BV Review
Business Valuation Review™
Volume 40 • Number 1
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Recent Developments in Delaware Valuation Cases

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This article discusses current developments in Delaware case law as they relate to valuation. It reviews all relevant Delaware Supreme Court decisions since 2017 and all relevant Court of Chancery decisions since 2019. We discuss the emphasis being placed by the Delaware courts on using discounted cash flow for valuations in related party transactions, as well as the substantial reliance on transaction price as the valuation measure in arm's-length transactions that have a satisfactory negotiation process. We conclude with a discussion of the impact of these and prior Delaware decisions on the valuation community and comments on the role of expert witnesses.

This article examines Delaware valuation decisions by the Supreme Court[1] in the past four years and by the Court of Chancery in the past two years. It discusses these cases from the point of view of valuation professionals, not lawyers. These opinions confirm Delaware's move toward (a) determining fair value in appraisal and "entire fairness" cases by applying the discounted cash flow (DCF) method and rejecting comparable companies[2] in related party transactions and (b) accepting the transaction prices less synergies as fair value in arm's-length transactions when the negotiation process is not negatively impacted by improper actions.

Fair Value

"Fair value" is the standard of value in Delaware appraisal cases. Fair value in Delaware is the stockholder's pro rata share of the value of the company's equity, with no minority or marketability discount and no control premium. It is based on the going-concern value of the company as it is being run by its current management (its "operative reality"), not on how it might be optimally run by a third party.

Defining fair value as a proportionate share of a company's equity distinguishes it from the other two commonly applied standards of value, fair market value, and control value. Fair market value permits and commonly includes discounts for minority interest and/or lack of marketability, whereas fair value for appraisals generally bars discounts. Fair value for appraisal is a different concept than fair value for GAAP accounting, which is a form of fair market value.

Recent Supreme Court Decisions

In the past four years, the Supreme Court has reversed three valuation decisions and affirmed seven:

Reversed:	Affirmed:
DFC Global (2017)	*ISN Software* (2017)
Dell (2017)	*SWS Group* (2018)
Aruba Networks (2019)	*ACP Master v. Sprint* (2018)
	PLX Technology (2018)
	Jarden (2020)
	Stillwater Mining (2020)
	SourceHOV (2021)

DFC Global

A private equity fund acquired DFC Global Corp., a highly leveraged payday lender that was publicly traded, for $9.50 per share in cash. Holders of 4.6 million shares sought appraisal.

After trial, Chancellor Andre Bouchard valued DFC Global at $10.21 per share, giving equal weight to each of the deal price ($9.50), comparable companies ($8.07), and DCF ($13.07). He attributed the weighting to "the uncertainties and other considerations" of each approach.[3] He gave only one-third weight to the deal price because the purchaser was a financial buyer that was focusing on achieving a certain internal rate of return (IRR):

[1]In this article, all references to the Supreme Court are to the Delaware Supreme Court.

[2]The Court of Chancery usually uses the term "comparable" rather than "guideline."

[3]*In re Appraisal of DFC Global Corp*., 2016 Del. Ch. LEXIS 103 (Del. Ch. July 8, 2016) ("*DFC Global I*"), *71; modified, slip op., C.A. No. 10107-CB [unpublished] (Del. Ch. Sept. 14, 2016) ("*DFC Global II*"); *rev'd, DFC Global Corp. v. Muirfield Value Partners, L.P*., 172 A.3d 346 (Del. 2017) ("*DFC Global III*").

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> Lone Star's status as a financial sponsor, moreover, focused its attention on achieving a certain internal rate of return and on reaching a deal **within its financing constraints, rather than on DFC's fair value** [*emphasis added*].[4]

After reargument, the Chancellor made an adjustment to working capital that reduced his DCF valuation. He also increased the perpetual growth rate used in his calculation from 3.1% to 4.0%. The net effect was to raise his DCF calculation to $13.33 and his appraisal valuation to $10.30.[5]

The Supreme Court endorsed the lower court's application of the comparable company method, commenting that "this was a rare instance where both experts agreed on the comparable companies the Court of Chancery used and so did several market analysts and others following the company."[6]

However, the Supreme Court reversed the lower court's decision for several reasons:

1. It rejected the concept that a leveraged buyout (LBO) buyer's winning bid in a contested deal was negatively impacted by its target IRR:

> [A]ll disciplined buyers, both strategic and financial, have internal rates of return that they expect in exchange for taking on the large risk of a merger, or for that matter, any sizeable investment of its capital. That a buyer focuses on hitting its internal rate of return has no rational connection to whether the price it pays as a result of a competitive process is a fair one.[7]

2. It rejected the higher growth rate used in the revised opinion:

> [T]he Court of Chancery then substantially increased its perpetuity growth rate from 3.1% to 4.0%, which resulted in the Court of Chancery reaching a fair value akin to its original estimate of the company's value. But, no adequate basis in the record supports this major change in growth rate.[8]
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> ***
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> With that [growth rate] error corrected, and addressing certain foreign exchange adjustments, the Court of Chancery's discounted cash flow model would yield $7.70 per share [rather than $13.33].[9]

3. It rejected the trial court's weighting and instructed that if it elects to weight different valuation methods, it must explain its weighting:

> [T]he Court of Chancery must exercise its considerable discretion while also explaining, with reference to the economic facts before it and corporate finance principles, why it is according a certain weight to a certain indicator of value... In this case, the decision to give one-third weight to each metric was unexplained and in tension with the Court of Chancery's own findings about the robustness of the market check.[10]

The case settled shortly after the Supreme Court's opinion; terms were not announced.

Dell

Dell, Inc., a major personal computer manufacturer, was sold in a management buyout (MBO) to a company controlled by an LBO firm for $13.75 per share in cash. Michael Dell, the company's founder and a 14% shareholder, owned a minority interest in the acquiring entity.

Vice Chancellor Travis Laster relied solely on DCF and valued Dell at $17.62 per share, 28% more than the deal price.[11] He enunciated several reasons why he gave no weight to the deal price:

1. Deal prices of MBO transactions are unreliable as measures of fair value.[12]
2. The price that LBO sponsors would pay is limited by the need to achieve IRRs of 20% or more, and by limits on financial leverage.[13]
3. The market for Dell's shares was inefficient, and a valuation gap existed between market perception and Dell's operative reality, driven by analysts' focus on short-term results.[14]
4. The shopping process was inadequate.[15]
5. Financial sponsors are concerned about a "winner's curse."[16]

The Supreme Court disagreed with each of the trial court's reasons for rejecting the deal price. It rebutted each point:

1. The transaction was not a management buy-out:

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[4] *DFC Global I*, *68.

[5] *DFC Global II*, 7.

[6] *DFC Global III*, 351.

[7] Ibid., 375.

[8] Ibid., 350.

[9] Ibid., 361.

[10] Ibid., 388.

[11] *Appraisal of Dell Inc*., 2016 Del. Ch. LEXIS 81 (Del. Ch. May 31, 2016) ("*Dell I*"); *rev'd, Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd*, 177 A.3d 1 (Del. 2017) ("*Dell II*").

[12] *Dell I*, *87–*88.

[13] Ibid., *90–*97.

[14] Ibid., *101–*115.

[15] Ibid., *115–*125.

[16] Ibid., *139–*142. The "winner's curse" is the result of the winning bid in an auction exceeding the value of the entity or asset being acquired.

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> [T]his was not a buyout led by a controlling stockholder. Michael Dell only had approximately 15% of the equity.[17]
>
> [A]ny outside bidder who persuaded stockholders that its bid was better would have access to Mr. Dell's votes.[18]
>
> [T]here is no evidence that management was critical here given both Blackstone's and Icahn's doubts about Mr. Dell's leadership and [their] apparent willingness to pursue transactions without his continued involvement.[19]

2. As discussed in *DCF Global*, the IRR requirements of an LBO sponsor did not justify the refusal to accept its bid as a measure of fair value:

> The trial court's complete discounting of the deal price due to financial sponsors' focus on obtaining a desirable IRR and not "fair value" was also error.[20]
>
> [T]o the extent that the Court of Chancery chose to disregard Dell's deal price based on the presence of only private equity bidders, its reasoning is not grounded in accepted financial principles, and this assessment weighs in favor of finding an overall abuse of discretion.[21]

3. The market for Dell's shares was efficient and there was no "valuation gap":

> The trial court believed that short-sighted analysts and traders impounded an inadequate—and lowball—assessment of all publicly available information into Dell's stock price, diminishing its worth as a valuation tool. But the record shows just the opposite: analysts scrutinized Dell's long-range outlook when evaluating the Company and setting price targets.[22]

4. The shopping process was satisfactory:

> The Committee, composed of independent, experienced directors and armed with the power to say "no," persuaded Silver Lake to raise its bid six times. Nothing in the record suggests that increased competition would have produced a better result.[23]
>
> [The lower court's] assessment that more bidders... should have been involved assumes there was some party interested in proceeding. Nothing in the record indicates that was the case. **Fair value entails at minimum a price some buyer is willing to pay—not a price at which no class of buyers in the market would pay** [*emphasis added*].[24]

5. The Special Committee addressed the information asymmetry problem and the "winner's curse" risk as best it could:

> [T]he likelihood of a winner's curse can be mitigated through a due diligence process where buyers have access to all necessary information. And, here, Dell allowed Blackstone [during the go-shop period] to undertake "extensive due diligence," diminishing the "information asymmetry" that might otherwise facilitate a winner's curse.[25]

