top the initially hostile bid, Vice Chancellor Parsons was sceptical of the DCF analysis that was dependent on management projections and a dearth of comparable transactions. He noted that:

> *"in the situation of a proper transactional process likely to have resulted in an accurate valuation of an acquired corporation, this Court has looked to the merger price as evidence of fair value and, on occasion, given that metric one hundred percent weight."*

Finding that the negotiated merger price ($3.10 per share) represented the fair value of shares, the court applied a $0.03 (roughly 1%) reduction for purposes of appraisal attributable to the synergies of the deal in accordance with Section 262 of the Delaware Code General Corporation Law, which requires that fair value for purposes of appraisal exclude any element of value arising from the merger itself.

Comment

Merlin Partners LP v AutoInfo Inc and *LongPath Capital LLC v Ramtron Int'l Corp* are part of a continuing trend in Delaware appraisal case law that demonstrates the risk to activist shareholders in bringing appraisal actions in the face of transactions that have been arrived at after a robust and properly conducted sale process.(3) Where the record does not demonstrate a robust and fair sale

Authors

Jason Freedman

Gregory Demers

Jacob Silberberg

process, the Delaware courts will not generally defer to the deal price. Instead, they are more likely to determine fair value for purposes of appraisal by referring to valuation analyses and methodologies that are generally considered acceptable in the financial community, such as DCF analysis.(4)

For further information on this topic please contact Jacob Silberberg or Gregory Demers at Ropes & Gray LLP's Boston office by telephone (+1 617 951 7000) or email (Jacob.Silberberg@ropesgray.com or Gregory.Demers@ropesgray.com). Alternatively contact Jason Freedman at Ropes & Gray LLP's San Francisco office by telephone (+1 415 315 6300) or email (Jason.Freedman@ropesgray.com). The Ropes & Gray website can be accessed at www.ropesgray.com.

Endnotes

(1) *Merlin Partners LP and AAMAF LP v AutoInfo Inc*, 8509-VCN (Del Ch April 30 2015).

(2) CA 8094-VCP (Del Ch June 30 2015).

(3) See *Huff Fund Investment Partnership v CKx Inc,* CA 6844-VCG (Del Ch May 19 2014) (for further details please see "Delaware court rejects attempt to stop accrual of statutory interest in appraisal action"), and *In re Appraisal of Ancestry.com Inc,* CA 8173-VCG (Del Ch January 30 2015) (for further details please see "Ancestry.com price was fair, despite challenge from appraisal arbitrage investors").

(4) See *Owen v Cannon*, CA 8860-CB (Del Ch June 17 2015) involving a closely held corporation where two principal stockholders squeezed out a third principal stockholder in a deal where the defendants failed to establish fair process.