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Fairness Compendium

A Summary of Relevant Court Cases Relating to Fairness Opinions and Issues

2021

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www.houlihancapital.com

Andrew Smith
asmith@houlihancapital.com
312.450.8610

Paul Clark
pclark@houlihancapital.com
312.450.8656

Michael Norton
mnorton@houlihancapital.com
312.450.8628

Monica Blocker
mblocker@houlihancapital.com
312.450.8699

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Glossary[1]

Beta: Measure of the volatility of a security or portfolio, in comparison to the market as a whole.

In re SWS Grp., Inc. (2017)
Dunmire v. Farmers & Merchants Bancorp of West. PA., Inc. (2016)

Business Judgment Rule: Presumption that the corporate directors are acting on an informed basis, in good faith, and in the best interests of the company.

In re Xura, Inc. Stockholder Litigation (December 2018)
In re MeadWestvaco Stockholders Litig. (2017)
Williams v. Ji (2017)
Cement Masons Local 780 Pension Fund v. Schleifer (2017)
Sciabacucchi v. Liberty Broadband Corp (2017)
In re Saba Software, Inc Stockholder Litig. (2017)
In re Tele-communications, Inc. Shareholders Litigation (2003)

Cash Flow: Net amount of cash and cash-equivalents moving in and out of a business.

In re SWS Grp., Inc. (2017)
Laidler v. Hesco Bastion Environmental, Inc. (2014)
Edgewater Growth Capital Partners, L.P. v. H.I.G. Capital, Inc. (2013)

Comparable Companies Analysis: Process used to evaluate the value of a company using the metrics of other businesses of similar size in the same industry.

In re SWS Grp., Inc. (2017)
Merlin Partners v. AutoInfo (2015)
Koehler v. Netspend (2013)

Controlling Stockholder: When a shareholder, or a group acting in kind, holds a majority of a company's stock.

Hsu v ODN Holding Corporation (2017)
In re Merge Healthcare (2017)

Discounted Cash Flow (DCF): Valuation method used to estimate the attractiveness of an investment opportunity.

DFC Global Corp. v. Muirfield Value Partners, L.P. (2017)
ACP Master, Ltd., v. Sprint Corp. (2017)
In re SWS Grp., Inc. (2017)
In re PetSmart, Inc. (2017)
Merion Capital L.P v. Lender Processing Services, Inc. (2016)
In re Dole Food Co., Inc. Stockholder Litig. (2015)

[1] Definitions found on Investopedia.com

Merion Capital v. BMC Software (2015)
Merlin Partners v. AutoInfo (2015)
Koehler v. NetSpend Holdings Inc. (2013)
Laidler v. Hesco Bastion Environmental, Inc. (2014)
Edgewater Growth Capital Partners, L.P. v. H.I.G. Capital, Inc. (2013)
In re El Paso Corp. Shareholders Litigation (2012)
In re Answers Corp. Shareholders Litigation (2012)
In Re JCC Holding Co., Inc. Shareholders Litigation (2003)
Crescent/Mach I Partners v. Turner (2000)

Discount Rate: Interest rate used in DCF analysis to determine the present value of future cash flows.

ACP Master, Ltd., v. Sprint Corp. (2017)
In re SWS Grp., Inc. (2017)
Dunmire v. Farmers & Merchants Bancorp of West. PA., Inc. (2016)

Dropdown Transaction: A corporation sponsors a master limited partnership ("MLP") contributing assets to the MLP, which then issues public securities to maximize the market value of those assets. Over time, an MLP's sponsor sells additional assets to the MLP in transactions known as dropdowns.

Morris v. Spectra Energy Partners (2017)

Duty of Care: Requires directors to make business decisions after taking all available information into account, and then act in a judicious manner that promotes the company's best interests.

In re MeadWestvaco Stockholders Litig. (2017)
In re Saba Software, Inc. S'holder Litig. (2017)
In re New York Stock Exchange/Archipelago Merger Litigation (2005)
Crescent/Mach I Partners v. Turner (2000)

Duty of Loyalty: A director's responsibilities to act at all times in the best interest of the company.

In re Dole Food Co., Inc. Stockholder Litig(2015)
Crescent/Mach I Partners v. Turner (2000)

Entire Fairness: Standard of review that is triggered where a majority of the directors approving a transaction are interested or where a majority stockholder stands on both sides of a transaction.

ACP Master, Ltd., v. Sprint Corp. (2017)
Buttonwood Tree Value Partners, L.P. v. R.L. Polk & Co. (2017)
Williams v. Ji (2017)
Cement Masons Local 780 Pension Fund v. Schleifer(2017)
In re Saba Software, Inc. Stockholder Litig.(2017)

In re Merge Healthcare Inc. (2017)
In re Dole Food Co., Inc. Stockholder Litig. (2015)
In re Morton's Rest. Grp., Inc. S'holders Litig. (2013)
In re Tele-communications, Inc. Shareholders Litigation (2003)
In re Pure Resources, Inc. Shareholders Litigation (2002)
Glassman v. Unocal Corporation (2001)

Fiduciary Duty: Relationship between two parties that obligates one to act solely in the interest of the other.

In re MeadWestvaco Stockholders Litig. (2017)
ACP Master, Ltd., v. Sprint Corp. (2017)
Buttonwood Tree Value Partners, L.P. v. R.L. Polk & Co. (2017)
Williams v. Ji (2017)
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In re Saba Software, Inc. S'holder Litig. (2017)
Hsu v ODN Holding Corporation (2017)
In re Dole Co., Inc. S'Holder Litig. (2015)
In re Answers Corp. S'Holders Litig. (2014)
In re Morton's Restaurant Group, Inc., S'Holder Litig. (2013)
Koehler v. Netspend (2013)
In re El Paso Corp. Shareholders Litigation (2012)

Go-Shop Period: A provision that allows a public company that is being sold to seek out competing offers even after it has already received a firm purchase offer.

Merion Capital L.P v. Lender Processing Services, Inc. (2016)
Merion Capital v. BMC Software (2015)
Koehler v. Netspend (2013)

Going Private: A transaction or series of transactions that convert a publicly traded company into a private entity.

In re PetSmart, Inc. (2017)
Merion Capital v. BMC Software (2015)

Joint Venture: Business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task.

Morris v. Spectra Energy Partners (2017)

Leveraged Buyout ("LBO"): Acquisition of another company using a significant amount of borrowed money to meet the cost of acquisition.

In re PetSmart, Inc. (2017)

Market Check: An investigation usually conducted by an investment banking firm, on behalf of a target's Board of Directors as part of a process to determine whether a proposed price for the target is fair.

DFC Global Corp. v. Muirfield Value Partners, L.P.(2017)
In re Answers S'holders Litig. (2014)
Koehler v. Netspend (2013)
In re El Paso Corp. Shareholders Litigation (2012)
In re Cysive, Inc. Shareholders Litigation (2003)

Master Limited Partnership ("MLP"): Business venture that exists in the form of a publicly traded limited partnership. It combines the tax benefits of a partnership with the liquidity of a public company.

Morris v. Spectra Energy Partners (2017)

No-Shop Clause: An agreement between a seller and a potential buyer that bars the seller from soliciting a purchase proposal from any other party.

Koehler v. Netspend (2013)

Private Placement: The sale of securities to a small number of investors as a way of raising capital.

Williams v. Ji (2017)

Proxy Agreement: Written authorization for one person to legally act on behalf of another person.

In re Xura, Inc. Stockholder Litigation (December 2018)
Sciabacucchi v. Liberty Broadband Corp. (2017)

***Revlon* Rule:** The legal requirement that a company's board make a reasonable effort to obtain the highest value for a company when a hostile takeover is imminent.

In re Saba Software, Inc. S'holder Litig. (2017)
In re Answers S'holders Litig. (2014)
In re Morton's Restaurant Group, Inc., S'Holder Litig. (2013)
Koehler v. Netspend (2013)

Self-Tender Offer: Defense against a hostile bid in which the company undertakes a tender offer for its own shares.

Buttonwood Tree Value Partners, L.P. v. R.L. Polk & Co. (2017)

Standstill Agreement: A contract that stalls or stops the process of a hostile takeover.

Koehler v. Netspend (2013)

Synergies Merger: The concept that the value and performance of two companies combined will be greater than the sum of the separate individual parts.

In re SWS Grp., Inc (2017)
Dunmire v. Farmers & Merchants Bancorp of West. PA., Inc. (2016)
Merion Capital v. BMC Software (2015)

Unjust Enrichment: A person unfairly gets a benefit by chance, mistake, or another's misfortune for which the one enriched has not paid or worked and morally and ethically should not keep.

Hsu v ODN Holding Corporation (2017)

Voting Agreement: Agreement under which two or more shareholders pool their voting shares for a common objective.

Williams v. Ji (2017)
Cement Masons Local 780 Pension Fund v. Schleifer (2017)
Omnicare v. NCS Healthcare (2003)

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Verition Partners Master Fund Ltd. v. Aruba Networks, Inc. (April 2019)

THE SUPREME COURT OF DELAWARE REJECTED THE CHANCERY COURT'S DEPENDENCE ON THE 30-DAY AVERAGE UNAFFECTED STOCK PRICE IN DETERMINING FAIR VALUE AND ENDORSED DEAL-PRICE-MINUS-SYNERGIES AS THE FOUNDATIONAL METHOD IN DETERMINING FAIR VALUE OF ARUBA'S STOCK.

A valuation corresponding to an acquisition determined that the fair value of the shares for Dissenting Shareholders was $19.10 per share based on the deal price minus synergies method. The Chancery Court determined that the fair value of shares was $17.13 per share based on the 30-day average unaffected stock price. The Supreme Court of Delaware vacated this decision and reaffirmed that the deal price in an arm's-length deal in an efficient market is the strongest indicator of the fair value of a company's stock.

Two funds managed by Verition Fund Management ("Verition" or the "Dissenting Shareholders") sought appraisal of the fair value of shares held in Aruba Networks, Inc. ("Aruba" or the "Company") when the Company was acquired by Hewlett-Packard Company ("HP"). [1]

Aruba's business focused on wireless networking, with an emphasis on security and mobile devices. Four years after its IPO on the Nasdaq exchange in 2007, Aruba exceeded $1 billion in revenue and was growing rapidly. In early 2015, HP announced its intent to acquire Aruba for approximately $3 billion in an all-cash deal, or $24.67 per share. The 30-day average unaffected stock price of Aruba was $17.13 per share. Verition Fund Management, an appraisal arbitrage hedge fund, sought statutory appraisal for shares worth more than $56 million (valued at the deal price of $24.67 per share). Verition argued that, using a discounted cash flow analysis, their shares were worth $32.57 per share. Aruba initially valued their stock by subtracting anticipated synergies from the deal price, which came out to $19.10 per share. However, after the Supreme Court ruling in *Dell and DFC,* Aruba changed its methodology and argued that the 30-day average unaffected trading price of the shares was the best evidence of the company's fair value. The Court of Chancery agreed and ruled the fair value of the Aruba shares was $17.13 per share. Verition appealed, and on review, the Supreme Court of Delaware ruled that the deal price minus synergies method was the best evidence to determine the fair value of Aruba's stock and held that the fair value was $19.10 per share.

Deal-Price Minus Synergies

The Chancery Court argued that using the deal-price minus synergies approach fails to account for the additional value created by a merger in reduction of agency costs. It believed that in order to fully capture value realized by the transaction, it would need to account for both synergies and expected agency cost reductions to arrive at Aruba's fair value. The Supreme Court disagreed, stating that there was no basis for concluding that reduced agency costs were not already incorporated in the calculated synergies.

[1] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc. C.A. 11448-VCL*

Use of 30-Day Average Unaffected Share Price

The Chancery Court agreed with Aruba's use of a 30-day average unaffected share price to be the best indication of its fair value. However, the Supreme Court disagreed, stating that although the unaffected stock price in an efficient market is an important indicator that should be given weight, stock price does not invariably reflect the company's fair value in an appraisal. Further, the Chancery Court used a 30-day period prior to the transaction's closing date, which in this case was several months prior due to the time lag between the transaction being announced and closed. The Supreme Court ruled that the stock price used was not reflective of Aruba's developments subsequent to the news of the deal being released. The deal price also reflected that HP had access to material non-public information, which gave it an informational advantage over the market.

The ruling confirmed, like *Dell* and *DFC*, that when an efficient market or an arm's-length deal generates evidence of a company's fair value, that evidence must be given significant weight.

In re Xura, Inc. Stockholder Litigation (December 2018)

THE DELAWARE COURT OF CHANCERY DECLINED TO DISMISS CLAIMS AGAINST XURA, INC.'s CEO FOR HIS ACTIONS IN NEGOTIATING THE SALE OF THE COMPANY. THE COURT REJECTED THE CEO'S CLAIM THAT HE SHOULD BE HELD TO THE DEFERENTIAL BUSINESS JUDGMENT RULE AND NOT THE HIGHER ENTIRE FAIRNESS STANDARD BECAUSE SHAREHOLDERS WERE NOT FULLY INFORMED ABOUT ASPECTS OF THE NEGOTIATIONS WHEN THEY APPROVED THE DEAL.

A valuation corresponding to an acquisition led to litigation against the former CEO of Xura, Inc. for breach of fiduciary duty. The Chancery Court concluded that the deferential business judgment rule did not apply under *Corwin v. KKR Financial Holdings LLC* because shareholders were not fully informed of certain aspects of the negotiations that took place when they approved the transaction. The Court also held that the Plaintiff pled a viable claim that the CEO favored his own interests over those of the shareholders and therefore may be personally liable for a breach of his duty of loyalty.

Obsidian Management LLC ("Obsidian" or the "Plaintiff") sough appraisal of the fair value of shares held in Xura, Inc. ("Xura" or the "Company") when the Company was acquired by an affiliate of Siris Capital Group ("Siris").[2]

During the discovery portion of the petition, Obsidian uncovered evidence that Xura's former CEO, Philippe Tartavull, breached his fiduciary duties to Xura stockholders in the sale process leading up to the merger. Obsidian soon after initiated a petition of breach of fiduciary duty and aiding and abetting action against Tartavull and Siris.

In August 2016, an affiliate of Siris Capital Group, LLC and two co-investors acquired Xura for $25 per share in a transaction that was approved by Xura's shareholders. Despite the board forming a strategic committee to evaluate and negotiate the deal, Xura's CEO oversaw negotiations almost exclusively. The CEO did not keep the Xura board or the company's financial advisor fully informed regarding developments (despite repeated requests from the financial advisor to do so) and defied the board's requested negotiating strategy on at least one occasion. The nondisclosure agreement executed between Xura and Siris required Siris to communicate through the CEO and to obtain his permission before communicating with others, and the board reaffirmed this authorization. Siris did communicate almost exclusively through the CEO, even though Xura's financial advisor made requests to Siris that communications go through the advisor.

The circumstances also suggested that the CEO tipped off one potential bidder regarding Siris' offer for the company, leading the potential bidder not to make its own offer to acquire Xura, but instead to co-invest with Siris. Throughout the process, the CEO faced job uncertainty, with the board considering management changes if there was no deal and major shareholders openly questioning his performance. Siris, however, indicated its willingness to work with existing management (including the CEO). Further, after closing, the CEO negotiated a $25 million long-term incentive, although he never realized on this plan because he was terminated before its

[2] *In re Xura, Inc. Stockholder Litigation C.A.No. 12698-VCS*

implementation. None of the issues surrounding the negotiations process were disclosed to shareholders voting on the transaction.

Shareholder Approval

In 2015 the Delaware Supreme Court case of Corwin v. KKR Financing Holdings held that a transaction that would be subject to enhanced scrutiny under Revlon would instead be reviewed under the deferential business judgment rule after it was approved by a majority of disinterested, fully informed and uncoerced stockholders. In addition to federal securities law requirements imposed on public companies, Delaware law requires disclosure of all material facts when stockholders are requested to vote on a merger. Corwin provides a strong incentive for companies to ensure full disclosure and as discussed below, based on the new case of In re Xura, Inc. Stockholder Litigation the failure to provide such disclosure may nullify the otherwise strong Corwin defense.

Following the Corwin decision, several Delaware courts enhanced the ruling, finding that the business judgment rule becomes irrebuttable if invoked as a result of a stockholder vote; Corwin is not limited to one-step mergers and thus also applies where a majority of shares tender into a two-step transaction; the ability of plaintiffs to pursue a "waste" claim is exceedingly difficult; even interested officers and directors can rely on the business judgement rule following Corwin doctrine stockholder approval; and if directors are protected under Corwin, aiding and abetting claims against their advisors will also be dismissed.

Once the business judgment rule is invoked, a shareholder generally only has a claim for waste, which is a difficult claim to prove. Corwin makes it difficult for plaintiffs to pursue post-closing claims (including those that would have nuisance value) because defendants will frequently be able to dismiss the complaint at the pleading stage based on the stockholder vote. It is thought that Corwin will help reduce M&A-based litigation which has become increasingly abusive over the years and imposes costs on companies, its stockholders and the marketplace.

Corwin should also be considered in conjunction with the Delaware Supreme Court's 2014 decision in Cornerstone Therapeutics Inc. Shareholder Litigation in which the Supreme Court held that directors can seek dismissal even in an entire fairness case unless the plaintiff sufficiently alleges that those directors engaged in non-exculpated conduct (i.e., disloyal conduct or bad faith). Cornerstone generally allows an outside, independent director to be dismissed from litigation challenging an interested transaction unless the plaintiff alleges a breach of the duty of loyalty against that director individually. The Corwin case goes further by providing that if there is an informed stockholder vote, then directors who are interested or lack independence can obtain dismissal without having to defend the fairness of the transaction.

Although following Corwin a string of cases strengthened and expanded its doctrine, the recent (December 2018) case of In re Xura, Inc. Stockholder Litigation reminded the marketplace that in order for Corwin to provide its protections, the stockholder approval must be fully informed. In Xura the court found that the disclosures made by the CEO to the board of directors and shareholders and that ultimately were included in the company's proxy statement were so deficient as to preclude a fully informed, uncoerced decision. The takeaway from Xura is that despite growing officer/director protections in an M&A transaction, process and disclosure remain the bedrock of any defense.

Keywords: Business Judgement Rule, Proxy Agreement

DFC Glob. Corp. v. Muirfield Value Partners L.P., 518, 2016, 2017 WL 3261190 (Del. Aug. 1, 2017)

THE SUPREME COURT OF DELEWARE REVERSED AND REMANDED THE CHANCERY COURT'S DETERMINATION OF THE FAIR VALUE OF DFC STOCK.

Lone Star bought DFC at $9.50 per share and a statutory appraisal followed. The lower court held that the fair value of shares was $10.21 per share. The Supreme Court of Delaware reversed this decision, and directed the Chancery Court to explain why more weight was not given to the deal price in determining the fair value of the shares.

Former stockholders ("Petitioners") of DFC Global Corporation ("DFC" or the "Company") sought appraisal of the fair value of shares they held when DFC was sold to private equity buyer, Lone Star Fund VIII ("Lone Star").

DFC's business focused on payday lending and was traded on the NASDAQ. Prior to the merger, DFC faced regulatory uncertainty in the United Kingdom, United States, as well as Canada. Based on these difficulties, DFC sought a buyer. After negotiations, Lone Star offered to buy DFC at $9.50 per share, and the deal was closed in June of 2014. After considering all relevant factors, the Chancery Court held that the fair value of Petitioners' shares was $10.21 per share. On review, the Supreme Court of Delaware ("Court") reversed and directed the Chancery Court Chancellor, Andre G. Bouchard, to reassess his findings and explain why more weight was not given to the deal price in determining the fair value.

Sale Process

The Chancery Court found the transaction, which involved thirty-five financial sponsors and three strategic bidders, was done at an "arm's-length" and was "robust."[3] Despite the adequate sale process, the Chancery Court declined to give it more than one-third weight in the fair value determination, for two reasons. First, the Chancery Court held that there was regulatory uncertainty facing DFC and "the market's assessment of the company's value was not as reliable as under ordinary conditions."[4] Additionally, this affected management projections, which in turn, affected the discounted cash flow. Next, the Chancery Court ruled that Lone Star "focused its attention on achieving a certain internal rate of return and on reaching a deal within its financing constraints, rather than on [the company's] fair value."[5]

I. This Court rejected the Chancery Court's first argument, holding that it was "not supported by the record."[6] First, this Court noted that DFC's "stock price often moved over the years, and that those movements were affected by the potential that the company's industry…would be subject to tighter regulation."[7] Further, the Chancery Court did not provide any evidence that would have suggested market participants did not examine the Company's fair value without factoring in regulatory actions.