The Supreme Court rejected the lower court's DCF valuation, commenting on the difficulty of applying DCF in this case:

> DCF valuations involve many inputs—all subject to disagreement by well-compensated and highly credentialed experts—and **even slight differences in these inputs can produce large valuation gaps** [*emphasis added*].[26]

An argument that the respondent lost was that the Vice Chancellor's DCF analysis had applied the wrong tax rate in calculating terminal value—the 21% effective tax rate instead of the marginal tax rate of 35.8%. The Supreme Court concurred with the Court of Chancery's conclusion that the effective tax rate should be applied.[27]

The Supreme Court concluded that Dell's transaction price should be the dominant factor in determining its fair value, writing, "Overall, the weight of evidence shows that Dell's deal price has heavy, if not overriding, probative value."[28]

> After trial, 70% of the petitioners settled with respondents at the deal price urged by the court, reasoning that, and with the vice chancellor in accord, a rehearing on remand was rendered pointless given the [Supreme] court's strong instructions.[29]

Aruba Networks

An important 2019 opinion was the Supreme Court's reversal of the lower court's opinion in *Aruba Networks*. Vice Chancellor Laster had valued Aruba at "unaffected market price"—the average price during the 30 days prior to a news article that leaked the pending transaction.[30] He appraised the company at 69.4% of the deal price.

[17] *Dell II*, 30.
[18] Ibid., 11.
[19] Ibid., 32.
[20] Ibid., 27.
[21] Ibid., 31.
[22] Ibid., 24.
[23] Ibid., 28.
[24] Ibid., 29.
[25] Ibid., 32.
[26] Ibid., 38.
[27] Ibid., 39.
[28] Ibid., 56–57.
[29] Thomas J. Meriam, "Protecting the Social Utility of Appraisal Arbitrage," *Brooklyn Law Review* (2020): 973, 1001, fn. 227.
[30] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2018 Del. Ch. LEXIS 52 (Del. Ch. Feb. 15, 2018) ("*Aruba I*"); *rev'd*, 210 A.3d 128 (Del. 2019) ("*Aruba II*").

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Neither petitioners nor respondent had discussed Aruba's unaffected market price at trial. After the Supreme Court issued its opinion reversing Laster's decision in *Dell*, he requested "supplemental briefing on 'the market attributes of Aruba's stock' in part because he 'learned how many errors [he] made in the *Dell* matter.'"[31] The respondent argued for unaffected market price in its subsequent post-trial brief. Laster's opinion ruled that "Aruba's unaffected market price provides the best evidence of its going concern value."[32]

The Vice Chancellor had noted that:

> Aruba management knew internally that Aruba was having an excellent quarter and would beat its guidance. But ... [it] time[d] the announcement of the merger to coincide with the announcement of February 2015 earnings.[33]

Despite the fact that the market did not know of Aruba's earnings improvement before the merger announcement, the Vice Chancellor concluded that "the record does not provide a persuasive reason to question the reliability of Aruba's trading price based on the decision by Aruba management to bundle together two pieces of information."[34] The Supreme Court disagreed, concluding that the not-yet-disclosed information would have affected the public market:

> HP [the buyer] ... had material, nonpublic information that, by definition, could not have been baked into the public trading price. ... In particular, HP had better insight into Aruba's future prospects than the market because it was aware that Aruba expected its quarterly results to exceed analysts' expectations.[35]

The Supreme Court criticized the Court of Chancery's opinion that the unaffected market price was fair value:

> The lack of a developed record on whether the stock price was an adequate proxy for fair value buttresses our holding that the Court of Chancery abused its discretion by awarding the thirty-day average unaffected market price of $17.13 per share.[36]

Because of requirements for SEC review and a shareholder vote, an acquisition of public companies necessarily cannot close until well after the announcement of a transaction. The Supreme Court pointed out that, although the Delaware appraisal statute requires that the company be valued at the closing date, the lower court had valued it as of an earlier date:

> Although §262 requires the Court of Chancery to assess Aruba's fair value as of "the effective date of the merger," the Court of Chancery arrived at the unaffected market price by averaging the trading price of Aruba's stock during the thirty days before news of the merger leaked, which was three to four months prior to closing.[37]

The Supreme Court agreed with the lower court's conclusion that the transaction price included substantial synergies. It directed a final judgment that petitioners be awarded $19.10 per share, which was Aruba's estimate of the deal price ($24.67) minus synergies.[38] The Supreme Court noted that the $19.10 valuation, which was 77.4% of the deal price and 11.5% above the unaffected market price, "was corroborated by ... Aruba's [expert's] DCF, comparable companies, and comparable transactions analyses."[39]

ISN Software

When ISN Software, a privately held company, converted to an S corporation, it squeezed out two minority shareholders who were ineligible to own S corporation shares. They filed for appraisal and each engaged its own expert.

Vice Chancellor Sam Glasscock III rejected all three experts' comparable company analyses, writing, "In this case, where ISN has no public competitors, and where the Company's alleged industry includes various and divergent software platforms, I find the [comparable company] method less reliable than a DCF to determine ISN's fair value."[40] He rejected respondent's expert's valuation based on private sales of ISN's shares, observing, "I find it unlikely that the prior sales generated fair value in return for ISN shares."[41] The Court also rejected his "direct capitalization of cash flow" (DCCF) method:

> DCCF is typically an appropriate valuation tool when the company has reached a steady state, or where no other feasible valuation methods exist. As neither of those factors are true here, I find that the DCCF method is a less reliable indication of ISN's fair value than is the DCF.[42]

Glasscock appraised ISN using DCF only, despite the wide divergence of the experts' calculations:

> In a competition of experts to see which can generate the greatest judicial skepticism regarding valuation, however,

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[31]*Aruba II*, 131, quoting the Court's letter to the parties.

[32]*Aruba I*, *4.

[33]Ibid., *63.

[34]Ibid., *66.

[35]*Aruba II*, 139.

[36]Ibid., 140.

[37]Ibid., 132.

[38]Laster had concluded that the transaction prices minus synergies was $18.20 per share. *Aruba I*, *45.

[39]Ibid., *142.

[40]*ISN Software Corp. Appraisal Litig.*, 2016 Del. Ch. LEXIS 125 (Del. Ch. Aug. 11, 2016), *9; *aff'd*, *ISN Software Corp. v. Ad-Venture Capital Partners, L.P.*, 173 A.3d 1047 (Del. 2017).

[41]Ibid., *13.

[42]Ibid., *10.

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> this case, so far, takes the prize: one of the Petitioners' experts opines that fair value is greater than eight times that implied by the DCF provided by the Respondent's expert.[43]

The petitioners' experts calculated DCF value of $860 million and $662 million, respectively, and ISN's expert arrived at a DCF value of $100 million; the squeeze-out price had valued ISN at $138.5 million.

Since ISN had no management projections, each expert prepared his own forecast. The Court rejected adjustments by petitioner's experts that reflected changes that were unlikely to be made by management:

> [A]djustments for executive compensation, charitable contributions, or private jet usage... were a part of the Company's operative reality on the date of the Merger, and there is no evidence sufficient, in my opinion, to demonstrate that they represent waste or actionable breaches of fiduciary duty; as such, they would have likely continued in a going-concern ISN. [44]

The Court based its valuation on ISN's expert's model. However, it made numerous substantial adjustments that substantially increased the valuation. Not only did it use a lower CAPM-based cost of equity and smaller small stock premium, but it also (a) removed an adjustment for incremental working capital, (b) added cash flow adjustments for changes in deferred revenue, (c) included an expected tax refund, and (d) added the unused balance of a "Buyout and Litigation Reserve" account.[45] As a result, it valued ISN at $357 million,[46] 257% more that ISN's expert and 158% more than the transaction price.

The Supreme Court issued an order affirming the Court of Chancery' opinion.

SWS Group

SWS Group's primary business was its broker-dealer subsidiary. It was financially troubled and was acquired by its principal lender for cash and stock; the package was worth $7.79 per share at announcement and $6.92 per share at closing.

Vice Chancellor Glasscock commented that "the record suggests that this was a synergies-driven transaction whereby the acquirer shared value arising from the merger" and he appraised SWS Group at $6.38 per share,[47] 82% of the value of the cash/stock package at the announcement date and 92% of the value at the closing date, which is the relevant date for a Delaware appraisal. He based his valuation on DCF, using management's three-year projections. He rejected petitioners' expert's comparable company analysis as well as his two-year extension of the projections that assumed SWS would turn around and achieve profit margins similar to the comparables. The Vice Chancellor observed that "SWS consistently underperformed management projections and there is minimal record support that a turnaround was probable given its structural problems."[48]

The Vice Chancellor rejected the petitioners' argument that a broker-dealer's excess regulatory capital was a non-operating asset that was additive to value, saying that they "seem to conflate distributable cash or assets with a balance sheet increase in regulatory capital."[49] He ruled that the exercise of warrants after the merger agreement but before closing was not contingent on the merger and thus "the exercise was part of the Company's operative reality as of the merger date."[50]

The Supreme Court affirmed the decision without comment.