[3] DFC Glob. Corp. v. Muirfield Value Partners L.P., 518, 2016, 2017 WL 3261190, at *1 (Del. Aug. 1, 2017).
[4] *Id.*
[5] *Id.* at 20.
[6] *Id.* at 31.
[7] *Id.* at 1.

Next, this Court found that the collective judgment of the market should have been a relevant factor in considering the fair value. The Court noted that "the market's collective judgment of the effect of regulatory risk may turn out to be wrong, but established corporate finance theories suggest that the collective judgment of the many is more likely to be accurate than any individual's guess."[8] Here, not only did the judgment involve DFC stockholders, but also potential buyers and Company debtholders with self-interest.

II. This Court rejected the Chancery Court's second finding, which concluded that the buyer was focused on a specific internal rate of return, rather than on the fair value of the company. This Court noted that it did "not understand the logic of this finding."[9] The Court opined that "any rational purchaser of a business should have a targeted rate of return that justifies the substantial risks and costs of buying a business."[10] Further, this Court noted that a buyer can focus on achieving a certain rate of return, but that "does not mean that the price it is willing to pay is not a meaningful indication of fair value."[11]

Discount Cash Flow ("DCF") Analysis

On a re-argument motion, the Chancery Court revised its working capital figures in the DCF analysis, due to a previous error. Later, "at the prompting of the petitioners,"[12] the Chancery Court increased the perpetuity growth rate from 3.1% to 4%. The Court noted that the Chancery Court had no basis to substantially alter the growth rate.

DFC's Proposed Rule

DFC advocated for a rule which consisted of "a judicial presumption that the deal price is the best evidence of fair value when the transaction giving rise to appraisal results from an open market check and when certain other conditions pertain."[13] The Court rejected DFC's argument and reaffirmed the Supreme Court's *Golden Telecom's* view, which concluded that, "[r]equiring the Court of Chancery to defer…to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the [appraisal] statute."[14]

[8] *Id.*
[9] *Id.*
[10] *Id.* at 2.
[11] *Id.*
[12] *Id.*
[13] *Id.* at 11.
[14] *Id.* at 13.

In re MeadWestvaco Stockholders Litig. (2017)

THE COURT GRANTED THE DEFENDANTS' MOTION TO DISMISS, HOLDING THAT THE BOARD DID NOT DEMONSTRATE INTENTIONAL DISREGARD TO FIDUCIARY DUTIES.

Stockholders involved in a stock for stock merger filed a claim for breach of fiduciary duty against the board of directors and for aiding and abetting against the corporation. Defendants moved to dismiss and the Court granted. In its decision, the Court noted that the fairness opinion provided to the board supported its approval of the merger.

Stockholders ("Plaintiffs") of MeadWestvaco Corporation ("MeadWest," "Company," or "Defendants") sought damages stemming from a 2015 merger between MeadWest and Rock-Tenn Company ("RockTenn"). Defendants moved to dismiss the claims. The Court granted Defendants' motion to dismiss, holding that Plaintiffs failed to plead facts sufficient to state a reasonably conceivable claim of bad faith.

MeadWest and Rocktenn manufactured packaging and paper supplies. In March 2014, Vertical Research Partners ("Vertical") published an analyst note,[15] which proposed a merger between RockTenn and MeadWest. Vertical stated that RockTenn, which had a pension deficit of $1 billion, could have benefitted from MeadWest's pension surplus of $1 billion. That same month, Starboard Value LP ("Starboard") began purchasing MeadWest stock.

Starboard accumulated 5.65% of MeadWest stock, which made it one of the Company's largest stockholders. In a June 2014 letter to MeadWest, Starboard contended that the Company "was not operating at its full potential and demanded an overhaul of the Company through cost cutting and the sale of its specialty chemicals business."[16] Later, the MeadWest board (the "Board") met with RockTenn to discuss the possibility of a merger. After on-again, off-again negotiations spanning nine months, the companies agreed to merge at $49.14 per share, a 9.1% premium over MeadWest's stock price. On June 24, 2015, MeadWest stockholders approved the merger, and the transaction was finalized on July 1, 2015.

First, Plaintiffs alleged the Board breached its fiduciary duty in connection with the merger, and second, the breach of fiduciary duty was aided and abetted by RockTenn. Defendants moved to dismiss the complaint for failure to state a claim.

Standard of Review

The merger consisted of two publicly-traded companies without any controllers, therefore, the Court held that the business judgment rule applied. Further, because MeadWest had an exculpation provision, which released the Board from any personal liability for a breach of fiduciary duty of

[15] Investment firm discussing a specific security, industry, or news item.
[16] In re MeadWestvaco Stockholders Litig., CV 10617-CB, 2017 WL 3526326, at *2 (Del. Ch. Aug. 17, 2017).

care, Plaintiffs had to allege "that (1) a majority of the Board was not both disinterested and independent or (2) that the [Board] did not act in good faith"[17]

Breach of Fiduciary Duty

To sufficiently allege a bad faith claim, Plaintiffs must have shown "either [1] an extreme set of facts to establish that disinterested directors were intentionally disregarding their duties or [2] that the decision under attack is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[18]

Plaintiffs claimed MeadWest's assets were improperly valued, and MeadWest knowingly approved an undervalued merger, therefore denying shareholders of "at least $3 billion of additional value."[19] The Court rejected Plaintiffs' argument that the merger was approved in bad faith. First, the Court noted that this was a strategic merger "ostensibly of equals,"[20] and the Board negotiated a 9.1% premium for its stockholders. The Court opined that even if the premium was low, "[t]here is no rule that a low premium represents a bad deal, much less bad faith."[21] Second, the Court held that the Board received a fairness opinion for the transaction, and a "board's receipt of a fairness opinion typically supports a factual inference that the board acted properly when deciding to proceed with a transaction."[22] Third, the Court noted that two independent proxy firms recommended the stockholders voted to approve the merger. Stockholders voted 98% in favor of the merger. Finally, the Court held that the deal protections within the merger agreement were not irrational, as Plaintiffs claimed. If the exchange ratio was irrational, "one might think some other buyer would emerge to capture this surplus."[23] Even though the transaction was not finalized for five months, no additional buyers expressed interest.

Aiding and Abetting

To plead an aiding and abetting claim, Plaintiffs must have alleged facts presenting, "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, (3) knowing participation in that breach by the defendants, and (4) damages proximately caused by the breach."[24] Here, Plaintiffs did not adequately state a breach of fiduciary duty claim. Therefore, the aiding and abetting claim failed, as the second element had not been established.

Key Terms: Bad Faith, Business Judgment Rule, Fiduciary Duty.

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[17] In re BJ's Wholesale Club, Inc. Shareholders Litig., CIV.A. 6623-VCN, 2013 WL 396202, at *6 (Del. Ch. Jan. 31, 2013) (citing In re NYMEX S'holder Litig., CIV.A. 3621-VCN, 2009 WL 3206051, at *6 (Del. Ch. Sept. 30, 2009)).
[18] CV 10617-CB, 2017 WL 3526326, at *7 (Del. Ch. Aug. 17, 2017).
[19] *Id.*
[20] *Id.* at 8.
[21] *Id.*
[22] *Id.* at 9.
[23] *Id.*
[24] *Id.* at 10.

ACP Master, Ltd. v. Sprint Corp., Nos. 8508-VCL, 9042-VCL, 2017 Del. Ch. LEXIS 125 (Ch. July 21, 2017)

THE COURT FOUND NO BREACH OF FIDUCIARY DUTY UNDER ENTIRE FAIRNESS REVIEW.

After a merger between Sprint and Clearwire, Petitioners sought appraisal of the fair value of their Clearwire shares. Additionally, Petitioners claimed Sprint and Softbank breached their fiduciary duties in connection with the merger. The Court held that the merger was fair to the stockholders. Additionally, the Court held that the fair value of the stock at the time of the merger was $2.13 per share.

This action arose from a 2013 merger between Clearwire Corporation ("Clearwire" or "Respondent") and Sprint Nextel Corporation ("Sprint"). In 2012, Sprint offered to pay Clearwire $2.97 per share to acquire the 49.8% of equity that it did not already own. A bidding war ensued with DISH Network Corp. ("DISH"), and Sprint raised its offer, later entering into an agreement with Clearwire at $5.00 per share. 70% of non-Sprint stockholders approved the deal in June 2013.

Following the merger, Aurelius Capital Management, L.P., Aurelius Capital Master, Ltd., and Aurelius Opportunities Fund II, LLC., ("Petitioners") sought appraisal of the fair value of their Clearwire shares. Additionally, Petitioners alleged Sprint breached its fiduciary duties in connection with the merger, which Softbank, Corp. ("Softbank") aided and abetted. The Court held that the merger was entirely fair. In the appraisal claim, the Court ruled the fair value to be $2.13 per share.

I. Fairness Evaluation

First, the Court analyzed whether the merger was a product of fair dealing and fair price. Fair dealing "embrace[d] questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[25] Fair price "relate[d] to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect[ed] the intrinsic or inherent value of a company's stock."[26]

The Court held that the Clearwire-Sprint merger was entirely fair to Clearwire stockholders. The Court noted that "Sprint and Softbank engaged in unfair dealing early in the process and when seeking to achieve stockholder approval at $2.97 per share."[27] Unfair dealings included: Sprint threatening the Clearwire stockholders and Sprint allowing an incorrect disclosure in the proxy statement. When stockholders refused to accept the merger at $2.97 per share, the atmosphere was "freshened."[28] After stockholders approved the merger at $5.00 per share, "the relevance, materiality, and effectiveness of Sprint and Softbank's misconduct faded."[29]

[25] ACP Master, Ltd. v. Sprint Corp., Nos. 8508-VCL, 9042-VCL, 2017 Del. Ch. LEXIS 125, at *49 (Ch. July 21, 2017).
[26] *Id.*
[27] *Id.* at 76.
[28] *Id.*
[29] *Id.* at 68.

Aiding and Abetting by Softbank

The Court rejected Petitioners' argument, opining that an "underlying breach of fiduciary duty"[30] was required for an aiding and abetting claim.

II. Appraisal Action

"An appraisal proceeding is a limited legislative remedy intended to provide shareholders dissenting from a merger on grounds of inadequacy of the offering price with a judicial determination of the intrinsic worth (fair value) of their shareholdings."[31] The Court began by evaluating the Parties' Discounted Cash flow ("DCF") analyses. Petitioners' expert contended each Clearwire share had a value of $16.08, while Respondent's expert argued Clearwire was worth $2.13 per share.

DCF Analysis

An accurate DCF analysis depended on accurate projections of future expected cash flows, found in management projections prepared in the ordinary course of business.

a. Management Projections

The Court employed Clearwire's management projections. The Court noted that the projections were made in the ordinary course of business, and the assumptions implemented in the projections "matched Clearwire's operative reality on the date of the Clearwire-Sprint Merger."[32] After Rejecting Petitioners' projections, the Court opined that the projections were not created in the ordinary course of business and were made by Sprint's management in order to "…convince Softbank to top DISH's tender offer by showing what it would look like to attempt the same business plan without owning Clearwire."[33]

b. Perpetuity Growth Rate

Petitioners employed a 4.5% perpetuity growth rate, while Clearwire utilized a perpetuity growth rate of 3.35%. Petitioners' rate was based on their management projections, which the Court earlier rejected for inaccuracy. Clearwire claimed the growth rate it implemented "take[s] account of all possibilities, from Clearwire becoming 'very successful' to it continuing to 'struggle along to stay out of bankruptcy'"[34] The Court adopted Clearwire's rate of 3.35%.

c. Discount Rate

The Court implemented a discount rate of 12.44%, opining that the discount rate had a minimal impact on the DCF valuation.

d. Unused Spectrum

The Parties contended the DCF valuation should add value for Clearwire's unused spectrum.[35] The Parties agreed that Clearwire had 40 MHz of unused spectrum. The Court employed Clearwire's valuation of $1.98 billion. Rejecting Petitioners' argument, the Court noted that the valuation was filled with assumptions and ultimately, was not persuasive.

30 *Id.* at 77.
31 *Id.*
32 *Id.* at 87.
33 *Id.* at 81.
34 *Id.* at 92.
35 Radio spectrum which has never been used or has become free as a result of technical changes.

Buttonwood Tree Value Partners, Ltd. P'ship v. R. L. Polk & Co., No. 9250-VCG, 2017 Del. Ch. LEXIS 126 (Ch. July 24, 2017).

CHANCERY COURT DECLINED TO DISMISS FIDUCIARY DUTY CLAIMS ARISING FROM A SELF-TENDER OFFER.

Defendant moved to dismiss claims for breach of fiduciary duty brought by minority stockholders against directors and members of the Polk family, who controlled Polk. The Court held that it was reasonably conceivable that Polk directors caused Polk to conduct a self-tender offer at a lower price in order to enable the Polk family to maximize proceeds from a future sale of Polk.

Buttonwood Tree Value Partners, L.P. was a stockholder in R.L. Polk and Co, Inc. ("Polk" or the "Company") at all relevant times. Along with former stockholder, Mitchell Partners L.P. (collectively, "Plaintiffs") they filed this action against Polk.

Polk, a privately held company, provided data and marketing solutions to the automotive industry. In 2008, Polk explored the idea of a self-tender offer. The company hired Stout Risius Ross, Inc. ("SRR") to provide a fairness opinion. The self-tender was never completed "due to the serious uncertainties and economic decline of the automotive industry."[36] In 2011, Polk President, Stephen Polk, informed the Polk board that members of management were interested in a self-tender offer. Once again, the Company retained SRR to provide a fairness opinion. SRR informed the Company that the proposed self-tender offer price of $810 per share was fair from a financial point of view. In March 2011, the Company offered to purchase up to 37,037 shares of outstanding common stock. In the offer to purchase ("Offer to Purchase"), the Company noted that, "[e]xcept as described in this document, we currently have no plans, proposals or negations that relate to or would result in: an extraordinary transaction, such as a merger, reorganization."[37]

In October 2012, fifteen months after the self-tender offer expired, the Company hired investment bank, Evercore Partners, to analyze strategic alternatives for the Company. This led to a short form merger with IHS, Inc. for $2,675 per share. To facilitate the merger, Company counsel at Honigman formed Holding Co., where Stephen Polk served as the sole director and officer.

Plaintiffs filed claims against multiple parties associated with the Company. Count I alleged directors of the Company ("Individual Defendants") and the family of the founder of the Company ("Polk Family") breached their fiduciary duties of care and loyalty, acted for their own personal benefit, and failed to disclose material facts regarding the 2011 self-tender offer. Counts II and III were dismissed in oral arguments. Count IV alleged SRR aided and abetted Stephen Polk and Holding Co., as well as Individual Defendants', stemming from the 2011 self-tender offer, and allegedly supplied misleading disclosures in the Offer to Purchase. Count V claimed Honigman aided and abetted Individual Defendants' breach of fiduciary duty, and aided and abetted in connection with the alleged misleading disclosures found in the Offer to Purchase. Defendants moved to dismiss the claims. The Court denied in part and granted in part.

[36] Buttonwood Tree Value Partners, Ltd. P'ship v. R. L. Polk & Co., No. 9250-VCG, 2017 Del. Ch. LEXIS 126, at *7 (Ch. July 24, 2017).
[37] *Id.* at 11.

Count I: Polk Family

"Where a transaction involving self-dealing by a controlling stockholder is challenged, the applicable standard of judicial review is entire fairness."[38] Here, Plaintiffs contended the self-tender offer was initiated out of self-dealing, specifically alleging the transaction was "part of an overall scheme to later sell the Company for three times the Self-Tender valuation."[39] The Court held that the entire fairness standard applied, noting that it was reasonably conceivable the Polk Family acted as a controlling stockholder. The Court opined that Stephen Polk "referred to the Polk Family as a controlling block when he told the Board 'the Polk family was no longer interested in pursuing a short-form merger as a way to restructure the Company.'"[40] Additionally, the Court opined that the Polk Family helped SRR set a price for the self-tender offer. SRR also worked for the Polk Family, individually. These contentions adequately alleged the self-tender offer was not entirely fair.

Count II: Individual Directors

Next, Plaintiffs claimed Individual Directors "knowing and intentionally disregarded their fiduciary duties in bad faith to further the Polk family's fraudulent scheme."[41] The Court held that Plaintiffs did not adequately allege Individual Directors acted in bad faith. Plaintiffs argued Individual Directors failed to disclose facts leading up to the self-tender offer, including facts that concerned SRR's involvement. The Court noted that Plaintiffs failed "to adequately allege bad faith…absent non-conclusory allegations that the [Individual Directors] had this knowledge."[42] Additionally, the Court opined that Plaintiffs did not proffer any evidence to suggest Individual Defendants had any knowledge of the alleged fraudulent schemes.

Counts IV and V: Aiding and Abetting against Honigman and SRR

To sufficiently allege an aiding and abetting claim. "Plaintiffs must allege facts demonstrating a fiduciary relationship, a breach of the fiduciary's duty, knowing participation in that breach by the defendants, and damages proximately caused by the breach."[43] The Court held it was not reasonably conceivable Honigman assisted in any fiduciary duty breach. The Court opined that Plaintiffs' claims did not "support scienter and knowing participation in the breach."[44]

Plaintiff contended SRR was required to disclose the past financial dealings it had with Polk. The Court rejected this argument, noting that "[d]isclosure of the fact that SRR had worked on a valuation of the Company prior to rendering its fairness opinion on the Self-Tender is, frankly, not clearly material to stockholders considering a tender."[45]

Key Terms: Entire Fairness, Self-Tender Offer, Aiding and Abetting, Self-Dealing, Bad Faith.

[38] *Id.* at 16.
[39] *Id.*
[40] *Id.* at 17.
[41] *Id.* at 20.
[42] *Id.* at 24.
[43] *Id.* at 25.
[44] *Id.* at 27.
[45] *Id.* at 29.

Williams v. Ji, No. CV 12729-VCMR, 2017 WL 2799156 (Del. Ch. June 28, 2017)

CHANCERY COURT DENIED MOTION TO DISMISS BREACH OF FIDUCIARY DUTY CLAIMS INVOLVING OPTION GRANTS TO DIRECTORS.

This action arose from an alleged scheme where directors ("Defendants") of Sorrento Therapeutics, Inc. ("Sorrento") granted themselves warrants and options ("Grants") for the stocks of five subsidiaries where Sorrento had voting control. Stockholder ("Plaintiff") claimed the Grants breached Defendants' fiduciary duty owed to stockholders. Additionally, Plaintiff alleged that a voting agreement between Sorrento and Yuhan Corporation ("Yuhan") constituted illegal buying. The Court denied Defendants' motion to dismiss, holding that Plaintiff had alleged a reasonably conceivable case.

1. Warrants and Options Grants

Five days before nominations were due for Sorrento directorships, Sorrento distributed its 2015 form 10-k, where it was disclosed that Sorrento subsidiaries had granted stock options and warrants to Sorrento directors. The Grants were not approved by the stockholders. Additionally, the Sorrento directors modified the certificates of incorporation of five subsidiaries, which allowed the issuance of Class B stock with 10 to 1 voting rights. These modifications were not approved by the stockholders. The five Sorrento subsidiaries are discussed below.

a. Scintilla

In October 2015, Scintilla issued options to purchase 1,600,000 shares of Scintilla common stock to the Sorrento directors. In addition, Scintilla granted Sorrento director, Henry Ji ("Ji"), a warrant to purchase 9,500,000 shares of Scintilla Class B stock with 10 to 1 voting rights, at an exercise price of $0.01.

b. Biologics

In August 2015, Sorrento agreed to an exclusive license with Mabtech Limited to produce and sell antibodies in three major markets. In October 2015, Sorrento transferred the exclusive license to its subsidiary, Biologics. In the same month, Biologics granted Sorrento directors 2,000,000 shares of Biologics common stock at $0.01 per share, and granted Ji a warrant to purchase 9,500,000 Class B shares with 10 to 1 voting rights, exercisable at $0.01 per share.

c. LA Cell

In May 2015, LA Cell granted Sorrento directors options to purchase 1,700,000 shares of LA Cell common stock, and issued Ji a warrant to purchase 9,500,000 shares of Class B stock with 10 to 1 voting rights. Both had an exercise price of $0.01 per share. In September 2015, LA Cell entered into a licensing agreement to research disease-causing molecules. Sorrento announced the deal could have been in excess of $170 million.

d. Concortis

In October 2015, Concortis granted options to Sorrento directors to purchase 1,600,000 shares of common stock. Additionally, Concortis granted Ji a warrant to purchase 9,500,000 shares of Concortis Class B stock with 10 to 1 voting rights. The Grants had an exercise price of $0.25 per share.

e. TNK Therapeutics

In May 2015, TNK granted directors of Sorrento options to purchase 1,700,000 shares of common stock. Additionally, TNK issued Ji a warrant to purchase 9,500,000 shares of TNK Class B stock, with 10 to 1 voting rights. Both had an exercise price of $0.01 per share.

2. Voting Agreement

In 2016, Sorrento entered into private placements[46] with four investors to raise $150 million in exchange for 45% of Sorrento's common stock ("Private Placements"). The Private Placements closed prior to the annual stockholder meeting, allegedly so the Private Placement investors could vote in support of Sorento's incumbent board. Yuhan, one of the Private Placement investors, signed the Yuhan Voting Agreement before the closing of the Private Placements. Per the agreement, Yuhan was required to vote as directed by the Sorrento board. Yuhan owned 2.75% of Sorrento common shares.

a. Plaintiff's Challenge to the Grants Stated a Claim for Relief

Defendants argued that the business judgment rule applied to executive compensation decisions, and alternatively, even if the entire fairness standard applied, Plaintiff had not adequately pled that the Grants were unfair.

To prove entire fairness, Defendants had to demonstrate fair dealing and fair price. Fair dealing addressed "questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[47] The fair price element examined "the economic and financial considerations"[48] of the transactions. In a claim for excessive compensation where Plaintiff had sufficiently pled that the board lacked independence, "plaintiffs need only allege some specific facts suggesting unfairness in the transaction in order to shift the burden of proof to defendants to show that the transaction was entirely fair."[49]

The Court held that Plaintiff's complaint adequately alleged both unfair dealing and unfair price for the Grants. As to unfair dealing, the Court recognized that "[t]he grants were also timed soon before or after Sorrento transferred valuable assets or opportunities to the subsidiaries,"[50] which in part, gave rise to a reasonably conceivable inference of unfair dealing. As to the unfair price, Plaintiff alleged that Defendant Ji was granted the right to acquire 25% of the voting power at LA

[46] The sale of securities as a way to raise capital.
[47] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).
[48] *Id.*
[49] *Williams v. Ji*, No. CV 12729-VCMR, 2017 WL 2799156, at *5 (Del. Ch. June 28, 2017).
[50] *Id.*

Cell, and if taken as true, was "large enough to sufficiently plead that the Grants were excessive."[51] At this stage, Defendants failed to demonstrate the Grants were entirely fair to Sorrento and the stockholders.

b. Plaintiff's Challenge to the Yuhan Voting Agreement Stated a Claim for Relief.

Defendants set forth two arguments. First, Defendants asserted that the Yuhan Voting Agreement was made to prohibit Yuhan from obtaining a competitive advantage by voting against Sorrento's interests. Second, Defendants contended that the 2.75% of Sorrento stock that was subject to the Yuhan Voting Agreement could not have been considered material to the control of Sorrento. In opposition, Plaintiff alleged that the Yuhan Voting Agreement was approved in order to disenfranchise stockholders. At this stage, the Court read all reasonable inferences in Plaintiff's favor and because the complaint adequately alleged disenfranchisement, the burden of proof shifted to Defendants. Defendants failed to prove that the agreement was fair and not designed to deprive Sorrento stockholders of their vote.

Key Terms: Entire fairness, warrants and options, private placements, voting agreement

[51] *Id.* at 6.

Cement Masons Local 780 Pension Fund v. Schleifer, No. 654453/2015, 2017 WL 2855101 (N.Y. Sup. Ct. June 28, 2017)

THE COURT HELD THAT THE ENTIRE FAIRNESS STANDARD APPLIED AND THE DEFENDANTS HAD TO PROVE THAT EXCESSIVE COMPENSATION WAS FAIR TO THE STOCKHOLDERS.

Stockholder, Cement Masons Local 780 Pension Fund ("Plaintiff") alleged a breach of fiduciary duty by the Board of Directors ("Defendants") during their term on the Board of Regeneron Pharmaceuticals, Inc. ("Regeneron"). Defendants moved to dismiss the claims. The Court granted in part and denied in part.

Plaintiff contended that despite declining financial results, Defendants awarded themselves excessively high compensation packages. Plaintiff referred to Regeneron's 2014 proxy statement, where it was documented that one of the defendants, Leonard Schleifer, was the thirteenth highest paid CEO in the United States. The average CEO in a peer company made $14,798,281 compared to Schleifer's $36,272,665.

In 2014, Regeneron introduced a new compensation plan ("2014 Plan"). According to Regeneron's proxy statement. The 2014 Plan provided the compensation committee "*sole and absolute discretion* to grant themselves and other non-employee directors any amount of Nonqualified stock options in addition to the automatic awards (stock options)."[52] After due diligence, proxy advisors notified shareholders to vote against the 2014 Plan. The voting finished 65,053,023 "for" and 40,855,936 "against" the 2014 Plan.

Moreover, Defendants controlled voting rights to an additional 20,018,090 shares held by non-party shareholders: Sanofi, Sanofi-Aventis US, LLC, Aventis Pharmaceuticals, Inc., and Sanofi-Amérique Du Nord (collectively "Sanofi"). Pursuant to a voting agreement between Regeneron and Sanofi ("Sanofi Agreement"), Sanofi was required to vote in support of the board because Regeneron's 2014 Plan was consistent with its "historical equity compensation practices."[53] Plaintiff contended that the Sanofi shares were voted on by interested shareholders and therefore, should have been subtracted from the "for" category of votes.

Defendants argued that the business judgment rule was conclusive on the compensation issues, opining that Plaintiff had not alleged fraud when Defendants set up the 2014 Plan. Defendants further claimed that excessive compensation claims should have been dismissed, as Plaintiff did not present any facts that alleged waste. Finally, Defendants pointed out that Plaintiff's claims should have been dismissed because Regeneron shareholders approved the 2014 Plan.

Business Judgment Rule and Stock Option Grants

Defendants contended that Plaintiff's claims should have been dismissed under BCL § 505(h), where it stated, "[i]n the absence of fraud in the transaction, the judgment of the board shall be conclusive as to the adequacy of the consideration, tangible or intangible, received or to be received by the corporation for the issue of rights or options for the purchase for the corporation

[52] Cement Masons Local 780 Pension Fund v. Schleifer, No. 654453/2015, 2017 WL 2855101, at *8 (N.Y. Sup. Ct. June 28, 2017).
[53] *Id.*

of its shares."[54] The Court dismissed the argument, holding that in a self-interested transaction, the business judgment rule may not be used as protection against board decisions.[55]

Shareholder Ratification

Defendants argued that the stockholder approval of the 2014 Plan protected them from judicial scrutiny. In support, they cited to BCL § 713(a)(2), which states, "[n]o contract or other transaction between a corporation and one or more of its directors, or between a corporation and any other corporation, firm, association or other entity in which one or more of its directors are directors or officers, or have a substantial financial interest, shall be either void or voidable for this reason alone"[56] The Court held that BCL § 713(a)(2) did not protect interested shareholders from judicial scrutiny noting that "even if the stockholders approve the stock incentive plan, [Defendants] cannot shield themselves with the business judgment rule where the plan lacks sufficient definition."[57] Thus, the Court held that the entire fairness standard applied.[58]

Excessive Compensation Claims

Defendants argued that all claims should have been dismissed under BCL § 713(e), which stated, "[u]nless otherwise provided in the certificate of incorporation or the by-laws, the board shall have authority to fix the compensation of directors for services in any capacity."[59] In support of this argument, Defendants referenced *Marx v. Akers*, which held that "a complaint challenging excessiveness of director compensation must—to survive a dismissal motion—allege compensation rates excessive on their face or other facts which call into question whether the compensation was fair to the corporation when approved, the good faith of the directors setting those rates, or that the decision to set the compensation could not have been a product of valid business judgment."[60] The Court rejected Defendants' argument explaining that in a situation where directors approve their own compensation, the directors must demonstrate that the transaction was fair to the corporation.[61]

Breach of Fiduciary Duty

In New York, to state a claim for breach of fiduciary duty, one must allege: "(1) the existence of a fiduciary relationship, (2) misconduct by the defendant, and (3) damages."[62] The Court held that Plaintiff had adequately pled a set of conceivable facts. The Court cited to *Matter of Kenneth Cole Prods., Inc., S'holder Litig.*, where the Delaware Supreme Court explained, "a complaint is sufficient to state a cause of action for breach of fiduciary duty—and the plaintiff may proceed to discovery—if it alleges 'a reasonably conceivable set of facts' showing that any of the six-enumerated shareholder-protective conditions did not exist."[63] Here, the Court held that Plaintiff adequately pled conceivable facts that the approving shareholder was not disinterested; thus, the Court denied Defendants' motion to dismiss.

[54] *Id.* at 6.
[55] *Id.*
[56] *Id.* at 7
[57] Seinfeld v. Slager, No. CIV.A 6462-VCG, 2012 WL 2501105, at *12 (Del. Ch. June 29, 2012).
[58] No. 654453/2015, 2017 WL 28855101, at *3 (NY. Sup. Ct. June 28, 2017).
[59] *Id.* at 8.
[60] 88 N.Y.2d 189, 203, 666 N.E.2d (1996).
[61] *Id.* at 204 n. 6.
[62] Burry v. Madison Park Owner LLC, 84 A.D.3d 699, 700 (2011).
[63] 27 N.Y.3d 268, 278 (2016).

Morris v. Spectra Energy Partners (De) GP, LP, No. CV 12110-VCG, 2017 WL 2774559 (Del. Ch. June 27, 2017).

THE COURT DENIED MOTION TO DISMISS CLAIMS ALLEGING THAT SEP GP BREACHED ITS CONTRACTUAL DUTY OF GOOD FAITH.

The Court found that the limited partner adequately pled that the general partner in a master limited partnership breached its contractual duty to act in good faith in connection with a conflicted transaction between the partnership and the general partner's parent.

Paul Morris ("Plaintiff") owned common units of Spectra Energy Partners, LP ("SEP") and brought this derivative action on behalf of nominal defendant SEP. SEP was an energy transportation company and was formed by Spectra Energy Corp ("SEP Corp") as a Master Limited Partnership ("MLP"). SEP was managed by Spectra Energy Partners GP ("SEP GP") and the board of directors of Spectra Energy Partners GP LLC ("SEP GP LLC"). For simplicity, SEP GP and SEP GP LLC were referred to as "SEP GP."

The Challenged Transaction

Plaintiff alleged bad faith with regard to a reverse dropdown transaction ("Transaction") between SE Corp and SEP. In a reverse dropdown transaction, an MLP may sell assets back to the general partner or related entity.

DCP Midstream LLC ("DCP") was an energy company that had two oil pipeline companies, DCP Sand Hills and DCP Southern Hills. In the 50-50 joint venture, SE Corp and Phillips 66 contributed assets to DCP in order to "address DCP's financial needs 'amid a downturn in the energy sector.'"[64] In September 2015, SE Corp announced it would contribute $1.5 billion in assets to DCP.

To fund the DCP joint venture, SE Corp sent SEP GP a letter proposing a transaction in which SEP would transfer its interests in Sand Hills and Southern Hills to SE Corp in exchange for "(i) returning $20 million SEP limited partnership units to SEP for redemption"[65] and "(ii) waiving its right to receive up to $4 million in incentive distribution rights per quarter for twelve quarters."[66] SEP GP formed a conflicts committee, where they received a fairness opinion, as well as a legal opinion regarding the Transaction. In October 2015, the SEP GP board approved the Transaction based on the committee's findings and recommendations. Defendants' motion to dismiss was granted in part and denied in part.

The Complaint Rebutted the Presumption of Good Faith

Plaintiff claimed the conflicts committee (i) was constrained by the net cash neutral mandate[67] in the written consent, which was written when the conflicts committee was established, and (ii)

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[64] Morris v. Spectra Energy Partners (De) GP, LP, No. CV 12110-VCG, 2017 WL 2774559, at *3 (Del. Ch. June 27, 2017).
[65] *Id.*
[66] *Id.*
[67] An even amount of money coming in and going out.

relied on a flawed fairness opinion, which used an erroneous valuation range, in approving an unfair transaction to rebut the presumption in state a breach of the Limited Partnership Act ("LPA") claim.[68] Section 7.9(b) of the LPA defined good faith, observing that the person (SEP GP board) acting "must believe that the determination or other action is in the best interests of the Partnership."[69] In order to survive the motion to dismiss, Plaintiff must have pled facts to support an inference that the Transaction was not in the best interest of SEP. The Court rejected Plaintiff's first argument, noting that the mandate did not limit the conflict committee's decision-making process, but rather, the mandate lent deference to the committee in making the best decision for SEP.[70] Further, the Court opined that it would have been "unreasonable to infer subjective bad faith based on the descriptive recital, where the operative portion of the agreement grants appropriate authority."[71]

Plaintiff set forth the following characterizations to support an inference of bad faith.

- Simmons, the financial advisor, flip-flopped in including a "Reduced GP Cash Flow" as an element of consideration in its presentation to the conflicts committee. Plaintiff viewed "the potential to avoid future payments to the General Partner as simply a mathematical consequence of 'transferring [productive] assets out of SEP and to SE Corp.'"[72] Additionally, Plaintiff argued that by including the Reduced GP Cash Flow, it impacted the distribution rights of SEP GP.
- Both Simmons, and the Conflicts Committee knew that "that SE Corp would immediately flip the Sand Hills and Southern Hills Assets to DCP in a transaction that undisputedly valued those assets at $1.5 billion," but for purposes of the fairness opinion, "Simmons used a valuation range of only $950 million to $1.15 billion for the Sand Hills and Southern Hills Assets; and"[73]
- Simmons calculated the value of Total LP Consideration flowing to SEP in the Transaction at just $946 million, consisting of $904 million for Redemption of LP Units and $42 million for the IDR Give–Back" excluding the "Reduced GP Cash Flow" as an actual element of consideration.[74]

The Court ruled that it could be conceivable that SEP GP acted in bad faith in approving a self-dealing transaction where SEP GP seized an SEP asset, which it knew was worth $1.5 billion, in return for a payment of less than $1 billion.[75]

[68] *Id.* at 8.
[69] *Id.* at 4.
[70] *Id.* at 15.
[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] *Id.* at 16.

Sciabacucchi v. Liberty Broadband Corp., No. CV 11418-VCG, 2017 WL 2352152 (Del. Ch. May 31, 2017).

STOCKHOLDER VOTE APPROVING ISSUANCES AND GRANT OF VOTING PROXY RULED STRUCTURALLY COERCED.

After stockholders approved both stock issuances and the grant of a voting proxy to the company's largest stockholder, Plaintiff alleged breach of fiduciary duties on the part of Liberty and Charter directors. The Court held that the vote was structurally coerced and was insufficient to cleanse the board and invoke the business judgment rule.

Directors of Charter Communications, Inc. ("Charter"), helped structure an acquisition of two entities, Bright House Networks, LLC ("Bright House") and Time Warner Cable ("TWC"). After review, the stockholders approved two proposals. The first was the acquisition of Bright House and TWC. The second was a purchase of $700 million worth of Charter shares by Liberty Broadband Corporation ("Liberty") and an agreement which increased Liberty's voting power in Charter by 6%.

Charter stockholder ("Plaintiff") alleged breaches of fiduciary duties by Liberty and Charter directors and officers when Liberty agreed to a $700 million purchase of Charter shares ("Issuances") and an agreement which granted Liberty a proxy that increased Liberty's voting Power in Charter by 6%. ("Proxy Agreement") (collectively with Issuances, the "Transaction"). The Court held that Plaintiff's Complaint supported a reasonable inference that the stockholder vote approving the Transaction, was structurally coercive. The Court reserved its judgment on the motions to dismiss, allowing time for the Parties to submit a supplemental brief addressing the matters.

Analysis

Defendants argued that, under the *Corwin v. KKR Financial Holdings LLC* doctrine, the Transaction had been cleansed by a ratifying vote of a majority of disinterested Charter shareholders.[76] Under *Corwin*, the business judgment rule applied, if (i) the vote was fully informed and (ii) uncoerced.[77] The Court first addressed whether the Issuances and Proxy Agreement were coercive.

The Court concluded that the Transaction was not inherently coercive. The Court noted that Liberty was not a controlling stockholder, which was a required element of inherent coercion. Next, the Court evaluated whether the stockholder vote was structurally coerced.

The Stockholder Vote was Structurally Coerced

Even where the Court found no inherent coercion, a stockholder vote could be deemed structurally coerced. Beginning its analysis, the Court defined structural coercion as a vote that "was structured

[76] 125 A.3d 304, 309 (Del. 2015).
[77] *Id.*

in such a way that the vote may reasonably be seen as driven by matters extraneous to the merits of the transaction, the Court cannot determine that the stockholders demonstrated thereby a determination that the challenged transaction was in the corporate interest."[78] The Court held that the Transaction was structurally coercive. The Court evaluated whether the vote provided stockholders "free choice between maintain their current status and taking advantage of the new status offered by the transaction."[79] The Court opined that stockholders were not offered a free choice because Charter disclosed that in order to receive benefits from the Bright House and TWC acquisitions, the stockholders had to approve.[80]

The Court noted that the record was bereft of any explanations as to why the Issuances and Proxy Agreement were necessary for the acquisitions. Additionally, the fairness opinions offered to the Board did not address the fairness of the Proxy Agreement and failed to analyze the fairness of the Issuances. Further, nothing in the pleadings suggested that the Issuances were the only method available to finance the acquisition. Finally, the Court opined that because the Transaction was structurally coercive, the breaches of fiduciary duties alleged by Plaintiff were not cleansed.

Key Terms: Business judgment rule, cleanse, acquisition, fiduciary duties, proxy agreement, disinterested shareholder.

[78] Sciabacucchi v. Liberty Broadband Corp., No. CV 11418-VCG, 2017 WL 2352152, at *20 (Del. Ch. May 31, 2017).
[79] *Id.* at 21.
[80] *Id.*

In re SWS Grp., Inc., No. CV 10554-VCG, 2017 WL 2334852 (Del. Ch. May 30, 2017)

THE COURT DETERMINED THE FAIR VALUE TO BE $6.38 PER SHARE, MOSTLY DUE TO THE SYNERGIES DRIVEN TRANSACTION.

After a merger between SWS and Hilltop, stockholders brought a statutory appraisal claim to this Court. After a Court-calculated value of SWS was done, the company's value was ruled to be $6.38 per share, a reduction from the $6.92 which was paid at the merger closing date.

SWS was a bank holding company with two business segments: traditional banking and brokerage services. In 2011, SWS entered into a credit agreement with another bank holding company, Hilltop, and Oak Hill Capital ("Oak Hill"). Oak Hill and Hilltop made a $100 million senior unsecured loan to SWS. The agreement provided that SWS would issue a warrant to purchase 8,695,652 shares of SWS common stock to Oak Hill and Hilltop, exercisable at $5.75 per share. SWS continued to struggle after the loan. On March 31, 2014, Hilltop and SWS agreed to merge and it was finalized on January 1, 2015. After the agreement was reached, Oak Hill exercised the majority of its warrants, eliminating $87.5 million in SWS debt. This action arose from Petitioners' statutory right to receive a judicial determination of the fair value of their shares of SWS. Stockholders ("Petitioners") sought statutory appraisal of the fair value of their shares. The Court determined the fair value of the shares to be $6.38, less than the merger price of $6.92 per SWS share. The Court noted this was not a surprising outcome considering this was a synergies driven transaction. This decision may be part of a trend to curb the use of appraisal rights.

After the Court rejected Petitioner's comparable companies analysis, finding that SWS had a unique structure, size, and business model and that it had few peers, Petitioners and Respondent set forth dueling Discounted Cash Flow ("DCF") analyses to determine the fair value of shares.