ACP Master v. Sprint (Clearwire)

Clearwire Corp., a small, struggling telecom company, had assembled a large block of 2.5 GHz spectrum. Sprint owned 51% of Clearwire but did not have voting control. Clearwire's unaffected market price was about $1.30 per share. When news of potential acquisition of Sprint by Softbank leaked, Clearwire shares jumped to $2.22.

In connection with Softbank's proposed acquisition of 70% of Sprint, Softbank wanted Sprint to have control of Clearwire. Sprint bought out a 5% holder at $2.97 to obtain 50.4% of the vote, and Clearwire's Special Committee then approved a merger with Sprint at $2.97. After minority shareholder opposition, Sprint raised its bid to $3.40. DISH made a hostile tender offer at $4.40. Sprint made a topping offer at $5.00 and Clearwire's shareholders approved the transaction.

Dissenting shareholders of Clearwire objected to the $5.00 transaction price and sought appraisal. Their expert valued Clearwire at $16.08 per share based on projections prepared by Sprint. Vice Chancellor Laster rejected Sprint's projections as contrary to Clearwire's operative reality, relying instead on Clearwire management's projections:

> Sprint management created the Full Build Projections to convince Softbank to increase the merger consideration by showing what Sprint's business would look like if the merger failed and Sprint nevertheless decided—contrary to the evidence—to use Clearwire's spectrum as Sprint would have if the merger had closed. Sprint and Softbank would

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[43] Ibid., *2.

[44] Ibid., *17, fn. 46.

[45] Ibid., *16–*17.

[46] Ibid., *20.

[47] *Appraisal of SWS Group, Inc.*, 2017 Del. Ch. LEXIS 90 (Del. Ch. May 30, 2017), *48–*49; *aff'd*, 181 A.3d 153 (Del. 2018).

[48] Ibid., *4.

[49] Ibid., *41.

[50] Ibid., *38.

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> not have done that. The Full Build Projections did not reflect Clearwire's operative reality on the date of the merger.[51]

Laster relied on respondent's expert's DCF analysis, which included the value of a non-operating asset, Clearwire's unused spectrum.[52] He awarded the dissenters $2.13 per share,[53] which was only 43% of the transaction price. This was the first Delaware appraisal that awarded dissenters less than 80% of transaction price. Laster concluded:

> There is also no evidence that anyone at Sprint or Softbank believed that Clearwire was worth $5.00 per share. Rather, they agreed to pay that price because of **the massive synergies from the transaction** and the threat that DISH posed as a hostile minority investor [*emphasis added*].[54]

He observed, "The deal price also provided an exaggerated picture of Clearwire's value," noting that "Sprint estimated that the merger yielded synergies ranging from $1.5 to $2 billion, or $1.95 to [$]2.60 per share."[55]

The Supreme Court affirmed Laster's opinion without comment.

PLX Technology

PLX Technology was a NASDAQ-traded manufacturer of specialized integrated circuits. The case was adjudicated under the "entire fairness" standard, which encompasses both fair process and fair price. A director of PLX—a hedge fund's representative on the board—was alleged to have breached his fiduciary duties by, among other things, having conversations with the buyer and its investment banker that were not disclosed to other board members.

Vice Chancellor Laster agreed with plaintiffs that the process was unfair, ruling that the hedge fund had aided and abetted breaches of the board's duties to shareholders. However, he rejected the plaintiffs' claim that the $6.50 deal price was unfair. He concluded that plaintiffs "were unable to prove that the breaches resulted in damages."[56]

The Vice Chancellor determined that the projections used by the plaintiffs' expert in his DCF calculations were flawed in three respects:

1. The projections included "a new line of business involving a new set of customers with a new set of requirements" and "evidence at trial did not give [the Court] sufficient confidence to base a damages award on this element of the projections."[57]
2. "PLX management had a track record of missing its projections."[58]
3. "[B]idders do not appear... to have believed that [the projection] supported valuations in the range that [plaintiffs' expert] posited.... If the projections were sufficiently reliable to support a credible valuation of $9.82 per share, then it seems likely that another buyer would have competed."[59]

Also, he concluded that plaintiffs' expert's discount rate was too low. He faulted expert's beta because it was based on daily returns rather than weekly or monthly returns:

> "[W]hen the return interval is shortened, the following occurs: Securities with a smaller market value than the average of all securities outstanding (the market) will generally have a decreasing beta, whereas securities with a larger market value than the average of all securities outstanding will generally have an increasing beta."[60]

Plaintiffs' expert based his DCF calculation on projections that the Court concluded were too aggressive. Defendants' expert did not fully credit the projections for the new line of business; his DCF calculation valued PLX at less than the transaction price.[61] The Court agreed, ruling that plaintiffs suffered no damages from the breaches of fiduciary duty:

> Although flawed from a fiduciary standpoint, the details of the sale process that the Board conducted and the nature of the synergistic deal with Avago that it generated means that the plaintiffs received consideration that exceeded the value of the Company on a stand-alone basis.[62]

The Supreme Court affirmed the trial court's decision, ruling that "the plaintiff-appellants did not prove that they suffered damages."[63]

Jarden

The *Jarden* opinion by Vice Chancellor Joseph Slights III in July 2019 determined the appraisal price in a third-party transaction solely on the unaffected market price,

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[51] *ACP Master, Ltd. v. Sprint Corp.*, 2017 Del. Ch. LEXIS 125 (Del. Ch. July 21, 2017), *87; *aff'd,* 184 A.3d 1291 (Del. 2018).

[52] Ibid., *93.

[53] Ibid., *97.

[54] Ibid., *75.

[55] Ibid., *79.

[56] *PLX Technology Inc. S'holders Litig.*, 2018 WL 5018353 (Del. Ch. Oct. 16, 2018), *56 ("*PLX I*"); *aff'd,* 211 A.3d 137 (Del. 2019) 56 ("*PLX II*").

[57] *PLX I*, *52.

[58] Ibid.

[59] Ibid., *53.

[60] Ibid., 54, quoting Gabriel Hawawini, "Why Beta Shifts as the Return Interval Changes," *Fin. Analysts J.*, May–June 1983, 73. Thinly traded stocks often show no daily change simply because they do not trade and the bid and asked prices do not change.

[61] Ibid., *52.

[62] Ibid., *56.

[63] *PLX II*.

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which he defined as $48.31, the closing price immediately before *The Wall St. Journal* published rumors of a transaction.[64] He relied on "expert testimony... including an event study that analyzed the market's response to earnings and other material announcements."[65] He noted that (a) Jarden had no control shareholders, (b) 94% of its shares were in the public float, (c) the bid-ask spread was only 0.02%, and (d) approximately twenty analysts had published reports on Jarden in the year prior to the merger.[66] Importantly, he also concluded that the unaffected market price was not "stale" on the closing date.[67]

The negotiated deal was a package of cash and stock of Newell Rubbermaid. The package was worth $60.03 per share of Jarden at the date of the agreement between the parties and $59.21 at the closing date. Newell announced that it expected "incremental annualized cost synergies of approximately $500 million over four years."[68] Jarden, a consumer products company, had 205 million shares (fully diluted) outstanding.

The Court determined that the transaction price was not an applicable valuation standard in this matter, explaining:

> I place less weight on this market-based valuation approach in this case because the sales process was not well-conceived or well-executed and the expert analysis of the transaction synergies raised more questions than it answered.[69]

The Court agreed with petitioners' claim that the negotiating approach of Jarden's Executive Chairman "may well have set an artificial ceiling on what Newell was willing to pay."[70]

Petitioners' expert posited that the market price was depressed by a "conglomerate discount." The Court rejected this argument, noting that "it is not clear that this notion is accepted within the academ[ic community] or among valuation professionals."[71]

The Vice Chancellor dismissed the petitioners' valuation based on comparable companies, saying, "After considering the evidence, I am satisfied that Petitioners' comparable companies analysis is not credible because Jarden had no reliable comparables."[72] Several appraisal opinions in recent years have arrived at a similar conclusion.

Slights noted that his valuation was confirmed by his DCF calculation ($48.31 per share) and by "the most reasonable estimate" of "the Merger price less synergies" ($46.21 per share).[73] In his DCF calculation, he used the midpoint of the experts' inflation and GDP growth estimates as the perpetual growth rate,[74] an approach often used by the Court of Chancery.

The *Jarden* case includes the Court of Chancery's first extensive discussion of the terminal investment rate (TIR), sometimes called the plowback rate, as a factor in calculating terminal value.[75]

> [Respondent's expert] calculated TIR by applying a formula from McKinsey & Co. The McKinsey formula posits that a company's return on invested capital ("ROIC") should converge towards its WACC over time. The formula rests on the premise that a company operating in a competitive industry will not "have both high and rising forever returns on invested capital."[76]
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> ***
>
> [His] testimony that, in competitive industries, the return on new invested capital should equal the company's WACC was credible, and it is supported by the valuation treatises.[77]

Petitioners moved for reargument, claiming that the Court's "DCF analysis does not corroborate [its] fair value determination because of ... certain structural and mathematical flaws" and that their corrected valuation ($61.59–$64.01 per share) was not corroborative of the Court's conclusion.[78] The Vice Chancellor agreed with some of the petitioners' adjustments, but he also revised the TIR in his earlier terminal value calculation,[79] arriving at a DCF value of $48.23,[80] very close to his earlier number.

The Supreme Court concluded that the Court of Chancery was within its discretion in finding that "the market did not lack material nonpublic information about Jarden's financial prospects" and in relying on unaffected market price to determine fair value.[81] After noting that

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[64] *Appraisal of Jarden Corp.*, 2019 WL 3244085 (Del. Ch. July 19, 2019) ("*Jarden I*"), *28; *modified*, 2019 WL 4464636 (Del. Ch. Sept. 16, 2019) ("*Jarden II*"); *aff'd*, *Fir Tree Value Master Fund, LP v. Jarden Corp.*, 236 A.3d 313 (Del. 2020) ("*Jarden III*").

[65] *Jarden I*, *2.

[66] Ibid., *27.

[67] Ibid., *31.

[68] Ibid., *20, quoting the merger announcement.

[69] Ibid., *26.

[70] Ibid., *24.

[71] Ibid., *31. A conglomerate discount occurs when the market value of a diversified company is less than the sum of the values of its separate businesses.

[72] Ibid., *3.

[73] Ibid., *50.

[74] Ibid., *32.

[75] The TIR had been discussed briefly in *In Re Appraisal of Ancestry.com, Inc.*, 2015 Del. Ch. LEXIS 21 (Del. Ch. Jan. 30, 2015), *36–*37 and *In re Appraisal of Solera Holdings, Inc.*, 2018 WL 3625644 (Del. Ch. July 30, 2018), *30, but it did not impact the valuation in either case.

[76] *Jarden I*, *40.

[77] *Jarden I*, *41.

[78] *Jarden II*, *1.

[79] Ibid., *5.

[80] Ibid., *4.

[81] *Jarden III*, 326.

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the lower court did not rely on its DCF model to find fair value,[82] it ruled that that it was not an abuse of discretion to change the TIR in its DCF calculation after reargument:

> [A]s best we can tell, the petitioners' argument that the McKinsey formula undervalued Jarden because it was in a certain class of companies lacks support from the experts. . . . [W]hile the petitioners cite McKinsey's concerns about undervaluing certain companies, they do not provide support for re-adopting the court's original solution to split the difference.
>
> On reargument, the court stated that [in *Jarden I*] it had "improperly depart[ed]" from the McKinsey formula. . . . Based on the record before the court, the court did not abuse its discretion by applying the McKinsey formula in its post-trial opinion or correcting what it believed was an erroneous application of the formula on reargument.[83]

It also ruled that the Court of Chancery did not abuse its discretion when it relied on the event study by respondent's expert.[84]

Stillwater Mining

Stillwater Mining is the only U.S. source of three "platinum group metals"—palladium, platinum, and rhodium. It was acquired for $18.00 per share in cash by a South African company that is the world's largest primary producer of platinum, second largest primary producer of palladium, and third largest producer of gold.

Vice Chancellor Laster ruled that the deal price in this arm's-length transaction was the appropriate measure of fair value.[85] He rejected trading price, given the availability of "a market-tested indicator like the deal price."[86] He also rejected DCF in this case:

> The legitimate debates over [contested] inputs and the large swings in value they create undercut the reliability of the DCF model as a valuation indicator.[87]

The Vice Chancellor determined that unaffected market price was not a measure of fair value because it was impacted by inadequate disclosure of Stillwater's reserves. He observed that SEC restriction against disclosure of reserves that did not rise to the "probable" level affected the viability of trading price as a valuation indicator:

> [The SEC did] not permit a mining company to disclose information about inferred resources, which are mineral deposits where the quantity, grade, and quality "can be estimated" based on "geological evidence," "limited sampling," and "reasonably assumed, but not verified, geological and grade continuity."[88]

The Vice Chancellor observed, "Between signing and closing, the prices of palladium and platinum increased materially, with a direct effect on Stillwater's value."[89] Petitioners' expert calculated that the price increases "equated to an increase of between $2.00 to $2.30 per share" in the unaffected market price.[90] However, the Vice Chancellor noted that "the petitioners never argued for an adjustment *to the deal price* based on an increase in value between signing and closing [*emphasis in original*]."[91] He rejected an adjustment to his appraisal for the higher palladium and platinum prices because petitioners had not argued for it or quantified its effect on value on the deal price:

> [W]hether to adjust the deal price for an increase in value between signing and closing presents numerous difficult questions. In this case, the petitioners did not argue for an adjustment to the deal price, and so the parties did not have the opportunity to address these interesting issues. ... The petitioners accordingly failed to prove that the deal price should be adjusted upward to reflect a change in value between signing and closing.[92]

The Supreme Court affirmed, agreeing that "the deal price was a reliable indicator of Stillwater's fair value."[93] It expressly accepted the lower court's decision not to adjust the appraisal value upward for the increase in palladium and platinum prices because the petitioners failed to meet their burden of proof, noting that the parties did not address the issue at trial.[94]

2019–2020 Court of Chancery Valuation Decisions

Next, I review the recent Court of Chancery decisions in valuation cases.

Trussway Holdings

In the appraisal of Trussway Holdings, a private company, the petitioner dissented from conversion of

[82]Ibid., 322.
[83]Ibid., 335.
[84]Ibid., 327.
[85]*In re Appraisal of Stillwater Mining Co.*, 2019 WL 3943851 (Del. Ch. Aug. 21, 2019) ("*Stillwater I*"), *50; *aff'd, Brigade Leveraged Capital Structures Fund, Ltd. v. Stillwater Mining Co.*, 240 A.3d 3 (Del. 2020) ("*Stillwater II*"),
[86]*Stillwater I*, *59.
[87]Ibid., *61.
[88]Ibid., *58, quoting the SEC's Industry Guide 7 [17 C.F.R. 229.801(g)]. Industry Guide 7 was rescinded on October 31, 2018 [www.sec.gov/corpfin/secg-modernization-property-disclosures-mining-registrants].
[89]Ibid., *48.
[90]Ibid.
[91]Ibid.
[92]Ibid., *50
[93]*Stillwater II*, 17.
[94]Ibid.

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the corporation into an LLC. The parties disagreed only with respect to the value of its wholly owned operating subsidiary, a manufacturer of components for constructing multifamily housing.

Vice Chancellor Glasscock rejected petitioner's expert's comparable company analysis because the "supposed 'comparable companies' are too divergent from [the subsidiary], in terms of size, public status, and products, to form meaningful analogs for valuation purposes."[95]

He relied solely on DCF for his appraisal. The Court averaged DCF calculations based on two periods: a nine-year management projection and the first five years of that projection. It described the five-year period as "more standard."[96] (However, the fact that five years is "more standard" does not stem from valuation theory, but simply reflects the fact that that few companies make projections beyond five years.) The valuation based on the five-year period was 15% lower than the valuation based on the nine-year period.

The management projections included "strategic initiatives" that included, among other things, selling new products to be added to the company's product line and gaining additional market share through sales to market segments in which the company did not yet participate.[97] Both experts adjusted their valuations to reflect their concerns that the longer-term projections were optimistic. Petitioner's expert increased his discount rate by 1% after the first five years. Respondent's expert gave 25% weight to DCF based on the nine-year projection and 75% weight to DCF based on the five-year period.[98]

In using the five-year period, the Court effectively substituted the 2.3% perpetual growth rate (as to which both experts agreed) for the higher growth rate that management expected in the final four years. The Court agreed with the experts' view that that an adjustment should be made to a value based on the nine-year projection, and it explained its decision to give partial weight to the shorter period:

> Of more concern to me is Trussway management's ability (or that of any human prognosticator) to accurately predict corporate performance nine years out, particularly concerning new facets of a business. I am also aware that there is a degree of huckster's optimism in these predictions.[99]

[95] *Hoyd v. Trussway Holdings*, 2019 WL 994048 (Del. Ch. Feb. 28, 2019), *5.

[96] Ibid., *7.

[97] Ibid., *2.

[98] Ibid., *6.

[99] Ibid.

The Court's award was 5% higher than the respondent's valuation and only 61% of the value claimed by the petitioner.

Promontory Financial

One of the 50% shareholders of Promontory Financial withdrew from the LLC. Pursuant to the LLC agreement, he was entitled to 50% of the value of the LLC's business exclusive of the value of his services. Promontory provided management consulting services to enhance the performance and profitability of financial service and other companies. It charged contingent fees based on a client's profit improvement. Its services, which appealed only to a limited number of companies, did not generate repeat customers because its profit improvement services were a one-time engagement. In the previous four years, the company had three engagements, one of which provide over 95% of its revenues.

Vice Chancellor Glasscock rejected the asset approach because, as a service business, Promontory's earning power was not a function of its tangible assets.[100] He rejected DCF because management's projections were not a reliable basis for valuation.[101] Plaintiff's expert valued the company based on a proposed transaction that the parties had negotiated but not consummated;[102] plaintiff had made the initial proposal and the other shareholder agreed to the terms. Glasscock decided that the $16.25 million implied enterprise value reflected fair value since it was near-contemporaneous with plaintiff's decision to withdraw.[103] Plaintiff's expert reduced his DCF valuation by 50% to account for that the impact of plaintiff's contribution to the business. The Vice Chancellor concluded that Promontory retained half its value, post-plaintiff.[104] He deducted corporate debt and awarded plaintiff 50% of the balance, less plaintiff's overdrawn capital account.[105]

Columbia Pipeline

Columbia Pipeline Group, a natural gas transporter, was acquired by TransCanada Corp. in an arm's-length cash deal. The petitioners' DCF valuation was 24% over the deal price and 57% over the unaffected market price. Vice Chancellor Laster rejected this argument as contrary to contemporaneous market evidence:

[100] *Smith v. Promontory Finl. Group, LLC*, 2019 WL 1934854 (Del. Ch. Apr. 30, 2019) at *11.