Appropriate Cash Flow Projections

As a starting point to the DCF analysis, the Court considered whether the Petitioners' or Respondent's management projections applied. Respondent used a standard three-year projection, 2014-2017. Petitioners set forth an extension, which included a projection for 2018 and 2019, claiming it was necessary to normalize SWS's financial performance.[81] The Court declined to use the extension, noting that there were a number of assumptions necessary in order for the extension to be factually supported.[82]

Petitioners also argued that the warrants exercised by Oak Hill should be included in the valuation, as it was part of SWS's operative reality. The Court agreed and noted that it was undisputed that the warrants exercised were known well in advance of the merger and part of the capital structure.

Finally, Petitioners argued that excess capital must be valued separately as a matter of law and accounted for in a valuation. The Court did not include this in valuation because the warrants cancelled $87.5 million in SWS debt, and this did not create excess capital in the sense of excess

[81] In re SWS Grp., Inc., No. CV 10554-VCG, 2017 WL 2334852, at *12 (Del. Ch. May 30, 2017).
[82] *Id.*

cash or marketable securities. The Court deferred to Respondent's management projections for the appropriate cash flow projections.[83]

Terminal Growth Rate

The Court favored Respondent's use of a 3.35% terminal growth rate, derived from the midpoint of the long term-expected inflation rate of 2.3% and the long-term expected economic growth rate of the economy at large of 4.4%.[84] The Court noted Respondent's rate was set without major adjustments to the cash flow, unlike Petitioners' assessment.

Proper Discount Rate

Both parties relied on the Capital Asset Pricing Model to calculate the cost of equity. Three inputs are proper to determine this: equity risk premium ("ERP"); equity beta; and size premium. The Court employed Petitioners' ERP valuation of 6.21%, a default method in this Court.[85] Respondent presented no facts which would've warranted the Court to deviate from this default. The equity beta was determined to be 1.10, the Court's reason being, Petitioners' surveyed multiple betas and used a blended median.[86] The size premium was determined to be 3.46%, the midpoint of Petitioners' and Respondent's valuations. The Court observed that SWS was a public company, which made it generally susceptible to Respondent's market capitalization approach. However, it had a substantial amount of warrants and significant influence by certain major creditors, making it in some ways more analogous to a private company.[87]

Key Terms: DCF Analysis, Valuation, Cash Flow Projection, Beta, Discount Rate.

[83] *Id.*
[84] *Id.* at 16.
[85] *Id.* at 16.
[86] *Id.* at 17.
[87] *Id.* at 18.

In re PetSmart, Inc., No. CV 10782-VCS, 2017 WL 2303599 (Del. Ch. May 26, 2017)

THE DEAL PRICE WAS THE BEST INDICATOR OF THE FAIR VALUE OF PETSMART'S SHARES.

PetSmart entered into a going-private transaction and cashed out at $83 per share. Stockholders invoked their statutory appraisal rights and the Court held that the deal price was the best indicator of the fair value of PetSmart's shares. The Court declined to adopt Petitioners' discounted cash flow analyses.

This action arose from stockholders' ("Petitioners") right to receive a determination of the fair value of their shares of PetSmart, Inc., ("Respondent" or "PetSmart"). Beginning in 2012, PetSmart's sales began to display a downward trend. After a change in management, PetSmart's board began to explore strategic alternatives including: (1) engaging in leveraged recapitalization, (2) selling PetSmart to a financial buyer; and (3) merging with Petco.

After evaluating multiple alternatives, PetSmart announced it would open to an auction process. In October 2014, Respondent received five preliminary bids. The PetSmart board met to discuss the bids, as well as any other strategic alternatives still available. During the final bidding process, JP Morgan made several presentations to the board and concluded that BC Partners, Inc., ("BC Partners") bid of $83 per share was fair from a financial point of view. Respondent accepted BC Partners offer to merge, and the deal was finalized on March 11, 2015. After considering multiple factors, the Court held that the deal price was the best indicator of the fair value of Petitioners' shares.

The Court analyzed three issues: "(1) was the transactional process leading to the merger fair, well-functioning and free of structural impediments to achieving fair value for PetSmart; (2) are the requisite foundations for the proper performance of a DCF analysis sufficiently reliable to produce a trustworthy indicator of fair value; and (3) is there an evidentiary basis in the trial record for the Court to depart from the two proffered methodologies for determining fair value by constructing its own valuation structure?"[88]

Did the PetSmart Auction Achieve Fair Value?

The Court noted that, even though the process used by Respondent to facilitate a sale was not perfect it, "came close enough to perfection to produce a reliable indicator of PetSmart's fair value.[89] The Court relied on the bidding process where Respondent, "announced to the world that it was pursuing strategic alternatives including a sale, so the whole universe of potential bidders were put on notice."[90] Respondent and its financial advisor, JP Morgan, entertained 27 potential bidders, which was later narrowed to five, three of which submitted bids. After the bids were submitted, Respondent "carefully considered its strategic options with the assistance of its financial and legal advisors. Only after Respondent analyzed all of its options did the Board

[88] In re PetSmart, Inc., No. CV 10782-VCS, 2017 WL 2303599, at *26 (Del. Ch. May 26, 2017).
[89] *Id.* at 27.
[90] *Id.* at 28.

conclude that accepting the $83 per share offer provided the best opportunity to maximize value for PetSmart stockholders."[91]

Petitioners' contended that a reliance on a leveraged buyout ("LBO") model, did not accurately indicate fair value because it was "built to allow the funds to realize a certain internal rate of return that will always leave some portion of the company's going concern value unrealized."[92] The Court rejected this argument, opining that, "while it is true that private equity firms construct their bids with desired returns in mind, it does not follow that a private equity firm's final offer at the end of a robust and competitive auction cannot ultimately be the best indicator of fair value for the company."[93]

Can a DCF Analysis that Relied on Projections Produce a Reliable Indicator of Fair Value?

Where unreliable management projections existed, this Court has looked to other projections as a basis for a DCF analysis. The projections "must be contemporaneous, meaning they must reflect the operative reality of the company at the time of the merger."[94] The Court ruled that Respondent's DCF relied on a variety of assumptions. Most notably: (1) PetSmart had not created five-year projections in its normal course of business; (2) management did not believe the projections were accurate representations of PetSmart's future performance; and (3) the projections created were used to facilitate PetSmart's pursuit of strategic alternatives and the data used was considered "aggressive and extra-optimistic about the future of the Company."[95]

Was There Any Evidence to Employ an Alternative DCF Analysis?

The Court considered any additional projections which would aid the Court in arriving at a more reliable DCF analysis. The Court held that no basis existed for altering the Parties' DCF models. The data implemented was not perfect, but the Court considered it reliable enough for a DCF analysis.

Key Terms: DCF analysis, leveraged buyout, appraisal action, going private, management projections, strategic alternatives.

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[91] *Id*.
[92] *Id.*
[93] *Id.* at 29.
[94] *Id.* at 36.
[95] *Id.* at 34.

In re Saba Software, Inc. Stockholder Litig., No. CV 10697-VCS, 2017 WL 1201108 (Del. Ch. Mar. 31, 2017)

THE COURT HELD THAT THE PLAINTIFF PLED SUFFICIENT FACTS ALLEGING THAT A STOCKHOLDER VOTE APPROVING A MERGER WAS NEITHER FULLY INFORMED NOR UNCOERCED.

In 2015, Vector expressed interest in acquiring Saba software and entered into a deal at $9.00 per share. A former stockholder set forth two claims. One alleged breach of fiduciary duty against the Saba board, and the second alleged aiding and abetting against Vector. The Court granted and denied in part.

This action arose out of Vector Capital Management, L.P's ("Vector Defendants" or "Vector") acquisition of Saba Software, Inc. ("Saba"). Before the merger, Saba executives were involved in a scheme to overstate its pre-tax earnings by $70 million. The SEC forced Saba to restate ("Restatement") its past financials for the fraudulent activity. Saba failed to complete the Restatement and the failure led to the deregistration of Saba stock from NASDAQ. In 2014, Saba formed a committee to explore strategic alternatives, and retained Morgan Stanley to evaluate its options. In 2015, Vector expressed interest in Saba and began preliminary negotiations. Morgan Stanley presented a fairness opinion to the Board in February 2015, and a deal was finalized the same month, at $9.00 per share. Former stockholder ("Plaintiff") set forth two claims: Claim I alleged breach of fiduciary duty against Saba board members ("Saba Defendants" or "Board"), and Claim II alleged aiding and abetting against Vector. Defendants moved to dismiss the claims. The Court granted in part and denied in part.

1. Corwin Analysis

Saba Defendants claimed that, under *Corwin v. KKR Financial Holdings LLC*, when a "transaction not subject to the entire fairness standard is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies."[96] Plaintiff must have pled facts that alleged it was reasonable conceivable that the stockholder vote was not fully informed, or the vote was coerced. Plaintiff alleged Saba's proxy was deficient in four areas: "(i) the reasons why Saba was unable to complete the restatement; (ii) Saba management's financial projections; (iii) Morgan Stanley's financial analyses supporting its fairness opinion and potential conflicts of interest; and (iv) the process leading up to the execution of the Merger Agreement."[97]

a. Saba Management's Financial Projections

First, Plaintiff alleged material information was omitted from the financial projections prepared by Saba's management, pointing to Saba's omission of management projections for 2020-2024. The Court rejected Plaintiff's contention, noting that "…the omission from a proxy statement of projections prepared by a financial advisor for a sales process rarely will give rise to an actionable disclosure claim."[98]

[96] 125 A.3d 304, 309 (Del. 2015).
[97] In re Saba Software, Inc. Stockholder Litig., No. CV 10697-VCS, 2017 WL 1201108, at *8 (Del. Ch. Mar. 31, 2017), as revised (Apr. 11, 2017).
[98] *Id.* at 9.

Next, Plaintiff contended that the proxy should have disclosed projections for revenue and EBITDA. The Court rejected the argument, noting that the proxy disclosed the relevant information for 2016-2018 and adjusted EBITDA for 2015-2019.

Finally, Plaintiff contended that "the Proxy does not adequately disclose the justifications for the modifications to the Company's forecast throughout the process and, in particular, following receipt of Vector's offer."[99] The Court rejected this contention, opining that historically, Defendants do not need to disclose a motive when making "transaction-related decisions."[100]

b. Omitted Information In Morgan Stanley's Valuation

Plaintiff contended that Morgan Stanley did not disclose adequate information in its valuation of Saba, or adequate information regarding Morgan Stanley's prior relationship with Vector. The court denied Plaintiff's first argument, opining that Plaintiff had not pled facts explaining why the alleged omitted information was material to the stockholders' vote. The Court noted that Morgan Stanley included the methods and projections used in its valuation, as well as the comparable companies and transactions considered. Rejecting Plaintiff's second argument, the Court held that the proxy disclosed Morgan Stanley had provided financial services to Vector in the past, but the proxy was not required to provide information as to what the specific services were.

c. Omitted Information Regarding the Failure to Complete the Restatement

Next, Plaintiff alleged the proxy did not provide an explanation to stockholders regarding Saba's failure to complete a Restatement by the SEC deadline. The failure to provide the Restatement led to the deregulation of Saba stock. The Court rejected Plaintiff's claim, noting that "asking 'why' does not state a meritorious claim."[101]

d. Omitted Information Regarding the Sales Process

Finally, Plaintiff alleged the proxy omitted information surrounding Saba's sales process. Specifically, Plaintiff pointed to the omission of possible alternatives to the Vector sale. The Court held that failure to disclose sales process information undermined the cleansing effect under *Corwin.* The Court opined that, "[i]n considering whether or not Saba was viable as a going-concern without the Merger, a reasonable stockholder would have needed to understand what alternatives to the Merger existed"[102]

Plaintiff Adequately Pled that the Stockholder Vote Was Coerced

Beginning its analysis, the Court noted that "[t]he coercion inquiry…focuses on whether the stockholders have been permitted to exercise their franchise free of undue external pressure created by the fiduciary that distracts them from the merits of the decision under consideration." The Court opined that stockholders were left in the dark after inadequate disclosures, coupled with the fact that Saba stock was deregistered. Further, the Court noted that "the Board forced stockholders to choose between a no-premium sale or holding potentially worthless stock."[103]

[99] *Id.* at 9.
[100] *Id.*
[101] *Id.* at 11.
[102] *Id.* at 13.
[103] *Id.* at 16.

Plaintiff Alleged Actionable Bad Faith

To state a *Revlon* claim, Plaintiff must have pled facts to suggest Saba Defendants "knowingly and completely failed to undertake their responsibilities"[104] and "utterly failed to attempt to obtain the best sale price."[105] Plaintiff alleged the Board acted in bath faith when it rushed the sale of Saba, directed Morgan Stanley to rely on inaccurate projections in its fairness opinion, and rushed the stockholder vote. The Court held that these facts were adequate to allege an inference of bad faith and therefore, enhanced scrutiny applied.

Saba Defendants' Breach of Duty of Care and Loyalty

To state a claim for breach of duty of care and loyalty, Plaintiff must have pled facts "to support a rational inference that the corporate fiduciary acted out of material self-interest that diverged from the interests of the shareholders."[106] Plaintiff alleged that Saba Defendants sold Saba to secure person benefits in the form of cash, and allowed Saba Board member, Farschchi, to negotiate on behalf of his own interests.

a. The Board's Personal Benefits

Plaintiff alleged self-interest when the Board approved an equity award to all independent directors, during the merger process. The Court held that the Board acted out of self interest in approving the cash compensation. The Court noted that "the fact that the Board received this cash compensation in lieu of suspended equity grants in connection with the Merger, given the uncertainty surrounding the Restatement, supports a reasonable inference that the Board approved the Merger in order to receive that compensation."[107]

b. Farshchi's Self-Interest

Next, Plaintiff contended that board member, Farshchi, dominated the Board out of self-interest. Plaintiff specially contended that Farshchi pushed to Board to approve the merger so he could stay employed with the newly merged Saba. The Court rejected Plaintiff's argument, opining that evidence did not exist to sufficiently allege Farshchi engaged in any employment discussions prior to the merger.

Aiding and Abetting Against Vector

Plaintiff must have pled "(i) the existence of a fiduciary relationship, (ii) the fiduciary breached its duty, (iii) a defendant, who is not a fiduciary, knowingly participated in a breach, and (iv) damages to the plaintiff resulted from the concerted action of the fiduciary and the non-fiduciary."[108] The Court rejected Plaintiff's argument, noting that any conclusory allegations that point to a third party receiving "too good of a deal,"[109] without providing more information, were insufficient to state a claim.
Key Terms: Revlon, Duty of Care, Duty of Loyalty, Coerced, Coercion, Aiding and Abetting.

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[104] *Id.* at 20.
[105] *Id.*
[106] *Id.* at 21.
[107] *Id.*
[108] *Id. at 23.*
[109] *Id.* at 24

Hsu Living Trust v. ODN Holding Corp., No. CV 12108-VCL, 2017 WL 1437308 (Del. Ch. Apr. 14, 2017)

THE COURT DENIED A MOTION TO DISMISS ALLEGED BREACH OF FIDUCIARY DUTY CLAIMS ON THE PART OF THE DIRECTORS AND CONTROLLING STOCKHOLDER. ADDITIONALLY, THE PLAINTIFF SUFFICIENTLY ALLEGED THAT DEFENDANTS ACTED DISLOYALLY BY ENGAGING IN A SERIES OF TRANSACTIONS TO MAXIMIZE THE AMOUNT OF CASH AVAILABLE TO THE CONTROLLER'S PREFERRED STOCK.

Plaintiff brought an action against ODN Holding Corp. alleging, among other things, breach of fiduciary duty in connection with the redemption of preferred shares owned by ODN Holding Corp.'s controlling stockholder, Oak Hill Capital. The Court denied Defendant's motion to dismiss the breach of fiduciary duty claims.

Frederick Hsu ("Plaintiff") filed this action against Oak Hill Capital Partners ("Oak Hill"), ODN Holding Corporation's (the "Company" or "ODN") board of directors ("Board"), and Company officers (collectively with "Board," "Defendants"). The Complaint alleged the following: (1) Oak Hill breached its fiduciary duties; (2) individual Defendants breached their fiduciary duties; (3) Oak Hill aided and abetted breaches of fiduciary duties by individual Defendants, (4) unjust enrichment; (5) waste; and (6) unlawful redemptions. The Court granted Defendants' motions to dismiss claims of waste and unlawful redemptions. However, the Court denied Defendants' motions to dismiss claims of breach of fiduciary duties, aiding and abetting, and unjust enrichment.

In 2000, Frederick Hsu and Lawrence Ng ("Ng"), co-founded Oversee.net ("Oversee"). Oversee provided marketing solutions to advertisers and publishers. In early 2008, Oak Hill invested $150 million in Oversee. Oversee and Oak Hill formed ODN to facilitate the investment. Oversee provided Oak Hill with 53,380,783 shares of preferred stock in exchange for $150 million. Per the preferred stock terms, Oak Hill had the option to exercise a mandatory redemption right beginning five years after the investment.

In 2009, Oak Hill purchased an additional $24 million worth of shares in the Company. Oak Hill now controlled the majority of the Company's voting power. The Company's Board was comprised of eight members, three of which were Oak Hill representatives. Other members included an attorney who practiced at a firm that represented Oak Hill and was a social friend with one Oak Hill Director.[110]

In 2011, Oak Hill decided that "exercising its contractual redemption right in February 2013 was the most effective way to achieve the return of its capital."[111] Oak Hill then shifted its business strategy from growing the Company to stockpiling cash.[112] In January 2012, the Company sold two lines of business for $15.4 million. The Company had paid more than $46.5 million to acquire

[110] Frederick Hsu Living Trust v. ODN Holding Corp., No. CV 12108-VCL, 2017 WL 1437308, at *5 (Del. Ch. Apr. 14, 2017), as corrected (Apr. 24, 2017).
[111] *Id.* at 40
[112] *Id.* at 29.

the two business lines in 2007. The sale had a significant effect on the Company. Annual revenue dropped from $141 million in 2011 to $89 million in 2012.

In August 2012, the Board formed a special committee ("Committee"), comprised of two people. One of the members had a prior social relationship with an Oak Hill Director. The Committee evaluated Company alternatives for capital raising in order to fund the redemptions, and negotiated the redemptions with Oak Hill. On February 1, 2013, Oak Hill requested the Company made a payment of $45 million for the preferred stock. The redemption would have left the Company with $5 million in cash reserves, but the Company officers claimed a cash reserve of only $2 million was needed to run the company. On March 18, 2013, the Board approved the redemption and paid Oak Hill $45 million.

In February 2014, a strategic acquirer had interest in purchasing a line of business from the Company. The business line was the Company's primary source of revenue, and one of two lines remaining. The Committee recommended the sale and on April 14, 2014, the Board approved the sale for $40 million.

In August 2014, Company officers presented a restructuring plan to the Board. The plan involved selling off segments of the remaining line of business and implementing cost cutting measures. The Board approved, after additional cost cutting measures were added. In light of the Company's new plan, the Committee determined that the Company could make another redemption payment to Oak Hill. The Board met on September 2, 2014, and approved a $40 million redemption payment.

1. Breach of Fiduciary Duty

a. Oak Hill Directors

The Court held that the Complaint supported "a reasonable inference that at some point in 2011, Oak Hill's interests as a venture capitalist holding the Preferred Stock diverged from the interests of the Company and its common stockholders."[113] The Court noted that, instead of redeeming small blocks of preferred stock over a longer period, Oak Hill, "…feared the Company would become a sideways situation and wanted to get its capital back as soon as possible."[114] Further, in ruling that Oak Hill Directors sought to serve their own interests, the Court cited a series of actions Oak Hill performed:

- In 2011, the Company changed its business strategy and began to stockpile cash.
- In 2011, the Company sold two of its four business lines, which supported an inference that the Company sold the two business lines to generate cash for the redemptions.
- In 2012, the cash stockpiling continued, evidenced by the Company's $50 million cash reserve.