[101] Id. at *12.

[102] Id. at *9.

[103] Id. at *13.

[104] Id.

[105] Id. at *14.

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> [Expert]'s opinion that the value of Columbia materially exceeded the deal price conflicts with the market behavior of other potential strategic acquirers who had shown interest in Columbia, and who did not step forward to top Trans-Canada's price.[106]

He also expressed concern about the high terminal value in the DCF calculation:

> In [petitioners' expert]'s calculation, the terminal value represented 125% of his valuation of Columbia.... This court has questioned the utility of a DCF in a case where the terminal value represented 97% of the result, finding that "[t]his back-loading highlights the very real risks" presented by using that methodology and "undermin[ing] the reliability of applying the DCF technique."[107]

Vice Chancellor Laster determined appraisal value based solely on the deal price.[108] He did not reduce the price for synergies because the respondent did not credibly quantify the synergies.

> TransCanada did not meet its burden of proof. **Trans-Canada likely could have justified a smaller synergy deduction, but it claimed a larger and unpersuasive one**. This decision therefore declines to make any downward adjustment to the deal price. [*emphasis added*][109]

He rejected petitioners' claim that the company's value increased between signing and closing because they failed to introduce supporting data:

> [P]etitioners] did not suggest a means of adjusting the deal price to reflect the increases in value that resulted from the factors they cite. **Perhaps an expert could have constructed a metric, but the petitioners in this case did not provide one**. For purposes of adjusting the deal price, the petitioners failed to satisfy their burden of proof. [*emphasis added*][110]

Some dissatisfied investors in Columbia Pipeline declined to seek appraisal and instead filed a class action claiming that they failed to receive adequate consideration because of a breach of fiduciary duties by the company's CEO and CFO. They claimed that the officers were motivated by a desire to sell the company in order to trigger change-in-control benefits and that they favored Trans-Canada to the detriment of other interested buyers. The plaintiffs also alleged that the officers withheld certain facts from the Board and that there were material omissions in the merger proxy statement.

The defendants moved for summary judgment. In March 2021, Vice Chancellor Laster, who had presided in the appraisal case, denied the defendants' motion to dismiss.[111]

It has long been generally accepted that Delaware courts use the same valuation analysis for appraisal and for the fair price prong of a fiduciary duty action.[112] Laster's 2021 decision differs, positing that fair price for a breach of fiduciary duty may be greater. He distinguishes between an appraisal valuation, which looks at the going-concern value of the company as it is being run, and a fiduciary duty case, which considers whether the breach affected the company's ability to negotiate a better price.

> [T]he Appraisal Decision examined the factual record to determine whether the alleged flaw undermined the reliability of the deal price as a persuasive indicator of standalone value using the criteria that the Delaware Supreme Court deployed in *Aruba*, *Dell*, and *DFC*. The court did not evaluate whether the flaws prevented the Board from securing the best value reasonably available for stockholders in the sense of a higher price from Trans-Canada or a better deal from a competing bidder.[113]
>
> * * *
>
> Notably, the current plaintiffs do not contend that the officers breached their fiduciary duties by inducing the Board to accept a price below standalone value or otherwise to forego a standalone alternative. They contend that the officers breached their fiduciary duties by inducing the Board to accept a price from TransCanada that was not the best value reasonably available.[114]

The Vice Chancellor explained why the amount owed to public shareholders could be greater than appraisal value. He posited that the damages from a breach of fiduciary duty could include the incremental amount that a buyer would have offered but for the improper actions of the CEO and CFO.

> [T]he defendants ... argue that the Company's stockholders could not have suffered damages if they received an amount that this court found to be the standalone value of the Company. That damages remedy is not what the plaintiffs are seeking. They contend that stockholders lost out on the difference between the $25.50 that they received and the higher amount that TransCanada or another bidder would have paid. ... The plaintiffs have articulated a viable theory

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[106] *Appraisal of Columbia Pipeline Group, Inc.*, 2019 WL 3778370 (Del. Ch. Aug. 12, 2019), *50.

[107] Ibid., *51, quoting *Union Ill. 1995 Investment LP v. Union Finl. Group, Ltd.*, 847 A.2d 340, 361 (Del. Ch. 2003).

[108] Ibid., *43.

[109] Ibid., *45.

[110] Ibid.

[111] *In Re Columbia Pipeline Group, Inc. Merger Litig.*, 2021 WL 772562 (Del. Ch. Mar. 1, 2021), *2.

[112] *See* Lawrence A. Hamermesh and Michael L. Wachter, "Rationalizing Appraisal Standards in Compulsory Buyouts," *B.C. L. Rev.* 50 (2009): 1021, 1030.

[113] *Columbia Pipeline Merger Litig.*, *46.

[114] Ibid., *48.

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> of damages and have pled all of the elements of a claim for aiding and abetting a breach of fiduciary duty.[115]

Laster's valuation standard (assuming that it is not successfully challenged on appeal[116]) breaks new ground by bifurcating Delaware's approach to valuation in dissenting shareholder cases from valuation for damages from breach of fiduciary duty.

UIP Companies

This case involved a dispute between the two 50% shareholders of a small private real estate management company. The plaintiff alleged a breach of fiduciary duty with respect to sale of newly issued shares to an associate of the defendant. Vice Chancellor Kathaleen McCormick ruled that plaintiff "proved facts sufficient to trigger entire fairness as the standard of review."[117] The entire fairness standard has two prongs, fair process and fair price. The Court decided that the process was unfair and then proceeded to consider whether the newly issued stock had been sold at a fair price.

The Court accepted defendant's expert's valuation analysis which used the capitalized cash flow (CCF) method, which the Court described as a "near-cousin of a discounted cash flow analysis."[118] The capitalization rate used by the expert included a company-specific risk premium.

Delaware courts have seldom accepted company-specific premiums in determining cost of capital. Indeed, Vice Chancellor Leo Strine, Jr. (later Chief Justice) strongly criticized company-specific risk:

> The calculation of a company specific risk is highly subjective and often is justified as a way of taking into account competitive and other factors that endanger the subject company's ability to achieve its projected cash flows. In other words, it is often a back-door method of reducing estimated cash flows rather than adjusting them directly. To judges, **the company specific risk premium often seems like the device experts employ to bring their final results into line with their clients' objectives**, when other valuation inputs fail to do the trick [*emphasis added*].[119]

However, Vice Chancellor McCormick explained why she decided in this case that special circumstances merited the application of this factor to reduce the company's value:

> Given UIP's unique circumstances as almost wholly dependent on the SPEs [special purpose real estate entities] and [UIP's two principals] for its revenue, the Court finds that Defendants have met their burden of showing that a specific-company risk premium is necessary in this case.[120]

She concluded that the price was fair and that, therefore, there was no breach of fiduciary duty.[121]

SourceHOV Holdings

In the appraisal of SourceHOV Holdings, a process outsourcing and financial technology company, both experts agreed that the income approach was the only appropriate valuation method. Petitioners' expert used both DCF and CCF. Respondent's expert used an adjusted present value DCF model that the Court said was "functionally the same as [the] CCF model."[122]

> CCF is a variation of DCF that is better suited to value future cash flows where a company's capital structure is expected to change. Ultimately, a traditional DCF and CCF are "algebraically equivalent."[123]

The principal differences between the two experts' income analyses of SourceHOV were:

1. the calculation of beta,
2. the small company premium,
3. debt load projections, and
4. the projection on which the analysis was based (not material).

Petitioners' expert determined beta using publicly traded guideline companies. Respondent's expert calculated beta based on the yield on SourceHOV's debt, explaining:

> "I use the available evidence to determine the minimum reasonable cost of debt of a standalone SourceHOV as of the valuation date, which then yields an implied minimum reasonable debt beta based on this minimum reasonable cost of debt. I then conservatively use this implied debt beta as a minimum possible estimate of the overall beta of SourceHOV's assets."[124]

[115] Ibid., *56

[116] A reversal of Laster's position is unlikely. The Supreme Court wrote in 2017, "The issue in an appraisal is not whether a negotiator has extracted the highest possible bid. Rather, the key inquiry is whether the dissenters got fair value and were not exploited." *Dell II*, 33, and in 2000, it said, "The Court of Chancery has greater discretion when fashioning an award of damages in an action for a breach of the duty of loyalty than it would when assessing fair value in an appraisal action." *International Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 441 (Del. 2000).

[117] *Coster v. UIP Cos., Inc.*, 2020 WL 429906 (Del. Ch. Jan. 28, 2020), *1.

[118] Ibid., *21.

[119] *Del. Open MRI Radiology Assocs. v. Kessler*, 898 A.2d 290, 339 (Del. Ch. 2006).

[120] *Coster v.* UIP, *25.

[121] Ibid., *28.

[122] *Manichaean Capital, LLC v. SourceHOV Holdings, Inc.*, 2020 WL 496606 (Del. Ch. Jan. 30, 2020), *14; *aff'd, SourceHOV Holdings, Inc. v. Manichaean Capital, LLC*, 2021 WL 225817 (Del. Jan. 22, 2021).

[123] Ibid., *12.

[124] Ibid., *14, quoting respondent's expert's written report.

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Vice Chancellor Slights rejected this unusual calculation of beta, describing it as "methodologically novel" and unsupported by academic literature.[125] He added that it "raised serious questions about the credibility of his entire valuation analysis."[126]

Petitioners' expert based his size premium of 2.08% on the 8th decile in Duff & Phelps' 2017 Valuation Handbook. Respondent's expert used a size premium of 2.68% based on the 9th decile. Both relied on the market price of shares of the surviving company, but the latter argued that this price included synergies. The Court was "persuaded the 2.68% size premium is more accurate on this record."[127]

Respondent's expert's DCF analysis assumed that that SourceHOV would have retired all its debt when it matured in 2020. This premise reduced DCF value by lowering the tax savings from interest deductions. The Court rejected this assumption, stating:

> Given SourceHOV's acquisitive history, and its past tolerance for high debt loads, it is unlikely SourceHOV would have abruptly abandoned its strategy of using debt to fuel future acquisitions. Management's projections realistically forecast that SourceHOV would continue to carry debt after the First and Second Liens matured.[128]

The Vice Chancellor's ruling is consistent with the Delaware courts' long-standing preference for using the company's actual capital structure at the valuation date as its operative reality, rather than accepting a hypothetical capital structure.

The Court commented favorably on an adjustment by petitioners that favored the respondent, whose forecast included depreciation substantially higher than capital expenditures:

> [Respondent's] forecast led to "depreciating and amortizing more asset value than [SourceHOV] even ha[d] on the books." If [petitioners' expert] had accepted this high level of depreciation and amortization..., the result would have been to increase SourceHOV's value in a DCF analysis. Instead, to account for his concern that depreciation and amortization forecasts were too high, [he] made a Respondent-friendly adjustment to provide a more accurate calculation.[129]

In the past, the Court of Chancery has sometimes erred by accepting terminal value calculations in which depreciation materially exceeded capex,[130] which is mathematically impossible for a going concern.[131]

The expert's valuations were $5,079 per share and $2,817 per share, respectively. The Court accepted all facets of the petitioners' report other than the small stock premium and appraised Source HOV at $4,591 per share.[132] The dissenting investors, who collectively owned 10,304 shares,[133] were awarded an aggregate of $47.3 million.

At trial, plaintiffs' expert testified that SourceHOV's Restricted Stock Units (RSUs) should be excluded from the number of shareholders outstanding because it was speculative whether they would vest and thereby dilute existing shareholders. Post-trial, respondents argued that many of the RSUs had been converted into shares and asked for a retrial to determine the appropriate share count. The Vice Chancellor rejected this argument, stating, "I see nothing that would have prevented SourceHOV from directing its expert to address the issue, or otherwise making this argument, at trial."[134]

The Supreme Court affirmed the appraisal without comment.

Panera Bread

Panera Bread, a publicly traded company, was acquired for more than $7 billion in cash by a Dutch holding company. Holders of about $250 million of common stock, including several merger arbitrage investors, sought appraisal.

Vice Chancellor Morgan Zurn rejected both experts' comparable transaction analyses because "neither sample size is reliable enough to afford it weight."[135]

He criticized the comparable companies selected by each expert, stating:

> Neither expert presents a **reliable** empirical analysis to show a suitable peer group; both sets have material weaknesses. For that reason, I do not find comparable companies as a fair measure of value. Instead, **I view both parties' comparable**

[125]Ibid., *21.

[126]Ibid.

[127]Ibid., *27.

[128]Ibid., *24.

[129]Ibid., *25.

[130]For example, *Emerging Communications, Inc. Sh'h's Litig.*, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004), *57, n. 56; *Lane v. Cancer Treatment Centers of America, Inc.*, 2004 Del. Ch. LEXIS 108 (Del. Ch. July 30, 2004), 111.

[131]Bradford Cornell and Richard Gerger, "Estimating Terminal Values with Inflation: The Inputs Matter—It Is Not a Formulaic Exercise," *Business Valuation Review* 36 (2017):117–118; Gilbert E. Matthews, "Capital Expenditures, Depreciation and Amortization in the Gordon Growth Model," *Business Valuation Review* 33 (2014):113.

[132]2020 WL 496606, *28.

[133]Ibid., *2.

[134]*Manichaean Capital, LLC v. SourceHOV Holdings, Inc.*, 2020 WL 3097678 (Del. Ch. June 11, 2020), *4.

[135]*Appraisal of Panera Bread Co.*, 2020 WL 506684 (Del. Ch. Jan. 31, 2020), *43.

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> **companies analyses as an attempt to corroborate their preferred valuation** [*emphasis added*].[136]

Panera operated "fast casual" eateries; it operated nationally through company-owned locations and franchisors. It ought not to have been difficult to put together a list of reasonably comparable companies. Nonetheless, both experts created flawed lists. One expert "selected comparable companies by reviewing equity analysts' reports in the year before the merger date and selecting the firms mentioned by three or more analysts at least once."[137] His list included full-service restaurants, which the Court rejected as valid comparables. The other expert "included McDonald's and Burger King, but excluded Wendy's; he included Domino's, but excluded Papa John's."[138] It appears that neither expert considered the selected comparable companies used in the fairness opinion described in Panera's proxy statement.

Vice Chancellor Zurn rejected petitioners' expert's DCF analysis because it assumed both an investment rate that was far too low and an "outsized" growth rate.[139] He did not criticize respondent's expert's DCF, which the expert "viewed . . . only as corroborative of his deal-price-minus-synergies value."[140] He concluded that Panera's appraisal value should be determined solely by reference to the deal price:

> I find that the process by which the company was sold bore several objective indicia of reliability, which were not undermined by flaws in that process. I therefore find that the deal price is persuasive evidence of fair value, and give no weight to other valuation metrics.[141]

The Vice Chancellor appraised Panera at $303.44, accepting the testimony of respondent's expert that the deal price of $315 per share included synergies of $11.56 per share.[142] However, the company did not benefit from this adjustment because it had prepaid the full $315 to the dissenters in order to avoid paying interest on the award. Zurn ruled that Delaware law did not authorize him to order a refund of the $11.56 per share difference,[143] which totaled about $9 million.

Real Time Cloud Services

In a dispute between partners of a small accounting services firm, plaintiff had been squeezed out of his 50% interest. Plaintiff's expert valued his interest at $1,682,000, using financial statements "recreated" for purposes of the litigation that were inconsistent not only with the company's records, but also with the plaintiff's own tax returns.[144] Defendant's expert, using the company's internal financials, testified that the fair value of plaintiff interest was $132,500. Vice Chancellor Glasscock based his valuation on the defendants' report, but he used the higher growth rate posited by the plaintiff. He ruled that the plaintiff was entitled to $173,000,[145] 10% of his overreaching claim.

Synapse Wireless

Synapse Wireless was an unsuccessful Internet of Things (IoT) company. After minority shareholders were bought out in 2019 at $0.42899 per share, one shareholder dissented. His expert valued the company at $4.1876 per share, while respondent's expert valued it at $0.06–$0.11 per share. Vice Chancellor Slights appraised the shares at $0.228 (53% of the transaction price), the second largest discount to transaction price in a Delaware appraisal.[146]

McWane, Inc., had acquired control of Synapse in 2012 at $4.997 per share. When it bought more shares in 2014 to reach the 80% level that would enable it to utilize Synapse's tax losses, it was contractually obligated to pay the same price it had paid in 2012.[147]

The projected revenues for 2015 (the year preceding the squeeze-out) that had been made in 2012 were 84 times higher than actual results.[148] The chart in Figure 1, copied from the opinion on the Delaware Court website, shows Synapse's inability to accurately forecast its future results.

The Vice Chancellor concluded, "I am satisfied that the 2012 Merger was either the product of Synapse's officers' misleading inflation of the company's value, or the product of McWane's failure to perform adequate due diligence."[149]

He rejected both sides' comparable transactions analyses, commenting, "Each expert was able to make well-considered, convincing objections to the other's model that were not effectively rebutted."[150]

The Court based its valuation on DCF but expressed its concerns about the company's projections:

> I acknowledge I have some reservations about relying on Synapse's management's projections given the Company's serial inability to meet its financial targets. But, both experts

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[136]Ibid., *42.
[137]Ibid.
[138]Ibid.
[139]Ibid., *41.
[140]Ibid., *40.
[141]Ibid., *1.
[142]Ibid., *40.
[143]Ibid., *44.

[144]*Zachman v. Real Time Cloud Services, LLC*, 2020 WL 1522840 (Del. Ch. Mar. 31, 2020), *16–*17.
[145]Ibid., *17.
[146]*Kruse v. Synapse Wireless, Inc.*, 2020 WL 3969386 (Del. Ch. July 14, 2020).
[147]Ibid., *4.
[148]Ibid., *9.
[149]Ibid.
[150]Ibid., *11.