[113] *Id.* at 28.
[114] *Id.*

b. Domeyer

Domeyer was on the Board during the period when the Company took measures to maximize the redemption values. Domeyer was highly compensated and "[u]nder the great weight of Delaware precedent, senior corporate officers generally lack independence for purposes of evaluating matters that implicate the interests of the controller."[115] Additionally, Domeyer received a bonus for reaching the $85 million redemption threshold. The Court held that the Complaint supported a reasonable inference that the bonus appeared to "incentivize Domeyer to pursue redemptions that would benefit Oak Hill."[116]

c. Outside Directors

The Complaint adequately alleged it was reasonably conceivable that outside directors breached their fiduciary duties. The Court opined that by selling three of its four business lines, the Company sought to generate cash for upcoming redemption dates. Rather than seeking to maximize the Company's value, the outside directors sought maximum value of Oak Hill's redemption rights by stockpiling cash. Next, the Court opined that by approving the $45 million redemption, outside directors acted for the benefit of Oak Hill. Management noted that the Company must have a cash reserve of $10 million in order to continue normal operations. Two outside directors asked management to reanalyze the cash reserve minimum. After reanalysis, management conveniently reduced the cash reserve minimum to $2 million, which allowed the Board to approve the $45 million redemption.

d. The Officers

The Court held that the Complaint alleged a reasonable inference that the officers breached their fiduciary duties by prioritizing Oak Hill's interests over the Company's. The Court noted that the officers reported to a Board controlled by Oak Hill, and the officers were "…conceivably beholden to Oak Hill for their continued employment, calling into question their independence."[117] Additionally, the Court cited to the officers' business plan which cut costs and freed up cash for redemptions, concluding it was conceivable that the officers breached their fiduciary duties.[118]

2. Breach of Fiduciary Duty Against Oak Hill

Next, the Complaint alleged that Oak Hill breached its fiduciary duties by "directing its employee appointed directors on ODN's Board to liquidate its investment in the Company" and "accept[ing] redemption payments totaling $85 million when it knew…that, if any legally available funds existed, they were a result of the Defendants' prior inequitable conduct."[119] The Court held that Plaintiff sufficiently stated a reasonable inference that Oak Hill breached its fiduciary duties. Defendants argued that the Complaint "pleads no specifics about what directives—if any—Oak Hill gave, what actions it took to implement this purported strategy, or what conduct it engaged in, other than exercising its contractual rights to redemption."[120] The Court rejected this argument, noting that the Complaint alleged a reasonable inference that Oak Hill Directors acted on behalf

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115 *Id.* at 30.
116 *Id.*
117 *Id.* at 39.
118 *Id.*
119 *Id.* at 40.
120 *Id.*

of Oak Hill to maximize redemption rights for Oak Hill's benefit, without acting for the benefit of the Company.

3. Aiding and Abetting

Plaintiff alleged Oak Hill aided and abetted breaches of fiduciary duties by individual Defendants. Oak Hill's conduct satisfied the aiding and abetting elements, which included: "(i) the existence of a fiduciary relationship, (ii) a breach of the fiduciary's duty, (iii) knowing participation in the breach, and (iv) damages proximately caused by the breach.."[121] This was considered a fallback claim, with the Court noting that, "[i]t seems highly likely that Oak Hill acted in a fiduciary capacity, but Oak Hill has not conceded the point, so it remains conceivable that the aiding and abetting claim could serve a purpose."[122]

4. Unjust Enrichment

Finally, the Complaint asserted a claim of unjust enrichment against Oak Hill and individual Defendants. Unjust enrichment was "the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience."[123] The Court held it was reasonably conceivable that Defendants were unjustly enriched, citing three officers who received bonuses of $587,184 for reaching the $75 million redemption threshold.[124]

Key Terms: fiduciary duty, entire fairness, duty of loyalty, aiding and abetting, unjust enrichment, special committee, board of directors.

[121] *Id.* at 41
[122] *Id.*
[123] *Id.* at 42.
[124] *Id.* at 9.

In re Merge Healthcare Inc., No. CV 11388-VCG, 2017 WL 395981 (Del. Ch. Jan. 30, 2017)

THE COURT FOUND THAT WHILE THE SALE PROCESS WAS LESS THAN PRISTINE, THE FULLY INFORMED STOCKHOLDER VOTE CLEANSED ANY FIDUCIARY VIOLATIONS.

In 2015, IBM acquired Merge Healthcare, Inc. for $7.13 per share. Plaintiffs brought this action alleging the Defendants breached their fiduciary duties of care and loyalty in connection with the merger, noting that the stockholders were not fully informed. The Court granted the Defendants' motion to dismiss, holding that the vote was fully informed and uncoerced.

This action arose from IBM's acquisition of Merge Healthcare, Inc. ("Merge") (the "Merger"). Former Merge stockholders ("Plaintiffs") claimed that Merge directors ("Defendants") breached their fiduciary duties in connection with the Merger.

In 2015, IBM expressed an interest in acquiring Merge. After negotiations, the Merger was completed at $7.13 per share. Plaintiffs alleged Defendants breached their fiduciary duties of care and loyalty in connection with the Merger, noting that proxy disclosures to the stockholders were inadequate. The Court granted Defendants' motion to dismiss, noting that the fully informed and uncoerced vote by minority stockholders cleansed any fiduciary violations.

Shareholder Vote Cleansed the Merger

Plaintiffs contended that the entire fairness standard applied, alleging one of the Defendants, Michael Ferro, was a controlling stockholder and that in approving the Merger, the Merge board had a conflicted relationship. The cleansing effect, as explained in *Larkin v. Shah*, noted, "the only transactions that are subject to entire fairness that cannot be cleansed by proper stockholder approval are those involving a controlling stockholder."[125] Next, the Court considered whether a controlling stockholder appeared on both sides of the transaction.

The Court explained that even if Ferro, who owned 26% of Merge stock, was a controlling stockholder, he was not on both sides of the transaction and his interests and benefits were equal to all stockholders. Plaintiffs claimed Ferro controlled the sale process to obtain financial and career benefits, specially alleging that Ferro used his control to "to ensure a 'quick exit' from his illiquid block of merge stock."[126] The Court rejected Plaintiffs' contentions, noting that a stockholder receiving liquidity value for his shares "does not establish a disabling conflict of interest when the transaction treats all stockholders equally."[127]

Stockholder Vote was Fully Informed

In order to rebut the cleansing effect, Plaintiffs "must sufficiently allege facts that make it reasonably conceivable that the disclosures were materially misleading in some regard; thus

[125] No. CV 10918-VCS, 2016 WL 448547, at *10 (Del. Ch. Aug. 25, 2016).
[126] In re Merge Healthcare Inc., No. CV 11388-VCG, 2017 WL 395981, at *7 (Del. Ch. Jan. 30, 2017).
[127] *Id.*

leading to an uninformed vote."[128] Plaintiffs claimed that Goldman Sachs' ("Goldman") financial analysis was not complete. The Court noted that the fair summary Goldman provided was "not a cornucopia of financial data, but rather an accurate description of the advisor's methodology and key assumptions."[129]

Further, Plaintiffs alleged the following: (i) the proxy statement did not disclose that Goldman's fairness opinion treated stock-based compensation as a cash expense; (ii) Defendants failed to disclose the present value of Merge's net operating losses ("NOL"); and (iii) the proxy statement did not disclose the real reason as to why Ferro waived his $15 million consulting fee. The Court rejected Plaintiffs' first contention, noting that the proxy sufficiently disclosed Goldman's treatment of stock-based compensation as a cash expense, which was consistent with GAAP.[130] Second, the Court noted that Defendants disclosed key inputs from their opinions, additionally opining that a separate NOL disclosure was not considered material to the stockholder's decision. Third, the Court noted that the proxy was not required to disclose Ferro's motivation for waiving the consulting fee. The Court opined that any additional disclosure that spoke to Ferro's subjective motivation would not have changed a stockholder's decision in approving the Merger.[131]

Key Terms: Fiduciary duties, duty of care, cleansing effect, entire fairness, duty of loyalty, controlling stockholder.

[128] *Id.* at 9.
[129] *Id.* at 10; see also In re Trulia, Inc. Stockholder Litig., 129 A.3d 884, 901 (Del. Ch. 2016); In re Pure Res., Inc., Shareholders Litig., 808 A.2d 421, 449 (Del. Ch. 2002).
[130] In re Merge Healthcare Inc., at *10 (Del. Ch. Jan. 30, 2017).
[131] *Id*. at 13

Merion Capital L.P v. Lender Processing Servs., Inc., No. CV 9320-VCL, 2016 WL 7324170 (Del. Ch. Dec. 16, 2016)

THE COURT HELD THAT THE MERGER PRICE WAS THE BEST INDICATOR OF FAIR VALUE, NOTING THAT THERE WAS MEANINGFUL COMPETITION DURING THE SALE PROCESS.

Fidelity acquired Lender Processing Services at $37.14 per share. Following this statutory appraisal proceeding, the Court concluded that the merger price provided reliable evidence of the Company's fair value at the time of the signing of the merger agreement, valuing the Company at $37.14 per share.

In 2014, Fidelity National Financial ("Fidelity") acquired Lender Processing Services ("LPS" or "Respondent"). During the sale process, LPS solicited multiple bids, but Fidelity was the only entity to submit an offer. The merger agreement included: "(i) a 40–day go-shop that would expire on July 7, 2013, (ii) a five-day initial match right that fell back to a two-day unlimited match right[132], and (iii) a $37 million termination fee for a deal generated during the go-shop."[133] Merion Capital L.P. and Merion Capital II L.P ("Petitioners") brought this statutory appraisal proceeding to determine the fair value of their shares. The Court relied solely on the merger price to determine the value, ruling that the final merger price of $37.14 per share evidenced its fair value.

1. Persuasiveness of The Initial Merger Consideration

a. Pre-Signing Phase Competition

First, the Court examined whether there was any meaningful competition during the pre-signing phase of the merger. The Court found that Respondent's sale process included five potential buyers, made up of three strategic buyers, as well as two financial sponsors.[134] Respondent entered all negotiations on equal terms and waited for management input before proceeding. Ultimately, the Court noted that Respondent conducted its pre-signing phase in a fair manner.

b. Adequate Information During Pre-Signing

Next, the Court looked to whether reliable information was available to the participants during the pre-signing phase. The Court ruled that all bidders had equal access to LPS information, noting that there was no evidence suggesting LPS favored one bidder over another.[135]

c. Lack of Collusion Towards Bidders

Next, the Court examined whether the sale process involved any collusion. The Court ruled that there were no relationships between Respondent and bidders that would be considered unfair.[136] Petitioners noted that there were past business dealings between some bidders and Respondent.

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[132] If a target company receives a superior proposal from a third party during the window-shop or go-shop period, the buyer has the right to match that offer.

[133] Merion Capital L.P v. Lender Processing Servs., Inc., No. CV 9320-VCL, 2016 WL 7324170, at *9 (Del. Ch. Dec. 16, 2016) judgment entered, (Del. Ch. Dec. 23, 2016).

[134] *Id.* at 18.

[135] *Id.* at 20

[136] *Id.* at 22

The Court held that past dealings had no bearing on the fairness of this deal. The Court noted that, although "[t]hese relationships warranted close examination…they did not compromise the sale process."[137] Additionally, the Court opined that none of the LPS directors expected to maintain their positions after the merger, which provided them incentive to obtain the maximum value for LPS.

3. Post-Signing Evidence

a. Absence of A Topping Bid

Next, the Court examined Respondent's dealings during the 40-day go-shop period. During the seven months between signing and closing the deal, no other bidder submitted a proposal. The Court noted that a few factors undermined the effectiveness of the go-shop period. First, the Court noted that the go-shop was not part of the bankers' original plan, but was included as a "lawyer-driven add on."[138] Second, the Court questioned the companies contacted during the go-shop period. The Court opined that a majority of the companies contacted had previously expressed no interest in LPS.[139] Third, the Court reasoned that the unlimited match right included in the agreement, acted as "a sufficient deterrent to prevent other parties from perceiving a realistic path to success."[140]

Discounted Cash Flow ("DCF") Analysis

Both Parties conducted a DCF analysis in which Petitioners found the fair value to be $50.46 per share, while Respondent opined the fair value to be $33.57 per share.[141] The Court declined to consider the Parties' DCF analyses, noting that Respondent generated reliable evidence of fair value during the sale process, additionally adding that a DCF analysis, here, would have depended heavily on assumptions.

Key Terms: merger price, fair value, appraisal, DCF, valuation, market price.

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[137] *Id.*
[138] *Id.* at 24.
[139] *Id.*
[140] *Id.* at 25.
[141] *Id.*

Dunmire v. Farmers & Merchants Bancorp of W. Pennsylvania, Inc., No. CV 10589-CB, 2017 WL 6651411 (Del. Ch. Nov.10, 2016)

THE COURT HELD THAT THE DISCOUNTED NET INCOME WAS MORE RELIABLE THAN THE TRANSACITON PRICE IN DETERMINING THE FAIR VALUE OF THE SHARES.

F&M merged with NexTier, after encouragement from the Snyder family, who controlled both F&M and NexTier, and stood on both sides of the transaction. The two banks merged at $83 per share. Shareholders brought this action to determine the fair value of their F&M shares. The Court determined the value of shares to be $91.90 per share.

Shareholders ("Petitioners") sought appraisal to determine the fair value of their Farmers & Merchants Bancorp of Western Pennsylvania, Inc., ("Respondent" or "F & M") shares. F & M was formed in 2008, after Farmers Bank and Merchants Bank merged. As part of regular business, F & M management produced a strategic plan that included potential opportunities, financial forecasts, and strengths and weaknesses of F & M. In the plan, management noted that the acquisition of a "distressed bank"[142] would be F & M's opportunity to "break through [its] economic and geographic constraints."[143]

The Snyder family, controller of both F & M and NexTier, Inc. ("NexTier"), encouraged merging the two banks, and in October 2014, F & M merged with NexTier. F & M hired Ambassador Financial Group ("Ambassador") to render an opinion regarding the fairness of an exchange ratio NexTier would be proposing. In its presentation to the F & M special committee, Ambassador discussed the benefits of a merger, "…noting that while F & M had maxed out its opportunities in Armstrong County, NextTier serves a high growth area in Pennsylvania."[144] Additionally, Ambassador's presentation implied the value of each F & M share was worth $85. After reviewing the Parties' analyses, the Court ruled the fair value of F & M to be $91.90 per share.

Merger Price Was Not a Reliable Indicator of Value

First, the Court held that the merger price was not a reliable indicator of value. Here, the merger was not conducted as an auction. The Court noted that third parties did not submit bids during the merger process because the Snyder family, controller of both F & M and NexTier, stood on both sides of the transaction.[145] Further, the Court noted that "the record does not inspire confidence that the negotiations were truly arms-length."[146]

Comparable Transactions Analyses

Next, Petitioners set forth a comparable transactions analysis to determine the fair value of F & M shares. In their calculations, Petitioners selected eight banks they thought were comparable to

[142]Dunmire v. Farmers & Merchants Bancorp of W. Pennsylvania, Inc., No. CV 10589-CB, 2017 WL 6651411, at *2 (Del. Ch. Nov.10, 2016).
[143]*Id.*
[144]*Id.* at 3.
[145] *Id.* at 7.
[146] *Id.*

F & M. Through their analysis, Petitioners determined the fair value to be $137.97 per share.[147] The Court rejected Petitioners' fair value assessment. The Court reasoned that the analysis did not adjust for any potential synergies involved in the merger, nor did Petitioners justify their decision to forego inclusion of synergies in their analysis.[148]

Conversely, Respondent set forth two methods for its comparable transactions analysis. The first was based on transactions from five community banks, and the second was derived from public trading prices from ten different community banks. The Court dismissed Respondent's first analysis. The court reasoned that the analysis used banks that were in larger cities, and factored in banks that had multiple branches. The Court noted that these banks were not appropriate in determining the fair value of F & M, opining that the banks used were not comparable.[149] Turning to the public trading prices analysis, the Court rejected Respondent's argument, opining that the banks factored into the analysis had low trading volumes, and the analysis was inappropriately based on a thinly traded, illiquid market.[150]

Discounted Net Income Analysis

1. Net Income: The Court adopted Respondent's net income estimate, which was derived from F & M's twelve-month net income after the merger closed. The Court noted that Respondent's estimate was comparable to management income projections used for budgeting purposes by F & M, and Respondent's projection was based on an accurate time frame (i.e. 12 months).[151]

2. Discount Rate: After the parties agreed on the risk-free rate (2.87%) and size premium (3.87%), the Court ruled on the remaining disputed inputs.

a. Equity Risk Premium (ERP): The Court implemented Respondent's 6.18% ERP, noting that Petitioners' data source was derived from an "online questionnaire that asked chief financial officers and other executives for their best guess as to the average annual return of the S & P 500 over the next decade."[152] Conversely, Respondent's data comes from a reliable source, the Duff & Phelps Handbook, "an established and familiar source of information for valuing a corporation."[153]

b. Beta: The Court rejected the Parties' beta estimates and decided to use a median unlevered beta of .70.[154] The Court rejected Petitioners' use of the First Trust NASDAQ ABA Community Bank ETF beta. Although generally applied to an analysis of community banks, the Court declined to adopt it, reasoning that, "whatever type of beta you ultimately choose to employ, you should match the source of the size premium with the type of beta estimate you have chosen for you subject company."[155] Turning to Respondent's data, the Court noted that the unlevered beta implemented

[147] *Id.*
[148] *Id.* at 9.
[149] *Id.* at 10.
[150] *Id.*
[151] *Id.* at 11.
[152] *Id.* at 12.
[153] *Id.* at 13.
[154] *Id.* at 14.
[155] *Id.*

would only apply if a company were financed solely with equity capital, which is not the case, here.[156]

3. Growth Rate: The Court adopted Respondent's 3.0% growth rate, opining that the figure was "consistent with the 3.0% annual growth rate projected in F & M's 2012 Strategic Plan."[157]

4. Excess Capital: The Court concluded that Respondent's estimated excess capital of $4,439,752 was the most accurate.[158] The Court noted that implementing Petitioners' 9% risk-based capital ratio "would expose it to regulatory intervention and leave it in a 'tenuous position.'"[159]

Key Terms: fairness, appraisal rights, comparable companies analysis, discounted net income, merger price, fair value.

[156] *Id.*
[157] *Id.* at 15.
[158] *Id.* at 16.
[159] *Id.*

Merion Capital LP v. BMC Software, Inc., No. CV 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015).

THE COURT HELD THAT THE MERGER PRICE WAS THE MOST RELIABLE INDICATOR OF FAIR VALUE, AS THE MERGER RESULTED FROM A THOROUGH AND DISINTERESTED SALE PROCESS.

Stockholders ("Petitioners") sought appraisal to determine the fair value of BMC Software, Inc. ("BMC" or "Respondent") shares. In 2012, BMC met with several bidders before agreeing to a merger with multiple investment firms ("Buyer Group") at $46.25 per share. Merion Capital LP and Merion Capital II acquired stock for the purpose of seeking appraisal of the shares. After weighing numerous factors, the Court held that the merger price of $46.25 per share was the best indicator of fair value.

Discounted Cash Flow ("DCF") Analysis: To determine the fair value of the shares, the Court began by examining the Parties' DCF analyses. The Parties arrived at significantly different DCF figures. The Court then conducted its own DCF valuation, arriving at a fair value of $48 per share. The Court noted that the "DCF valuation is a product of a set of management projections, projections that in one sense may be particularly reliable due to BMC's subscription-based business."[160] Additionally, the Court opined that "Respondent's expert, pertinently, demonstrated that the projections were historically problematic, in a way that could distort value."[161] Taking these factors into consideration, the Court did not have complete confidence in its DCF analysis, and therefore, declined to consider a DCF analysis in making its decision as to the fair value of the shares.

Merger Price: Next, the Court considered whether the merger price was a reliable indication of the fair value of the shares. The Court noted that "where the sales process is thorough, effective, and free from any specter of self-interest of disloyalty, the deal price is a relevant measure of fair value."[162] Petitioners set forth three arguments that questioned the reasonableness of BMC's sales process.

1. Petitioners argued that investors in BMC rushed the sales process, which ultimately undervalued BMC's worth. The Court rejected this argument, noting that BMC, "conducted two auctions over roughly the course of a year, actively marketed itself for several months in each, as well as vigorously marketed itself in the 30-day Go Shop period."[163] Additionally, BMC spoke with multiple potential bidders during this period and BMC was able to reach a reasonable conclusion in considering these potential bidders.