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Year-over-Year Budgeted Revenues Compared to Actual Revenues

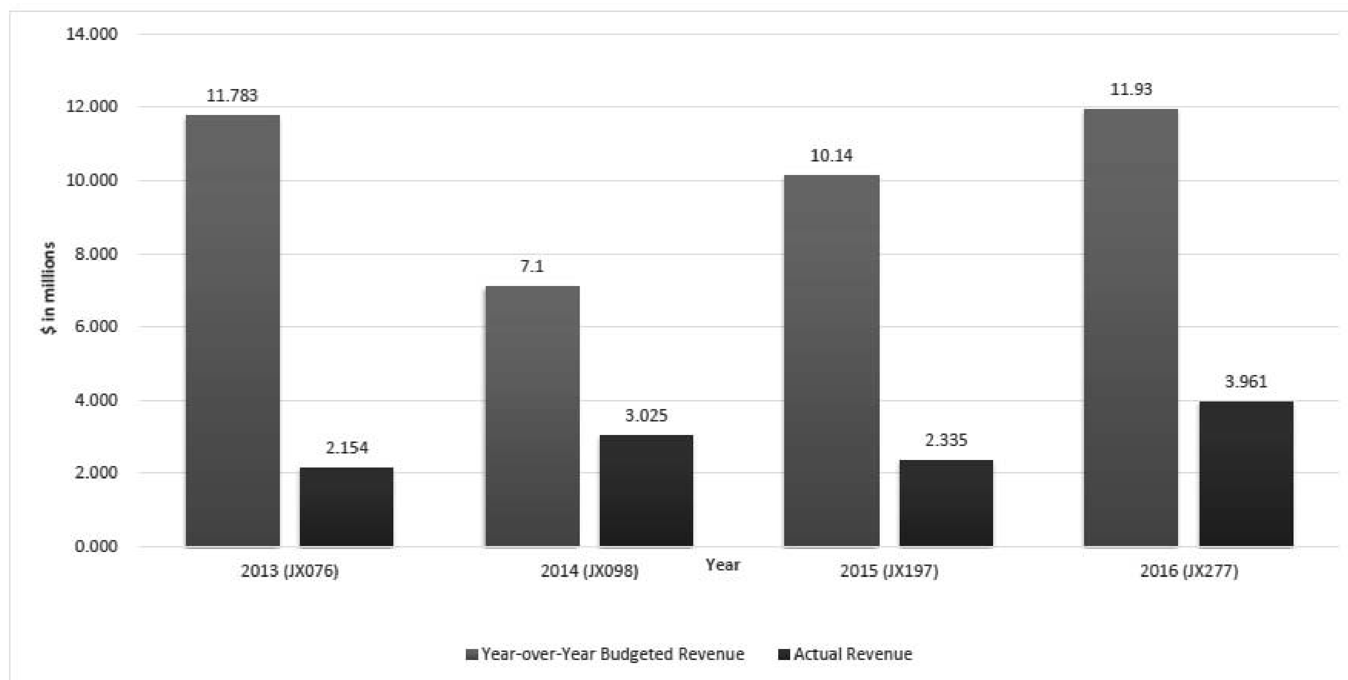

Figure 1
Synapse's Budgeted Revenues Compared to Actual Revenues

> rely on management projections in their analyses, and no alternate projections were offered for my consideration.[151]

The petitioner's expert's longer-term projections were rejected because the assumed profit margins were unrealistic.[152] Vice Chancellor Slights accepted respondent's expert's 12% discount rate based on WACC and rejected his alternative of a 40% venture capital discount rate.[153]

The Vice Chancellor accepted a terminal value based on a perpetual growth rate of 3.1% as "standard and accepted."[154] He said that terminal value based on an EBITDA multiple was "different, but also well-accepted," but he rejected the multiple used by petitioner's expert because it implied a perpetual growth rate greater than 10%.[155]

Experts in appraisal cases seldom use multiples to determine terminal value. This is only the second case since 2007 in which it was proposed by an expert,[156] and a terminal value based on a multiple had last been accepted by the Court of Chancery in 2005.[157]

Happy Child World

A September 2020 opinion in this lengthy litigation[158] addressed entire fairness as well as appraisal; both sides alleged breaches of fiduciary duty to the corporation by the other prior to a squeeze-out merger. This small but interesting case was challenging for the Court because of the paucity of evidence:

> While both parties allege they are casualties of serious breaches of fiduciary duty by the other, neither party took care to marshal evidence in support or defense of their claims, making the post-trial adjudication of this long-running dispute exceptionally difficult.... Consequently, I

[151] Ibid., *13.

[152] Ibid.

[153] Ibid.

[154] Ibid., *18.

[155] Ibid., *18–*19.

[156] The other was *Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 Del. Ch. LEXIS 172 (Del. Ch. July 8, 2013), *78.

[157] *U. S. Cellular Operating Co.*, 2005 Del. Ch. LEXIS 1 (Jan. 6, 2005), *67.

[158] Litigation between the parties commenced in 2007, the relevant transaction occurred in 2012, the trial was in 2019, and the final briefs were submitted in June 2020.

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> am left with an evidentiary record that is disjointed, incomplete and wholly inadequate to enable thoughtful post-trial deliberations. But the matter is submitted for decision and the Court must render judgment.[159]

Vice Chancellor Slights "value[d] the competing derivative claims, incorporate[d] those values in the appraisal of the corporation and then adjust[ed] the petitioner's appraisal recovery to account for his liability to the corporation."[160] He rejected all but three of the numerous fiduciary duty claims. He valued two of the derivative claims against plaintiffs at $62,199 and one against the defendant at $20,099.[161] (The Court's analysis of these claims is outside the scope of this article.)

The Vice Chancellor castigated plaintiffs' expert's valuation of the company (a day care center that had ceased operations), stating that he "solved for the wrong problems – fair market value (as opposed to fair value) as of 2008 (as opposed to as of the [2012] Merger Date)"[162] and that he "conducted the real estate appraisal himself even though he admittedly lacks that expertise."[163]

Defendant's valuation expert testified as to the valuation he had performed prior to the squeeze-out. In that valuation, he relied upon a real estate expert's appraisal of the company's unoccupied real estate, its sole material asset. The real estate was valued by using the sales comparison method and the income capitalization method, weighted equally.[164] The valuation expert adopted that real estate appraisal and deducted the company's liabilities to arrive at its net asset value.

Defendant's valuation expert then used the capitalization of earnings method to determine the value of the company as a going concern. He gave equal weight to net asset value and capitalization of earnings to value the company as of the date of the squeeze-out.[165] The opinion does not discuss any details of his calculation, but the Court rejected the plaintiffs' challenges to the cost of equity and cost of debt.[166]

The Court adopted all aspects of the defendant's valuation (weighting, methodologies, amount of debt) with one material exception. The appraiser had been unaware that the defendant was negotiating a lease while the appraisal was being prepared and had leased it two weeks after the report.[167] The Court applied the income capitalization method based on the terms of the new lease. This single change increased the valuation of the company, before the Court's adjustments for damages from breach of fiduciary duty, from $85,237 to $135,962.

Prior to the squeeze-out, the defendant had owned 55% of the equity, and plaintiffs owned 45%. The Vice Chancellor added the total value of both parties' derivative claims ($82,398) to the value of the company, calculated the value of plaintiffs' 45% interest, and deducted the amount assessed against them ($62,199) for their breaches of fiduciary duty. Thus, the plaintiffs were awarded $36,018.[168]

In this case, it the Court accepted a 50% weight given to asset value because of the inactive status of the business. Asset value is not often considered in Delaware appraisals.

Valuation Methods Accepted by Delaware Courts

The valuation approaches that the Court of Chancery will accept necessarily depend on the facts of the specific case.

> The appraisal exercise is, at bottom, a fact-finding exercise, and our courts must appreciate that, by functional imperative, the evidence, including expert evidence, in one appraisal case will be different from the evidence presented in any other appraisal case. Different evidence, of course, can lead to different decision paths and different outcomes.[169]

The trend toward the use of transaction price as the principal factor in arm's-length deals and away from using comparable companies in related party deals is clearly visible in Table 1, which is based on the author's review of all Delaware appraisal cases.

The valuation methodology most often accepted by Delaware courts for appraisals in related party transactions and in "entire fairness" valuations is DCF.[170] The courts generally reject DCF only if projections are unavailable, inadequate or unreliable. For example, Vice Chancellor Glasscock wrote in his 2013 *CKx* opinion:

> Because I have little confidence in the reliability of [the projections], I conclude that a DCF analysis is not the appropriate method of valuation in this case.[171]

In the past 15 years, comparable companies have rarely been accepted by the Court of Chancery. As the table shows, the method had previously been accepted in numerous cases. The Court of Chancery has become very

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[159] *Happy Child World, Inc.*, 2020 WL 5793156 (Del. Ch. Sept. 29, 2020), *1.

[160] Ibid., *2.

[161] Ibid., *8.

[162] Ibid., *27, fn. 301.

[163] Ibid., *28.

[164] Ibid., *27. The real estate appraiser also testified at trial.

[165] Ibid., *32.

[166] Ibid., *31.

[167] Ibid., *29.

[168] Ibid., *34.

[169] *Jarden I*, *1.

[170] For a discussion of how the Delaware courts determine cost of capital, see Chapter 38, "How Courts View Cost of Capital—Appraisal and Fairness Cases," pp. 899–915 in *Cost of Capital*, 5th Ed., Shannon P. Pratt and Roger J. Grabowski, Eds. (John Wiley & Sons, 2014).

[171] *Huff Fund Investment P'ship v. CKx, Inc.*, 2013 Del. Ch. LEXIS 269 (Nov. 1, 2013), *35; *aff'd*, 2015 Del. LEXIS 77 (Del. Feb. 12, 2015).