2. Next, Petitioners argued that BMC's financial advisors produced confidential email communications about the sales process, which resulted in a minimized offer price. The Court noted that there was not sufficient evidence to prove BMC's financial advisors leaked material

[160] Merion Capital LP v. BMC Software, Inc., No. CV 8900-VCG, 2015 WL 6164771, at *18 (Del. Ch. Oct. 21, 2015), judgment entered, (Del. Ch. Nov. 3, 2015).
[161] *Id.*
[162] *Id.* at 14.
[163] *Id.* at 15.

information, and there was no evidence to show that the Buyer Group had any knowledge of the alleged leaked material.

3. Finally, Petitioners argued that leaked emails proved BMC had a gentleman's agreement with the Buyer Group. Petitioners alleged the agreement included not pursuing any other potential bidders. The Court held that there was no evidence that demonstrated a gentleman's agreement was in place, and "even if the Company had made such an agreement, the record shows that by the time such an agreement would have been made the Alternate Sponsor Group had already notified the Company that one of its members had dropped out."[164]

Synergies Resulting from the Merger: Here, the merger included a financial buyer rather than a strategic buyer, so the merger resulted in few synergies. BMC argued that synergies must be deducted because of the tax savings and other savings that resulted from BMC going private. The Court rejected this argument, noting that "to the extent value has been generated here by taking BMC private, the record is insufficient to show what, if any, portion of that value was included in the price-per-share the Buyer group paid for BMC."[165]

Key Terms: Merger Price, DCF analysis, appraisal rights, fair value, synergies merger, sale process, go-shop period.

[164]*Id.* at 16.
[165]*Id.* at 17.

In re Dole Food Co., Inc. Stockholder Litig., No. CV 8703-VCL, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015)

DEFENDANTS DEPRIVED STOCKHOLDERS OF THE ABILITY TO CONSIDER A MERGER ON A FULLY INFORMED BASIS.

The Court found that the chief executive officer (David H. Murdock) and president and general counsel (C. Michael Carter) of Dole Food Co., Inc. breached their duty of loyalty to Dole and its stockholders in a $1.6 billion going-private acquisition of the company in November 2013, and held them personally liable for payment of $148 million in damages.

The issue presented was whether David Murdock ("Murdock") and C. Michael Carter ("Carter" or collectively, "Defendants"), breached their fiduciary duties during a going-private merger.[166] In November 2013, David Murdock, owner of 40% of Dole Food Co. ("Dole"), paid $13.50 per share to acquire all Dole stock he didn't already own. The transaction required approval from a committee made up of disinterested directors. Plaintiff alleged Defendants obstructed the committee's dealings by seeking to restrict the committee's authority, intentionally supplying the committee with inaccurate budget projections, and making public announcements that would drive the stock price down, all of which would help Murdock obtain the stock at a lower price. The Court held that Murdock and Carter had committed fraud by misleading the committee and by taking actions that reduced Dole's stock price prior to the transaction. Damages were valued at approximately $148,190,590.18.

When a transaction involving self-dealing by a controlling shareholder was challenged, the standard of judicial review is entire fairness, where defendants have the burden of persuasion.[167] In order to rebut the entire fairness standard of review, Defendants must have proved fair dealing and fair price. Fair dealing "…embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[168] Fair price took the "…economic and financial considerations of the proposed merger into review, including: assets, market value, earnings, future prospects, and any other elements that affect the value of a company's stock."[169]

1. Fair Dealing

A. Timing and Initiation: "A calculated effort to depress the market price of a stock until the minority stockholders are eliminated by merger or some other form of acquisition constitutes unfair dealing."[170] A representative for Dole notified the markets that Dole could achieve $50 million in cost cutting efforts following a merger with Japanese company, ITOCHU. After the merger, Carter notified the public that Dole could only achieve $20 million in cuts. The Court explained that Carter intentionally supplied the market with a reduced estimate of savings in order

[166] A Transaction that converts a publicly traded company into a private entity.
[167] *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1239 (Del. 2012)
[168] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)
[169] *Id.*
[170] *Sealy Mattress Co. of New Jersey v. Sealy, Inc.*, 532 A.2d 1324, 1336 (Del. Ch. 1987).

to drive the stock price down, which, in turn, would have benefitted Murdock when negotiating a price.

B. Transaction Negotiation: Fair dealing also addressed questions of how a transaction was negotiated. The committee must be fully informed before making a decision and required information included: "(i) all of the material terms of a proposed transaction; (ii) all material facts relating to the use or value of the assets; and (iii) all material facts relating to the market value of the subject matter of the proposed transaction."[171] Carter provided false projections to the committee and never disclosed the full and accurate information about the cost savings Dole could have achieved. The Court opined that Defendants interfered with the committee's efforts by attempting to limit the scope of the committee's activities, while secretly preparing a hostile offer if the committee did not accept Murdock's offer.[172]

C. Transaction Structure and Approval: The Court held that Defendants' fraud, tainted the committee's approval of the merger.

2. Fair Price: The Court next analyzed whether the price was "within a range of fairness."[173] Here, the Court found that the Discounted Cash Flow analysis that the committee relied on, needed to be adjusted to include facts of misrepresentation. Additionally, the Court looked at savings Dole achieved from previous transactions, which would have generated additional income. Defendants argued that these factors should not have been included in a valuation, noting that they occurred after the merger. The Court disagreed, opining that that cost savings were part of Dole's operative reality prior to the merger.

3. Aiding and Abetting Claim Against Deutsche Bank: Plaintiffs alleged the financial advisor, Deutsche Bank, aided and abetted Carter and Murdock's breaches of fiduciary duty. To establish an aiding and abetting claim, Plaintiff must prove: "(i) the existence of a fiduciary relationship, (ii) a breach of the fiduciary's duty, (iii) knowing participation in the breach, and (iv) damages proximately caused by the breach."[174] The Court found that Plaintiffs failed to prove the existence of the third element, knowing participation in the breach. The Court opined that "Deutsche Bank did not make any of the misrepresentations, was not present for them, and did not conceal information from the Committee. Deutsche bank was not directly involved, not even secondarily involved, in the critical breaches of duty."[175]

[171] *In re Dole Food Co., Inc. Stockholder Litig.*, No. CV 8703-VCL, 2015 WL 5052214, at *29 (Del. Ch. Aug. 27, 2015)
[172] *Id.* at 17.
[173] *Id.* at 34.
[174] *Id.* at 41.
[175] *Id.* at 42.

Merlin Partners LP v. AutoInfo, Inc., No. CV 8509-VCN, 2015 WL 2069417 (Del. CH. Apr. 30, 2015)

AN ARM'S-LENGTH, FAIR SALE PROCESS WAS THE MOST RELIABLE INDICATOR OF FAIR VALUE.

Merlin Partners and AAMAF, LP ("Petitioners") are former stockholders of AutoInfo, Inc. ("Respondent" or "AutoInfo"). Petitioners demanded appraisal of their shares stemming from a merger with AutoInfo (the "Merger"). AutoInfo was a transportation services company that provided contract carrier services through a variety of independent sales agents in North America. After evaluating its strategic options, Respondent reached out to potential purchasers and in early 2013, AutoInfo and the highest bidder, Comvest, entered into a deal at $1.05 per share.

Petitioners set forth a discounted cash flow ("DCF") analysis and two comparable companies analyses, while Respondent relied on the Merger price as the sole indicator of fair value.

DCF Analysis: Petitioners DCF analysis relied on input data derived from management projections. The Court rejected this analysis, opining that the projections were "indisputably optimistic,"[176] additionally noting that management did not have any confidence in its ability to forecast financial projections. Because Petitioners were not able to establish the credibility of the projections, the Court did not give any weight to the DCF analysis. The Court then conducted its own DFC valuation, but ultimately rejected the analysis, citing reliance on unreliable data.

Comparable Companies: Petitioners offered two comparable companies analyses, one using a 2012 EBITDA figure, and the other using an estimated 2013 projected EBITDA. The Court rejected both analyses, holding that the companies utilized by Petitioners were not similar in size and did not employ the same business model. Therefore, no weight was given to these analyses.

Merger Price: The Court agreed with Respondent's reliance on the Merger price as an indication of fair value. In response, Petitioners contended that: (i) AutoInfo was thinly traded and lacked financial analyst coverage; (ii) large stockholders pressured the board to sell; and (iii) Comvest overwhelmed the board during negotiations. First, the Court opined that, while the market may not have been aware of AutoInfo before the sale, its investment bank provided information to potential bidders during the process. Rejecting Petitioners' second argument, the Court noted that by the time one of the biggest stockholders, Baker Street, purchased shares in the company, AutoInfo had already begun a sales process. Additionally, the Court opined that Kinderhook, another large stockholder, "…was not adamant that AutoInfo be sold."[177] Denying Respondent's third contention, the Court noted that due diligence was a standard practice for Comvest, and an accountant was hired for the sole reason of investigating AutoInfo's basic accounting software.

Fairness Opinion: The Court did not have an issue with Respondent's reliance on the Stephens, Inc. ("Stephens") fairness opinion. Before evaluating the fairness of the transaction, Stephens completed a comparable companies analysis where, "[i]t selected a lower multiple range, based on

[176] Merlin Partners LP v. AutoInfo, Inc., No. CV 8509-VCN, 2015 WL 2069417, at *8 (Del. CH. Apr. 30, 2015)
[177] *Id.* at 13.

differences between AutoInfo and the comparables, including size, business model, and the quality of management."[178] Petitioners argued that historically, the Court was skeptical "of an expert [who] throws out his sample and simply chooses his own multiple in a directional variation from the median and mean that serves his client's cause."[179] The Court noted that Respondent's small size and riskier agent-based business model supported the data used in Stephens's comparable companies analysis, and further, "Stephens's choice of a multiple was not a post hoc determination made during litigation, but a reasoned selection based on industry experience."[180]

For the reasons set forth above, the Court ruled the fair value of AutoInfo was $1.05 per share, reasoning that, "the process by which AutoInfo was marketed and sold would be expected to have led to a price indicative of the fair value of the Company's stock."[181]

Key Terms: DCF, fair value, comparable companies analysis, fairness opinion, merger price.

[178] *Id.* at 10.
[179] *Id.* at n.131.
[180] *Id.*
[181] *Id.* at 14.

In re Answers Corp. S'Holders Litig., No. CIV.A. 6170-VCN, 2014 WL 463163 (Del. Ch. Feb 3, 2014).

THE COURT HELD THAT THE DIRECTORS SATISFIED THEIR *REVLON* DUTIES IN APPROVING THE DISPUTED MERGER.

Plaintiffs claimed the Defendants breached their fiduciary duties stemming from a merger between Answers Corp. and A-Team Acquisition Sub, Inc. Defendants moved for summary judgment. The Court granted Defendants' motions for summary judgment. In its decision, the Court noted that the directors of the company had satisfied their *Revlon* duties when they approved the merger.

This action stems from a merger between Answers Corporation ("Answers") and A-Team Acquisition Sub, Inc., a subsidiary of AFCV Holdings, LLC ("AFCV"), which was a portfolio company of private equity firm, Summit Partners, L.P. (collectively, "Buyout Group"). Stockholders ("Plaintiffs"), alleged that Answers' Board of Directors (the "Board") breached its fiduciary duties in connection with the merger, and the Buyout Group aided and abetted the breach. The Board and the Buyout Group ("Defendants") moved for summary judgment. The Court granted their motion, noting that no genuine issue of material fact existed and the transaction was approved by an independent and disinterested majority of the Board, who did not act in bad faith.

Plaintiffs claimed that Defendants breached their fiduciary duties because: (i) the CEO and two director nominees were conflicted and controlled the board; and (ii) the four directors on the seven-person board acted in bad faith. Finally, Plaintiffs alleged that the Buyout Group aided and abetted the Board's breach of fiduciary duty.

Directors Control of The Board

Plaintiffs argued that Answers' CEO, Robert Rosenschein, controlled the Board during its decision-making process. Plaintiffs alleged Rosenschein needed the merger to go through, or else he would have been fired.[182] The Court rejected the claim, noting that Plaintiffs offered no explanation as to how Rosenschein controlled the Board. Further, Plaintiffs do not offer evidence to show Rosenschein would have been fired, nor do they explain why disinterested Board members would have favored Rosenschein when approving the merger.[183]

Did the Board Act in Bad Faith?

Under *Lyondell*, the Supreme Court of Delaware found that when evaluating bad faith claims, "an inquiry in such a context should be based upon 'whether [the] directors utterly failed to attempt to obtain the best sale price.'"[184] The Court concluded that there was no genuine issue of material fact regarding the Board's compliance with its fiduciary duties. The Court noted that Answers received several unsolicited offers, and the Board considered multiple transactions.[185] Despite

[182] In re Answers Corp. S'Holders Litig., No. CIV.A. 6170-VCN, 2014 WL 463163, at *15 (Del. Ch. Feb 3, 2014).
[183] *Id.*
[184] Lyondell Cham. Co. v. Ryan, 970 A.2d 235, 244 (Del. 2009).
[185] In re Answers Corp. S'Holders Litig., 2014 WL 463163, at *11.

interest, only AFCV made an offer. Further, the Court opined that Answers' management spoke to various financial buyers in 2010, which provided the Board with information regarding potential acquirers. Additionally, Plaintiffs claimed that the Board focused on strategic, rather than financial buyers. The Court rejected this argument, noting that, "even this limited market check does not constitute a complete abandonment of fiduciary duty."[186]

Additionally, Plaintiffs claimed the fairness opinion was flawed. The Court rejected this argument, noting that the fairness opinion was valid and by performing a market check, Defendants were able to demonstrate its validity.[187]

Aiding and Abetting

Plaintiffs contended that the Buyout Group participated in the Board's alleged breaches of fiduciary duties. Plaintiffs set forth two arguments in support: (i) the Buyout Group knowingly participated in the breach because Answers' financial advisor sent an email stating, "time is not a friend to this deal;" and (ii) the Board sent confidential information to the Buyout Group because a UBS financial advisor indicated the Buyout group pushed for a two-week market check.[188] The Court rejected these arguments, noting that the correspondence cannot "reasonably be interpreted as evidence of a plan to breach or to induce a breach."[189] Additionally, the Court noted that, "Plaintiffs essentially invite the Court to interpret certain negotiations as evidence that confidential communication was elsewhere before being exchanged."[190] Plaintiffs did not offer any evidence to demonstrate a knowing participation in a breach and therefore, the Court granted Defendants' motion for summary judgment.

Key Terms: Fiduciary duties, aiding and abetting, merger, market check, board of directors, bad faith, summary judgment.

[186] *Id.* at 12
[187] *Id.* at n.96.
[188] *Id.* at 16
[189] *Id.*
[190] *Id.*

Laidler v. Hesco Bastion Environmental, Inc. C.A. No. 7561-VCG.

LACK OF CASH FLOW PROJECTIONS COMPELS USE OF DCCF

In a statutory appraisal action arising out of a short-form merger, the Delaware Court of Chancery (J. Glasscock) adopted the direct capitalization of cash flow (DCCF) analysis the parties' experts advocated because of the unique nature of the target's business and factors affecting the transaction. This was a less common approach than the discounted cash flow (DCF) analysis, the Chancery noted. Since there was wide agreement over the inputs and calculations to be used, the court focused its role on resolving value disputes.

Background of the Court Case:

- The merger involved a group of related entities in the United Kingdom and the United States operating under common control and being players in the flood barrier industry.

- Controlling interest in the entities was transferred to the British inventor's estate following his death in 2010.

- The petitioner was the company secretary, general manager, and managing director of the U.K. corporation, who was terminated in 2011 in connection with fraud allegations. She and two other individuals each owned 10,000 shares of the target company, which amounted to a 10% interest per person. Under a shareholder agreement, the petitioner could force the target company to repurchase her shares. Anticipating she would exercise her right, the company in November 2011 requested a fair market opinion from Willamette Management Association (Willamette), which then valued the stock at $180 per share. The petitioner chose not to sell at that price.

- In January 2012, the two other minority stockholders tendered their shares to the entity acquiring the target—the respondent—for $207.50 per share. The petitioner rejected the $207.50-per-share offer and requested a statutory appraisal—i.e., a determination of the fair value of the target on the merger date—from the Delaware Court of Chancery.

- The target company which assemble proprietary Concertainer units had a difficult time predicting revenue since sales depended on natural disasters and similar weather-related events. The company never created forward-looking projections.

- There were other factors creating uncertainty. For instance, the record showed that on the merger date there were plans to open a company for manufacturing components of the Concertainer units in South Carolina. But it was not clear whether this project was a part of the target's business plan or of the controlling U.K. entity. Moreover, the target was about to lose a license and the patent covering its sole product.

- The petitioner retained an expert who performed a DCCF-based valuation and concluded the fair value of her shares was $515 per share on the merger date.

- The respondent also obtained a post-merger valuation that was a combination of a DCCF analysis and guideline companies and guideline transaction analyses. It stated a $322-per-share price.

- An executor of the estate disapproved of the valuation. It “did not adequately reflect particular issues around normalized earnings,” he believed. In testimony, he said he had not instructed the expert as to how to do the valuation but had told him that there were “extraordinary events” that he should have factored into the calculation but did not. Subsequently, the expert backed out revenues related to “nonrecurring” events,” including those connected to the dam project, the BP oil spill, and the 500-year flood. Based on the revised “normalized” revenues, he decreased the per-share value to $250.30.

- The court quickly disposed of the respondent’s arguments in favor of considering the merger price and its expert’s market analyses. As for the merger price, it dismissed the respondent’s suggestion that this transaction was comparable to the situation in Huff Fund, where the court (also J. Glasscock) leaned on the merger price for its valuation because the target’s unique assets and circumstances surrounding them made it almost impossible to predict future cash flows. . (Huff Fund Inv. P’ship v. CKx, Inc., 2013 Del. Ch. LEXIS 262 (Nov. 1, 2013)).

- The Chancery also declined to adopt the respondent expert’s comparable transaction and comparable companies analyses. He failed to make a persuasive argument that the companies or transactions on which his analyses relied were truly comparable. Further, the petitioner’s expert pointed out that the selected companies made building products: “They are not in the business of anything close to flood control barriers.”

- Both experts relied primarily on an income approach and agreed that the commonly used discounted cash flow (DCF) method did not work in this case because the target’s management had never made cash flow projections in the ordinary course of business. Therefore, both primarily relied on the DCCF analysis, which the court adopted.

- The Chancery described the DCCF as a two-step method: (1) determine the normalized cash flow figure; and (2) calculate a capitalization rate. It noted that it was “unfamiliar with the methodology typically employed in a DCCF analysis.” But since the experts agreed as to the necessary inputs and calculations, the court would use the methodology to resolve disputes as to the values for each.

- There were issues and disagreements dealing with appropriate cash flows to use in a DCCF analysis.
    1. The petitioner’s expert derived his cash flow figure from weighting the target’s actual revenues in 2010 and 2011 at 40% and 60%, respectively. He then multiplied the resulting figure by a projected 55% profit margin and subtracted $1.5 million in estimated overhead expenses.

2. The respondent's expert weighted actual and "normalized" EBITDA figures for 2009, 2010, and 2011; the "normalized" figures backed out revenues resulting from the Howard Hanson Dam project, the BP oil spill, and the 500-year flood. He used the 2009 figures to represent poor years, the 2010 figures to represent typical years, and the 2011 figures to represent active years, he explained. The actual results made up 25% of the target's cash flow estimate, and the normalized results represented 75%.

- The court concluded that the best predictor of future cash flows was the past cash flows for the three years, weighted equally. Considering EBITDA in 2009 was nearly $5.9 million, in 2010 $5.3 million, and in 2011 $11.3 million, the average was $7.5 million, which was the court's estimate of future cash flow.

- Both experts arrived at their capitalization rate by multiplying the company's weighted average cost of capital (WACC) by its long-term growth rate. Both agreed the growth rate was 4% but disputed the various inputs with which to compute the WACC.

- Concerning the cost of equity, they both used a build-up model but disagreed over the Ibbotson deciles for the industry risk premium and size premium.

- Industry Risk Premium:
  1. The petitioner's expert said he used "something that was roughly consistent with the average" of three SIC codes over several years. The codes were 34 (Fabricated Metal Products, Except Machinery and Transportation Equipment) and two subsets of the category, 344 (Fabricated Structural Metal Products) and 3499 (Fabricated Metal Products, N.E.C.). However, in his deposition, he cautioned that code 34 and code 3499 were not very good, and in testimony in front of the court he said that code 344 was not comparable to the target.
  2. The respondent's expert used only code 344 for 2011. He said, with emphasis, that he had contacted Morningstar, the publisher of the Ibbotson Valuation Yearbook, and learned that "the appropriate use of their statistic is to use the latest available data, not to average codes over a period of years because a code of the latest year already incorporates statistical data for previous years."

- The court found the respondent expert's approach more persuasive and determined that using code 344 for the year 2011 led to a 5.91% industry risk premium.

Size Premium:

- Both experts had good arguments, said the court. The respondent's expert said 10a was inappropriate because it included companies with market capitalizations that were too high and the petitioner's expert said 10b was inappropriate because it included companies with too much debt.

- Therefore, the court used decile 10. The resulting risk premium was 6.10%.

Cost of Debt:

- At the time of the merger, the target had no debt. However, both experts agreed that as a going concern it would be expected to take on some debt.

- The petitioner's expert used a ratio of 85% equity-to-15% debt, whereas the respondent's expert determined a ratio of 90% equityto-10% debt.

- The court pointed out that neither of them provided supporting evidence for his choice, but it decided the respondent's ratio was more conservative and adopted it. The cost of debt, it explained, was from Moody's rating of a Baa company as of the merger date. It was 5.24%. Based on the formula with which to calculate WACC, the Chancery arrived at a figure of 21.83%. Subtracting the long-term growth rate (4%) from the WACC yielded a 17.83% capitalization rate, with its inverse, 5.6, as the capitalization multiple.

Outcome:

- The Chancery's DCCF analysis resulted in a fair value of $364.24 per share. The court held the respondent owed the petitioner $3,642,400, plus statutory interest for her 10% interest in the target.

Huff Fund Inv. P'ship v. CKx, Inc., Civil Action No. 6844-VCG, 2013 Del. Ch. LEXIS 262 (Ch. Oct. 31, 2013)

THE COURT FOUND THAT THE MERGER PRICE WAS A RELIABLE INDICATOR OF FAIR VALUE OF THE SHARES.

The Court found that the price paid in the acquisition of CKx, Inc by Apollo Global Management was a reliable indicator in determining fair value of the company shares. The expert valuations provided by both parties were based on inapplicable comparables and unreliable projections. The Court ultimately relied on the merger price as the best available indicator of value.

Huff Fund Investment Partnership ("Petitioners") opted for statutory appraisal to determine the fair value of CKx, Inc, ("CKx" or "Respondent") stock. CKx was an entity created to own and manage iconic entertainment properties. CKx had significant assets including, 19 Entertainment, which owned the rights to *American Idol.* In early 2011, CKx elicited interest from private equity funds looking to purchase CKx and in 2013, three parties submitted bids. Apollo's bid of $5.50 per share was selected and finalized. This action arose from Petitioners' right to receive a fair value appraisal of their CKx shares. The Court held that due to unreliable or unavailable valuation methods, the sole factor when determining the fair value was the merger price. It follows that the fair value was $5.50 per share.

Petitioners set forth a comparable company approach to determine the fair value of the shares. The Court rejected this argument, noting that the model companies used by Petitioners were not comparable in size; none owned assets similar to CKx; and none utilized the same business model.[191]

DCF Analysis: The Court found several deficiencies in the Parties' DCF analyses. The reliability of a DCF analysis depended on the accuracy of its inputs and without a reliable five-year projection, any values generated from a DCF analysis were meaningless.[192] Here, Petitioners assumed that revenues under a soon to be negotiated *American Idol* contract would have increased to approximately $20 million each year.[193] The Court noted that there was no basis to determine whether cash flows under that contract would have increased revenues by $20 million.[194] Therefore, Petitioners' DCF analysis was based on speculation.

Respondent set forth a DCF analysis which assumed the fees generated from a new Fox contract would grow at four percent per year, for five years. The Court rejected this projection due to its fundamental uncertainty. Further, the Court held that it would not employ a DCF analysis. The court likened the case to *Doft & Co. v. Travelocity.com*, where a DCF analysis was declined. The court reasoned that the uncertainty of management projections arose from the inherent unpredictability of the financial performance of a travel and booking company in the aftermath of

[191] *Huff Fund Inv. P'ship v. CKx, Inc.,* Civil Action No. 6844-VCG, 2013 Del. Ch. LEXIS 262, at *29 (Ch. Oct. 31, 2013).
[192] *Id.*
[193] *Id.* at 14
[194] *Id.* at 33

September 11, 2001.[195] Here, future revenue estimates were considered speculative. The unreliability of the revenue estimates affected the Court's ability to provide a reliable DCF analysis.

Merger Price: Because a comparable company approach and DCF analysis could not be accurately employed, the Court relied on the merger price as the best indicator of CKx's value. Petitioners argued that merger price was irrelevant in an appraisal context and the Court should not consider it when determining fair value. The Court rejected this argument, noting that the court had a statutory mandate to consider all relevant factors in conducting an appraisal proceeding and there had not been a systematic favoring of one factor over the others.[196] In reaching its decision, the Court opined that the process CKx went through to reach potential buyers was thorough, effective, and free from any self-interest or disloyalty, which supported the conclusion that in light of the absence of any other valuation methods, the merger price was the primary and accurate factor in determining fair value of the shares.[197]

2014 Update: Upon re-argument, the Court ruled that (i) the record contained insufficient evidence to support a finding that the buyer formed its $5.50 bid based on cost savings that, had the company continued as a going concern, management could not have itself realized; (ii) the subjective valuation placed by the winning bidder on revenue opportunities was not relevant; and (iii) the Court declined to upwardly adjust the merger price to include value for support arguments. For the reasons stated in the original case, the sales price was the best indicator of value, which was $5.50 per share.

Key Terms: DCF Analysis, appraisal, merger price.

[195] No. 19734, 2004 Del. Ch. LEXIS 75, at *4 (Ch. May 20, 2004)
[196]*Huff Fund Inv. P'ship*, Civil Action No. 6844-VCG, 2013 Del. Ch. LEXIS 262, at *39 (Ch. Oct. 31, 2013).
[197] *Id.*

In re Morton's Rest. Grp., Inc. S'holders Litig., 74 A.3d (Del. Ch. 2013)

THE COURT DISMISSED ALL CLAIMS, NOTING THAT THE PLAINTIFFS DID NOT SUPPORT THEIR ENTIRE FAIRNESS AND *REVLON* CLAIMS.

Morton's Restaurant Group, Inc. entered into a merger agreement with subsidiaries of Landry's, Inc. The deal closed at $6.90 per share. Plaintiffs argued that Morton's Restaurant Group, Inc., stockholder, Castle Harlan, Inc., was a controlling stockholder. Defendants moved to dismiss the claims. The Court dismissed the claims, noting that the Plaintiffs failed to plead any facts that supported an inference of a conflict of interest on the part of Castle Harlan or any director.

In early 2011, Castle Harlan, Inc. ("Castle Harlan"), Morton's Restaurant Group, Inc. ("Morton's") private equity sponsor, suggested that Morton's considered selling itself. After a nine-month search, Morton's entered into a merger agreement (the "Merger") with Fertitta Morton's Restaurants, Inc. and Fertitta Morton's Acquisition, Inc., (collectively "Fertitta") at $6.90 per share, a 33% premium over Morton's closing market price. Former shareholders ("Plaintiffs") claimed that: (i) the sale should have been subject to the entire fairness standard or enhanced scrutiny under *Revlon*; (ii) the board breached their fiduciary duties; and (iii) the board's reliance on inaccurate fairness opinions constituted a breach of fiduciary duty. The Court granted Defendants' (collectively, "Morton's" and "Fertitta") motion to dismiss, noting, in part that, Plaintiffs failed to support their *Revlon* claims.

Standard of Review

Plaintiffs argued that the entire fairness standard or enhanced scrutiny under *Revlon* should have applied, reasoning that Castle Harlan controlled the transaction, and Castle Harlan became conflicted due to its need for liquidity. The Court rejected both arguments. Beginning its analysis, the Court noted that "[w]hen a stockholder owns less than 50% of the corporation's outstanding stock, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct."[198] Here, no facts were proffered by Plaintiffs to prove Castle Harlan controlled the board, and further, the Court opined that Castle Harlan's two employees on the board did not establish domination or control of the board. Additionally, Plaintiffs provided no basis for the Court to infer there was a *Revlon* breach. The Court noted that the board reached out to 100 buyers, over 50 signed confidentiality agreements, bidders were treated fair, and two investment banks were hired to test out the market.[199]

Conflict of Interest

Next, Plaintiffs contended that Castle Harlan had a conflict of interest because it wanted to flip the company and divest its majority ownership of Morton's. The Court rejected this argument, noting that Plaintiff's failed to allege with particularity what motivated Castle Harlan to sell.[200]

[198] In re Morton's Rest. Grp., Inc. S'holders Litig., 74 A.3d 656, 664 (Del. Ch. 2013).
[199] *Id.* at 662.
[200] *Id.* at 667.

Fairness Opinion

Plaintiffs argued (i) the board's decision to allow its financial advisor to provide financing for Fertitta's bid was done to allow Fertitta to lower its bid, and (ii) financial analysis in the fairness opinions had obvious errors that only the board could have relied on with an intent to approve a lower price transaction.[201] In rejecting the first argument, the Court noted that the M & A committee weighed in on the idea of letting Jefferies Finance LLC ("Jefferies") finance Fertitta's deal, and only after Jefferies agreed to terms set out by the Committee, were they allowed to continue. Further, by reducing its fee by $600,000, Fertitta was able to hire an additional firm to provide another unconflicted fairness opinion. Second, Plaintiffs alleged that the fairness opinions were not accurate, thereby establishing a breach of loyalty. In support, Plaintiffs noted that the 2% perpetuity growth rate employed in one of the fairness opinions was unreasonably low. The Court rejected Plaintiffs' argument, noting that the opinion provided to Defendants did not have any material omissions, and if any stockholder felt differently, they could have voted for appraisal, instead of supporting the merger. Additionally, the Court opined that just because "the two banks used some different assumptions and came to somewhat different outcomes does not create any rational inference of impropriety."[202]

Key Terms: Revlon, merger, entire fairness, fairness opinion, entire fairness.

[201] *Id*. at 672.
[202] *Id.* at 675.

Koehler v. NetSpend Holdings Inc., No. CIV.A. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013)

THE COURT FOUND IT LIKELY THAT THE NETSPEND BOARD BREACHED ITS REVLON DUTIES DURING THE SALE PROCESS.

A dissenting shareholder sought a preliminary injunction to stop the merger and acquisition of the target company, claiming the sale process was not reasonably designed to maximize the sale price because of the board's reliance on a weak fairness opinion resting on multiple problematic valuations.

Brenda Koehler ("Plaintiff"), a stockholder of NetSpend Holdings, Inc., ("NetSpend") sought to enjoin an acquisition of NetSpend by Total System Services, Inc., ("TSYS" or collectively, "Defendants"). In 2012, NetSpend's largest stockholder, JLL Partners Inc., ("JLL"), gave notice to NetSpend that it was interested in selling its stake in NetSpend. Private Equity A and Private Equity B sought to buy JLL at $12 per share. Subsequently, TSYS expressed interest in acquiring NetSpend. TSYS wanted to conduct an all cash tender offer for 100% of NetSpend at $14.50 per share. After receiving the offer, JLL lost interest in selling its shares to Private Equity A, and ended communications. After negotiations, NetSpend and TSYS agreed to a merger price of $16.00 per share.

The parties executed a merger agreement and NetSpend's advisor, Bank of America, provided NetSpend with a fairness opinion, which included a discounted cash flow analysis ("DCF"), comparable companies analysis, and comparable transactions analysis.[203] The DCF concluded the fair value to be in a range of $19.22 to $25.52 per share.[204] Plaintiff sought to enjoin the acquisition, claiming that NetSpend breached its fiduciary duties under *Revlon*, and additionally, did not disclose sufficient information to the stockholders. The Court ruled that Plaintiff had met the burden under *Revlon*, and the Court would not enjoin the merger because the Plaintiff did not show that the balance of equities favored enjoining the merger, as there were no other potential bidders.

Fairness Opinion

First, the Court held that the fairness opinion provided by Bank of America was weak. The Court noted that the merger price of $16.00 per share was below the bottom range of values implied by the DCF.[205] Additionally, the Court opined that the comparable companies and comparable transactions analyses were not useful, as they both involved dissimilar companies and transactions.

Standstill Agreement

The Court also found that NetSpend acted unreasonably by not waiving the standstill agreements found in the confidentiality agreements with Private Equity A and Private Equity B. By binding itself to the standstill agreements, any interest shown by either Private Equity A or Private Equity B was lost. The Court also noted that NetSpend did not understand the "don't ask don't waiver"

[203] Koehler v. NetSpend Holdings Inc., No. CIV.A. 8373-VCG, 2013 WL 2181518, at *10 (Del. Ch. May 21, 2013).
[204] *Id.* at 9.
[205] *Id.* at 17.

clause and commented that, "[n]othing in the record indicates that the retention by the Board of the don't ask don't waive provisions, or in the Board's importation of the provisions in the Merger Agreement, was informed, logical and reasoned."[206]

Bidding Process

Next, the Court held that NetSpend's single-bidder process was unreasonable. The Court noted that once NetSpend learned of the merger, the board had a duty to provide a market check in order to determine whether it had received the best price. Further, the Court noted that failure to obtain a go-shop period, combined with the reliance on a weak fairness opinion, resulted in uniformed sale process.[207] Specifically, the Court noted that the fairness opinion:

- Contained an uninformative premium analysis, which led the board to believe the market price undervalued NetSpend; and
- Contained companies and transactions that were not similar to NetSpend or the acquisition.

Preliminary Injunction

To demonstrate the merger caused irreparable harm, Plaintiff also "bears the burden of showing that the magnitude of the harm absent an injunction exceeds the potential harm of an injunction."[208] While the Court noted Plaintiff demonstrated irreparable harm without an injunction, Plaintiff did not demonstrate the magnitude of harm "exceeds the potential harm of an injunction."[209] The Court opined that three months had passed since the merger agreement and the market had been informed of the agreement, but no entities appeared to make an offer.[210]

Key Terms: standstill agreement, don't ask don't waive, Revlon, no-shop, go-shop, single bidder, irreparable harm.

[206] *Id.* at 19.
[207] *Id.* at. 20.
[208] *Id.* at 21.
[209] *Id.* at 22.
[210] *Id.*

Edgewater Growth Capital Partners, L.P. v. H.I.G. Capital, Inc. C.A. No. 3601-CS

EXPERT USES IRRELEVANT BASIS OF COMPARISON AND SABOTAGES VALUATION

The plaintiff contested the foreclosure of a company in the Delaware Court of Chancery, claiming it was not commercially reasonable under the Uniform Commercial Code (UCC) as to the sale process and price, considering its expert's valuation and "real-world" indications of value.

Background of the Court Case:

- Through debt financing, a private equity firm invested in several businesses that it merged into one company, leaving the new entity heavily leveraged.

- In February 2006, a month after the merger, the company failed to meet its EBITDA requirement. Subsequent default events forced the PE firm to guarantee about $4 million of senior debt. The December 2006 balance sheet showed negative stockholder equity of about $28.7 million. At that time, the firm's executive who was primarily responsible for the investment asked the company director for a $9 million rebate, stating that, at the time of the acquisition, the valuation of the combined company was approximately $170 million, but a year later it was closer to $90 million.

- A September 2007 internal e-mail cautioned the firm "not to engage any consultant to discuss valuation." Around that time, one of the defendants, the debt purchaser, bought 39% of debt from a senior lender at about 76 cents on the dollar. Some two weeks later, it bought an additional 6% of the same debt for about 72 cents on the dollar and became the largest senior lender.

- The lenders decided to sell the company assets under Article 9 of the UCC rather than place it in bankruptcy. Under a foreclosure sale agreement, the debt purchaser gave the company 55 days and funds to hire a qualified investment banker to procure a buyer for its assets. -- Did not get a single bid.

- The debt purchaser then arranged for an open auction, and, in March 2008, an affiliate (co-defendant) bought the company's assets for $41 million, plus the assumption of $50 million in liabilities. -- The PE firm did not bid.

- The firm claimed the debt purchaser and its affiliate violated Article 9 of the UCC by staging a sale that was not commercially reasonable in terms of process and price. The defendants argued the firm sued to avoid paying the $4 million guaranty.

- To support its position that the price "bore no relation to the value of the company," the PE firm retained a valuation expert, who performed a discounted cash flow (DCF) analysis to establish its enterprise value. He testified that, on the date of sale, the company was worth $110 million. He admitted that he did not use the available actual cash flows but rather projections a company employee had prepared in August 2007 based on the assumption that the company would undergo a "dramatic turn-around" after restructuring of its debt.

- The plaintiff's expert also used the guideline company method, deriving an EBITDA multiple for three public companies that operated in the same industry but were in different financial shape.

- "Some glaring mistakes" in the original report. The analysis rested on the wrong basis of comparison. The subject company had no earnings on its revenues, whereas the comparable companies had significant profit margins. Also, he overstated the EBITDA multiple for at least one of the comparables.

- The PE firm itself proposed an even higher value than its expert, claiming, on the date of the auction, the company was worth $130 million to $150 million because in the prior year, potential bidders had sent an "indication of interest in that range."

- A company director stated that the board hoped to obtain a minimum bid of $100 million, including liabilities. He "felt strongly" the resulting bid, at $41 million, was fair and explained that the purchase price dropped from $56 million to $41 million toward the end of negotiations because the debt purchaser agreed to assume additional liabilities, including the company's employment contracts. The director also acknowledged that, based on what he knew about the company's operations and performance at that time, he "would not have paid $20 million."

Outcome:

- The court found that the valuation the PE firm's expert submitted was unreliable. In terms of the DCF analysis, he used "optimistic cash flow projections" based on a turnaround plan that was never carried out. It remains unclear, the court said, why he relied on "stale, not to mention, unrealistic data" even though he had access to the actual financials until at least October 2007.

- He failed to compare the company to other distressed companies, the only relevant point of comparison.

- Further, it "makes no sense" that he changed a valuation multiple for one company but not his ultimate conclusion as to the overall value.

- The PE firm could not sell the company in 2007 for $130 million to $150 million, or even lower, because it could not obtain the requisite going concern opinion and survive buyer's due diligence.

- The firm failed to explain why it did not bid for the company's assets if it believed the subject was worth as much as the firm claimed. Its decision suggested "it did not believe that the company was worth more than the minimum bid."

- Because the court concluded the sale was commercially reasonable, the price the buyer paid for the assets was reasonable as well.

- Ruling for the defendants, the Court of Chancery required the PE firm to pay the $4 million it owed under the guaranty.

In re El Paso Corp. Shareholders Litigation C.A. No. 6949-CS.

DELAWARE CHANCERY SAYS 'SUSPICIOUS' VALUATIONS TAINTED MERGER

Vice Chancellor Leo Strine of the Delaware Court of Chancery charged Goldman Sachs with using "questionable" and "suspicious" valuations to exert a "troubling" influence over Kinder Morgan's billion-dollar bid for the El Paso Corp.

Background of the Court Case:

- El Paso is an energy company that operates a natural gas pipeline business as well as an exploration and production (E&P) division. In May 2011, El Paso publicly announced that it would spin off the E&P business.

- In an attempt to preempt other bidders for the spinoff, Kinder Morgan offered El Paso $25.50 per share for the entire company. After consulting with its longtime financial advisors, Goldman Sachs, as well as an independent bank (Morgan Stanley), the El Paso board countered with an offer of $28.00 per share and sent its CEO to negotiate the deal directly with the Kinder CEO. By late September 2001, the chief executives had agreed on a $27.55 merger price, subject to due diligence by Kinder Morgan.

- A day after the agreement, as V.C. Strine recounts it—"Kinder said, 'Oops, we made a mistake. We relied on a bullish set of analyst projections in order to make our bid. Our bad." Instead of telling the Kinder CEO "where to put his drilling equipment," the El Paso CEO backed down and then continued to take the deal on a "downward spiral," according to Strine, compromised by "debatable negotiation tactics" on the part of El Paso advisors as well as its principals.