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Table 1
Valuation Methods Used by Delaware Court of Chancery in Appraisal Decisions

	Number of Valuations	DCF or similar	Comparable Companies	Comparable Transactions	Asset Value	Transaction Price	Unaffected Market Price
Arm's-Length Transactions							
1998–2005	2	2	0	0	0	1	0
2006–2013	4	3	1	0	0	2	0
2014–2020	16	7	2	1	0	13	1*
Total	22	12	3	1	0	16	1
Related Party Transactions							
1998–2005	21	11	10	4	2	1	0
2006–2013	7	7	1	1	1	0	0
2014–2020	11	11	0	0	1	0	0
Total	39	29	11	5	4	1	0

* Excludes reversed decision.

selective in accepting the comparability of companies selected by testifying experts.

Current value of net assets cannot be used as a valuation standard for most operating companies. Use of asset value is permissible for investment companies, financial institutions, and real estate companies, companies for which asset value is a direct driver of income. Liquidation value cannot be used for a going concern.

Rules of thumb are almost always rejected. The last case in which the Court of Chancery used a rule of thumb in an appraisal was in 1990.[172]

The Court of Chancery has faulted an expert for failure to normalize income data, commenting, "The earnings figures used to derive the earnings base should be adjusted to eliminate non-recurring gains and losses."[173] Income and cash flow should be normalized to exclude nonrecurring items. Normalizing adjustments include not only items classed as "extraordinary" by auditors, but also other items that are, by their nature, nonrecurrent.

Since the 2013 *CKx* case, the Delaware courts have expressed a strong preference for basing the appraisal value on the transaction price in arm's-length transactions, provided that sales process is deemed to be reliable for determining value. The courts adjust the deal price to exclude synergies when they are demonstrated by evidence or testimony. As discussed above, two recent Court of Chancery decisions used unaffected market price in arm's-length deals, and one of those was reversed.

[172]*Neal v. Alabama By-Products*, 1990 Del. Ch. LEXIS 127, 36; *aff'd*, *Alabama By-Products Corp. v. Neal*, 588 A.2d 255 (Del. 1991).

[173]*Reis v. Hazelett Strip-Casting Corp.*, 28 A. 3d 442, 470 (Del. Ch. 2011).

Other States Have Different Standards

All the cases above were decided under Delaware law. Expert witnesses should be aware that other states have standards that sometimes differ materially from Delaware, *e.g.*:

a. Some states define fair value as acquisition value (third party sale value) rather than going-concern value, *e.g.*:

> As a going concern, the value of an enterprise... is **the price a knowledgeable buyer would pay for the entire corporation** [*emphasis added*].[174]

b. California uses the term "fair market value" in its dissent statute, but it uses "fair value" in its oppression statute.[175]

c. New York permits a discount for lack of marketability:

> [W]hatever the method of valuing an interest in such an enterprise, it should include consideration of any risk associated with illiquidity of the shares.[176]

d. Ohio awards dissenters the market price prior to announcement rather than fair value:

[174]*Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1122, 1125 (Mass. 1986).

[175]Cal. Corp. Code, §1300 (a) ("The fair market value shall be determined ..."); Cal. Corp. Code, § 2000 (a) ("The fair value shall be determined ...).

[176]*Matter of Seagroatt Floral Company, Inc.*, 583 N.E.2d 287, 290 (N.Y. 1991); *Friedman v. Beway Realty Corp.*, 661 N.E.2d 972, 974 (N.Y. 1995).

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> The fair cash value of a share for the purposes of this section is the amount that a willing seller, under no compulsion to sell, would be willing to accept, and which a willing buyer, under no compulsion to purchase, would be willing to pay.[177]

Expert Witness Testimony

Delaware case law in valuation decisions continues to evolve. A review of the individual opinions shows that the decisions in each case are fact-specific and the Court of Chancery's conclusions depend on these facts. But the decisions are also impacted by the points made in counsels' briefs and by expert testimony.

When professionals undertake a valuation for litigation purposes, they should consult with counsel as to the appropriate valuation standard and how it is applied in the relevant jurisdiction. Using the appropriate standard, an expert witness should apply customary valuation techniques generally accepted by the business valuation profession and the investment community.

The Court of Chancery recognizes the importance of expert testimony from valuation experts:

> [T]he remarkably broad "all relevant factors" mandate necessarily leads the court deep into the weeds of economics and corporate finance. These are places law-trained judges should not go without the guidance of experts trained in these disciplines.[178]

Despite the burden of articulating fair value ultimately falling on the Court, I am, as a practical matter, generally guided in my valuation by the adversarial presentations of the parties.[179]

The Court of Chancery rejects not only expert testimony that is not persuasive, but also testimony that is not supported in the valuation literature, such as the conglomerate discount rejected in *Jarden,* the beta based on daily price changes rejected in *PLX Technology* and the beta based on debt yield in *SourceHOV*. In contrast, an expert was able to persuade the Court that it was appropriate to use a company-specific premium in the *UIP* case.

The Court on numerous occasions has criticized experts who overreach in their valuations. The Supreme Court has warned that "the Court of Chancery should be chary about imposing the hazards that always come when a law-trained judge is forced to make a point estimate of fair value based on widely divergent partisan expert testimony."[180] As discussed above, the Court of Chancery faulted the petitioners' expert's DCF analysis in *Columbia Pipeline* as contrary to market evidence. Also, the respondent's expert in *Columbia Pipeline* was deemed to have been unpersuasive as to the amount of synergies included in the transaction price; the Court commented that respondent "likely could have justified a smaller synergy deduction" than its aggressive claim that was denied.

The 2020 decisions provided numerous examples of inadequate or improper expert testimony. Neither expert in *Panera* compiled a reasonable selection of comparable companies. A witness in *Real Time Cloud Services* used financial statements that were inconsistent with the company's records. The respondent in *SourceHOV* failed to have its expert testify as to the appropriate share count. In *Happy Child World,* an expert used the wrong standard of value. An expert in *SourceHOV* assumed a debt structure that did not reflect the company's operative reality.

On the other hand, the absence of testimony on relevant valuation issues can be harmful. Because there was no testimony as to the impact of increased palladium and platinum prices on the deal price in *Stillwater Mining*, the Court was unable to quantify impact of this change on the appraised value.

In a comment directed to counsel, but that applies to experts as well, Laster wrote in 2016 (and twice repeated in 2019):

> An argument may carry the day in a particular case if counsel advance it skillfully and present persuasive evidence to support it. The same argument may not prevail in another case if the proponents fail to generate a similarly persuasive level of probative evidence or if the opponents respond effectively.[181]

Laster also addressed expert witnesses in both *Columbia Pipeline* and *Stillwater Mining,* quoting a 2010 Strine opinion:

> [T]he approach that an expert espouses may have met "the approval of this court on prior occasions," but may be rejected in a later case if not presented persuasively or if "the relevant professional community has mined additional data and pondered the reliability of past practice and come, by a healthy weight of reasoned opinion, to believe that a different practice should become the norm."[182]

In recent cases, many experts have not used guideline companies and guideline transactions. This may be a consequence of the Court of Chancery's frequent

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[177] Ohio Rev. Code Ann. §1701.85(b).

[178] *Jarden I*, *1.

[179] *SWS Group*, *27–*28.

[180] *Dell II*, 35.

[181] *Merion Capital L.P. v. Lender Processing Services, L.P.*, 2016 WL 7324170 (Del. Ch. Dec. 16, 2016), *16; quoted in *Columbia Pipeline*, *16, and *Stillwater Mining*, *20.

[182] *Columbia Pipeline*, *16, and *Stillwater Mining*, at *20, quoting *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 517 (Del. Ch. 2010); *aff'd*, 11 A.3d 214 (Del. 2010).

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rejection of these approaches and its use of "comparable" rather than "guideline." The market approach is widely used in the investment community. Both guideline companies and guideline transactions are customarily included in investment bank presentations to corporate clients and in fairness opinions. Guideline companies are frequently used in security analysists' research reports. For companies that were appraised in Delaware from 2010 through 2020, 97% of the related fairness opinions considered guideline companies and 77% considered guideline transactions as a valuation method. Chancellor William B. Chandler III wrote in 2011:

> [I]t is preferable to take a more robust approach involving multiple techniques—such as a DCF analysis, a comparable transactions analysis (looking at precedent transaction comparables), and a comparable companies analysis (looking at trading comparables/multiples)—to triangulate a value range, as all three methodologies individually have their own limitations."[183]

Experts ought to continue to use guideline companies when they deem it appropriate and should be prepared to explain to the Court the basis for their selection of the companies and why they are relevant to a valuation of the subject company. Guideline transactions can be useful in appraisals if and when they can be adjusted for the impact of synergies.

In the past, event studies were often used in other types of security cases but not in appraisals. The current focus on deal prices and historical market prices in arm's-length transactions has necessitated testimony on event studies in appraisal cases where the Court relies on market factors rather than corporate valuations.

Recent cases demonstrate the importance of high-quality expert testimony in valuation litigation. Although each decision is fact-specific, experts should be familiar with past practice in the Court of Chancery and with its interpretation of fair value and operative reality. Experts should be careful to utilize practices that are supported in the academic and valuation communities and should be aware of current developments in the profession.

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[183] *Muoio & Co. v. Hallmark Entertainment Investments Co.*, 2011 Del. Ch. LEXIS 43 (Mar. 9, 2011), *83–*84.