- Included among these:
  1. Goldman Sachs stood on both sides of the transaction, ostensibly advising the El Paso board on the financial soundness of the Kinder bid (for a $20 million fee) while also owning roughly 19% of Kinder Morgan stock (worth nearly $4 billion).
  2. Goldman also occupied two seats on the Kinder board and was part of the control group that collectively held over 78% of the voting power of Kinder stock.
  3. More troubling still, the lead Goldman advisor to the El Paso board failed to disclose that he personally owned $340,000 worth of Kinder holdings.
  4. After Morgan Stanley was brought on to "cleanse" any perceived conflicts, Goldman was able to accomplish the "remarkable feat," Strine said, of giving the new bankers an incentive to favor the merger by tying their fees to the completion of the deal.
  5. On the executive side, the El Paso CEO failed to disclose his "secret motive" for closing the deal, which involved making a post-merger management buyout of the E&P division.

- In less than a month after Kinder reneged on its original terms, El Paso ended up taking a package that was valued at $26.87 per share as of the signing date (Oct. 16, 2011). The merger price, comprised of $25.91 in cash and stock and a warrant with a strike price of

$40 per share, was $13 above Kinder's then-current stock price and failed to protect against ordinary dividends.

- The merger agreement also contained a "no-shop" provision, preventing El Paso from soliciting other bids, permitting it only to take a "superior offer" for over 50% of its assets, on payment of a $650 million termination fee.

- Even though the merger price rose to $30.37 per share, (a 47.8% premium over El Paso's then-trading price), a group of El Paso stockholders sued to enjoin the merger, asserting numerous breaches of fiduciary duty based on the alleged conflicts of interest.

- Some of the "questionable decision" include the board failing to:
    1. Shop the company's two divisions separately to any other bidder after Kinder's first overtures, despite knowing that Kinder wanted to deflect other buyers from the attractive E&P division;
    2. Force Kinder to go public and face market pressure to raise its bid in a hostile takeover;
    3. Object when Kinder reneged on its original deal, based on the "arguably ludicrous" assertion that it relied on forecasts by one of the "most bullish analysts" covering El Paso's stock;
    4. Negotiate deal protections that would permit a post-signing market check for better bids for the separate divisions; and
    5. Negotiate a deal that at least equaled the value of Kinder's original offer.

- These narrowed down the option that the board had. They had two options: sell the entire company to Kinder or spin off its E&P assets.

- Goldman was permitted to remain as lead advisor on any spinoff, even after the board brought in Morgan Stanley. Therefore, Goldman "was in a position to continue to exert influence over the merger."

- When El Paso first announced its spinoff plan, Goldman first valued the E&P assets at $8 billion to $10 billion, using a comparable company's analysis and based on enterprise value to earnings multiples. By September 2011, when Kinder negotiations were well underway, Goldman said that declining EV/EBITDA multiples caused the E&P assets to lose another $1 billion in value; by October and the closing of the deal terms, their range of value had bottomed out at $6 billion to $8 billion.

- Kinder Morgan's advisors valued the same assets as of late September 2011 at $7.86 billion. Moreover, aspects of Goldman's valuations were "questionable," Strine noted, because short-term volatility in commodity prices had depressed the market multiples, making them inadequate indicators of long-term value. Further, "solely looking to market multiples to generate a hypothetical trading value fails to take into account the control premium that could be achieved on the sale of the E&P business," he said.

- Additionally, the failure by Goldman's lead banker to disclose his ownership of Kinder stock, "a very troubling" lapse that tended to undercut his testimony regarding the soundness of the deal and the strategic advice that he gave the El Paso board.

- Even worse Goldman tainted the cleansing effect of Morgan Stanley" by refusing to permit it to collect a fee if only the spinoff is consummated. In other words, if Morgan approved a deal (in which Goldman owned 19% of the acquiring entity), it received a $25 million fee. If it counseled the board to go with the spinoff or another option, Morgan got "zilch, nada, zero," Strine said.

- This fee incentive led to "odd" valuations by Morgan Stanley. Morgan used an unreasonably low terminal value for a portion of its discounted cash flow analysis of the El Paso pipeline business. Rather than use a perpetual growth model to calculate this terminal value, the Morgan analysts used a midpoint exit EV/EBITDA multiple of 10x, which resulted in a long-term growth rate of only 0.7%. -- This assumption conflicted directly with testimony from the El Paso CEO, who insisted the pipeline business had strong growth potential. It also conflicted with the management forecasts used by Morgan Stanley, which included capital expenditures for both maintenance and growth.

- Morgan may have used internally inconsistent values for Kinder's cost of equity, using a higher rate (11.8%) when benchmarking El Paso's COE but using a substantially lower rate (7.5%) when valuing Kinder directly. This arguably skewed Morgan's analysis in favor of the merger by overvaluing the stock portion of the Kinder price and undervaluing El Paso's stock.

Outcome:

- Based on all the "distortions" of the deal and concealed self-interests of the key players, the plaintiffs were reasonably likely to prove that El Paso breached its fiduciary duty and that "more faithful, unconflicted parties" could have secured a better merger price from Kinder Morgan.

- Monetary damages might not provide an adequate remedy, particularly since the board of largely independent directors (the El Paso CEO was the only insider) were shielded by an exculpatory provision in their charter and appeared to rely on their financial advisors in good faith.

- Goldman Sachs could be seen as an aider and abettor, "it has substantial, some might say government-insured, financial resources." Kinder Morgan also bargained hard, as it was entitled to do. For these reasons, the plaintiffs were likely to incur irreparable harm without an injunction, the court held.

- In truth, the plaintiffs were also asking for an odd mixture of remedies, requesting the court to enjoin the merger while the company shopped itself in whole or parts but then lift the injunction should a better deal fail to materialize. That would be unfair to Kinder Morgan.

- As a result, the court "reluctantly denied" the plaintiffs' request for a preliminary injunction, concluding that the El Paso shareholders should have the chance to decide for themselves about the proposed merger, "despite the disturbing nature of some of the behavior leading to its terms."

In re Answers Corp. Shareholders Litigation C.A. No. 6170-VCN. (Del. Ch. Apr. 11, 2012) (Noble, V.C.)

OPINION FLAWED FOR REJECTING DCF FOR HARD-TO-VALUE COMPANY?

The company operates Answers.com, which provides answer-based search services in six languages from two different platforms. Historically, the company has been highly dependent on Google. In 2010, for example, 75% of its revenue and 90% of its traffic came from Google, although the company expects that dependency to decrease in 2011. Further complicating the revenue picture, the Google and other search engine algorithms that direct traffic to the site tend to change unpredictably and for reasons outside the company's control. As a result, the company was unable to make long-range financial projections.

Background of the Court Case:

- In 2010, the board of directors decided to sell the company due to increasing competition and market uncertainty.

- A private equity group negotiated a bid at $10.50 per share. The fairness opinion completed by financial advisor (UBS) confirmed that the $10.50 price was fair.

- A group of shareholders moved to enjoin the sale in the Delaware Court of Chancery, claiming the sale process and price were unfair.

- The court considered whether the board's reliance on the UBS fairness opinion was improper.

- The plaintiffs claimed the opinion suffered from numerous flaws; for example, it was not based on a discounted cash flow (DCF) analysis of the company's value as a going concern, and its market analysis failed to use sufficiently comparable companies. The fairness opinion also did not account for the free cash that the company had on hand at the time of the transaction, which the buyer would receive in part to finance the transaction.

- Because of this cash, the premium represented in the sales price was "illusory," the plaintiffs argued, and once the value of the cash was backed out of the deal, the "real" sale price was simply equal to the company's trading price in February 2011 when the deal terms were set (approximately $8.75).

- The company's structure is "somewhat unusual", roughly one-fifth of its value is cash, resulting in a "sizeable difference" between its equity and enterprise value. The plaintiffs sought to "make much" of this condition by claiming the lack of a price premium on sale.

- "That criticism depends on a comparison of the outcomes of two different valuation measures," the court explained. The plaintiffs rightly emphasized the significance of the company's cash holdings, "but that does not impugn the fundamental valuation analysis and comparison necessary to determine the premium."

- UBS did not perform a DCF in its fairness opinion due to the company's "inability to forecast performance beyond the next fiscal year." Instead, UBS chose to use a comparable company analysis, "even though no other company was all that comparable," the court noted. UBS attempted to adjust its market approach, but "sometimes appraisal tools do not inspire confidence," the court said; "this is one of those times."

Outcome:

- The public company comparable analysis adopted by UBS in its fairness opinion was within the range of reasonableness, especially in light of the "discretion accorded to the work of experts," the court held. Moreover, UBS used this methodology to value the company without cash and then added the cash back into its final numbers. Thus, the board acted reasonably in relying on the UBS fairness opinion, "which was sensibly crafted given the limited universe of information available and the unique characteristics of the company," the court held, and declined to enjoin the sale.

Ehrlich v. Phase Forward, Inc., No. 4978392 (Mass. App. Ct. 2011)

FINANCIAL INFORMATION REQUIRED IN AN APPRAISAL ACTION DOES NOT INFORM MATERIALITY IN THE CONTEXT OF THE DIRECTORS' DUTY OF DISCLOSURE IN A PROXY STATEMENT

In Ehrlich v. Phase Forward, Inc., the appellate court affirmed the dismissal of the complaint that the proxy statement contained materially deficient disclosures, including the lack of a control premium in the comparable company analysis.

Background of the Court Case:

- In April 2010, Oracle announced its acquisition of Phase Forward, a publicly traded company that provided software for use in global clinical drug trials and safety procedures, for $17.00 per share, or 30% above the company's then trading price.

- Oracle initially had expressed interest in acquiring the company at $16.00 per share in 2006, which the board of directors declined after forming an independent special committee to investigate the offer and seek the advice of its investment advisors.

- In 2010, Oracle returned with the same offer. Again, the company formed a special committee comprised of disinterested directors to consult with its legal and financial advisors. The latter group tested the market for comparable bids; however, no potential bidders came forth. Nevertheless, the company rejected the offer, prompting Oracle to increase its asking price to $16.75 and finally $17.00 per share.

- The company filed its proxy statement with the SEC and delivered copies to shareholders outlining the sale process and summarizing the merger agreement as well as the fairness opinion by its investment bankers. Two independent shareholder advisory firms recommended shareholder approval based on, among other things, the completeness of the sale process.

- Several shareholders sued, claiming that the directors breached their fiduciary duties to shareholders by failing to conduct an adequate sale process. However, the trial court dismissed the compliant as it failed to state a cause of action under Delaware, and the plaintiffs appealed.

- The appellate court found that a majority of the company's directors were disinterested and had conducted the sale with significant board involvement. Although the directors may not have sought financial buyers (in addition to strategic buyers), that lapse did not rise to justify claim for breach of fiduciary duty under Delaware standards.

- The plaintiffs further claimed that the proxy statement contained materially deficient disclosures that left shareholders "unable to determine how to vote on the merger."

Among these claims, the plaintiffs complained that the proxy statements failed to disclose that the investment bank did not apply a control premium in its comparable company analysis. But the Delaware cases on which they relied addressed the context of statutory appraisal actions, “wherein use of a control premium was deemed necessary to correct the implicit minority discount in a comparable company analysis,” the court explained. In this case, the plaintiffs did not establish that the investment bankers had to meet the same requirements in the context of a fairness opinion for a proposed merger, or that failing to disclose the lack of a control premium was a “material omission that would have significantly altered their assessment of the offer,” the court added. Delaware precedent clearly provides that “financial information required in an appraisal action does not inform materiality in the context of the directors’ duty of disclosure in a proxy statement.”

Ha-Lo Industries, Inc. v. Credit Suisse Boston, No. 23505 (U.S. Dist. 2005)

A CALL FOR MORE "INDEPENDENT" OPINIONS.

Fairness opinions often are rife with potential conflicts of interest, none so obvious as when an investment firm's fee is contingent to the completion of a deal, which in turn depends upon that same firm issuing an opinion that the deal is financially "fair."

Background of the Court Case:

- Ha-Lo Industries, Inc. ("Ha-Lo") a promotional products company, sought to acquire a technology platform for internet expansion.

- Ha-Lo hired the defendant investment banking firm as financial advisor. The defendant's fee was specifically tied to the purchase price; if the deal fell through, the defendant would end up with no more than its retainer and a modest "break-up" fee.

- Since the defendant did not have specific expertise in technology systems, it advised the plaintiff to hire Ernst and Young ("E&Y") to assess this aspect of the deal. E&Y's report came back negative, indicating that the target's systems were incomplete, requiring significant investments. The plaintiff's CEO allegedly presented a positive picture to the board, however, and the company proceeded with the acquisition. Further, the defendant, who disputed receiving E&Y's report, issued its fairness opinion and earned a $2.5 million fee.

- Despite investing millions post-merger, the plaintiff later filed Chapter 11 bankruptcy and also filed suit against the defendant for "gross negligence" in rendering its fairness opinion. Specifically, the plaintiff claimed (1) the investment bank had valued the target using a methodology that would overstate its value; (2) it had disregarded relevant information about value and public information about the target's management practices; and (3) it had permitted self-interest in a lucrative fee and future business to override reasonable judgment.

- Before the facts went to a jury, the defendant filed a motion for summary judgment, arguing that the claims lacked legal merit. In denying the motion, the U.S. District Court (N. Dist. Illinois) touched on several undisputed facts, primary among them defendant's admission that any errors in its valuation of the target resulted from "simple mistakes." Given that the analyst who'd gathered the data had asserted his Fifth Amendment right to avoid self-incrimination rather than testify how the "simple mistakes" occurred, the court could not, as a matter of law, absolve defendant from bad faith.

- For now, the case is moving forward, while fairness opinions are headed for further scrutiny as more "independent" opinions are called for.

In re New York Stock Exchange/Archipelago Merger Litigation, Index # 601646 (NY 2005)

A FAIRNESS OPINION MUST BE FREE OF CONFLICTS OF INTEREST IF A SHAREHOLDER IS TO MAKE A TRULY INFORMED DECISION.

In re New York Stock Exchange/Archipelago Merger Litigation, the fairness opinions prepared by two separate firms were called into question because of various conflicts of interest. The report of a third firm however was deemed truly independent by the Court and a vote by seatholders of the NYSE was allowed to go on as scheduled regarding the contemplated merger. Shareholders can not make a fully informed decision based upon the fairness opinion of a third party, where conflicts of interest exist.

Background of the Court Case

- In late 2003, the NYSE board of directors began to consider strategic combinations;
- In the fall of 2004, Goldman, Sachs & Co. ("Goldman") along with other investment banks first suggested a deal with Archipelago Holdings, Inc. ("Archipelago");
- At the time of the contemplated merger, the NYSE's CEO was a former executive of Goldman;
- Goldman was to act as a facilitator of the deal, receiving fees from both NYSE and Archipelago;
- Goldman recommended an investment banking firm to write a fairness opinion for presentation to the NYSE board of directors;
- Certain of NYSE's seatholders complained on the following basis:
    - Breach of fiduciary duty and of loyalty
    - Breach of fiduciary duty of care; and
    - Aiding and abetting breach of fiduciary duty by Goldman;
- A settlement was reached requiring a second fairness opinion;
- Additionally, a third party performed a report regarding the fairness of the transaction; and
- the Court opined that the report of the third-party firm along with the second fairness opinion provided enough information for NYSE seatholders to make an informed decision and allowed a vote on the merger to go on as scheduled.

In re Tele-communications, Inc. Shareholders Litigation, C.A. No. 16470 (Del. 2003)

FINANCIAL ADVISORS MAY NEED TO CONSIDER "RELATIVE FAIRNESS UNDER THE ENTIRE FAIRNESS STANDARD.

In Re Tele-Communications, Inc. (TCI) Shareholder's Litigation, the Court suggested that the special committee members' actions were subject to the entire fairness standard of review (instead of the business judgment rule) because one stock group had personal interests that significantly diverged from those holders of the other stock group. Additionally, the Court's opinion implied (1) the role of the financial adviser and the substance of its advice and opinion must be clear and (2), the mandate of the special committee's financial adviser, as set forth in its engagement letter and its opinion, should be unambiguous. The special committee chose to use TCI's advisors instead of retaining their own separate legal and financial advisors. The TCI decision reinforces that the special committee (1) should be authorized under the adopting resolution or charter to select its own financial and legal advisers, (2) should select advisers who are free from relationships that could compromise their independence and (3) should not permit the interested party to influence the selection process. It may no longer be enough for the financial advisor to opine on financial fairness, but may have to expand their analysis to fair dealing as well.

Background of the Court Case

- At the time of an acquisition AT&T, TCI was organized as three divisions and had two separate classes of stock (high-vote and low-vote) for each division with the purpose of tracking their respective performances;
- The Chairman and CEO, and other directors of TCI owned the majority of the high-vote stock;
- In order to consent to and approve the AT&T transaction, the Chairmand and CEO insisted that the high-vote stock shareholders receive a 10 percent premium over the low-vote stock shareholders of each division;
- TCI's board formed a special committee to negotiate the transaction;
- The special committee chose to use TCI's advisors instead of retaining their own separate and independent legal and financial advisors;
- The special committee voted unanimously to recommend the transaction to the board of directors of TCI partially based upon the opinion of the financial advisor;
- The financial advisor delivered its opinion that the exchange ratio was fair to the holders of each class, from a financial point of view; and
- The transaction was approved unanimously by the board on the same date, however, the financial advisor did not opine as to the "relative fairness" of the exchange ratio to be received by holders of one class of stock as compared to the exchange ratio to be received by holders of another class.

In Re JCC Holding Co., Inc. Shareholders Litigation, No. 19796 (Del. Chan. 2003)

BOARD IS NOT OBLIGATED TO DISCLOSE UNDERLYING ANALYSES FOR VALUATION METHODOLOGIES THAT HAVE BEEN EXCLUDED FROM THE VALUATION CONCLUSION.

In Re JCC Holding Co., Inc., Shareholders Litigation, the court rejected a group of minority shareholders claims that a proxy detailing the fairness opinion did not provide fair disclosure. According to the court, "Under Delaware law, there is no obligation [...] to disclose information that simply does not exist-in this case, a non-exist DCF valuation."

Background of the Court Case:

- In 2002, Harrah's Operating Company held 63% of the stock of JCC Holding Co., Inc. ("JCC"), casino operator in New Orleans, Louisiana, and sought to acquire the remaining outstanding shares for $10.54 per share. Prior to the merger, JCC had undergone two bankruptcy reorganizations.

- In connections with the merger, JCC's board obtained a fairness opinion. Further, in the proxy statement supporting the merger, the summary of the fairness opinion disclosed that JCC was valued using a comparable company approach and also noted that while a discounted flow method is commonly utilized in this situation, one could not be performed here because JCC had no reliable long-term projections.

- A group of minority shareholders challenged the fairness of the merger arguing that the proxy did not make a fair disclosure because (a) it should have included analyses (e.g., discounted cash flow method) not performed by the investment banker, and (b) the analyses that were preformed were performed incorrectly; more specifically, the selection of comparables were not comparable to the subject company.

The court rejected both arguments provided by the minority shareholders group. The court found that the proxy statement adequately disclosed the fact that the valuations were not performed and the reasons why that was so. Regarding the second claim, the court stated, "This does not suggest the absence of fair disclosure; indeed, it inclines the mind in the opposite direction, because the proxy statement was written in a manner that allowed a reasonably sophisticated investor to see the key judgments that…[the investment banker] made and to make her own independent determination of whether those judgments struck her as proper."

Omnicare v. NCS Healthcare, 818 A.2d 914 (Del. 2003)

MERGER AND ACQUISITION TARGETS CAN NO LONGER FOLLOW A "PRE-COMMITMENT STRATEGY," OFFERING CONTRACTUAL CERTAINTY AS A MEANS OF NEGOTIATING A BETTER DEAL FOR SHAREHOLDERS.

In Omnicare v. NCS Healthcare, the Delaware Supreme Court suggested that boards of directors may no longer agree to a fully-protected merger agreement. Instead, the Court's opinion suggested, as a requirement of law, that target boards include an escape clause, in the form of a fiduciary out, in their merger agreements. A pre-commitment strategy offering contractual certainty as a means of negotiating a better deal for shareholders may no longer be prudent.

Background of the Court Case

- The board of directors of NCS Healthcare, Inc. ("NCS") an insolvent publicly traded Delaware Corporation, agreed to the terms of a merger with Genesis Health Ventures, Inc. ("Genesis") a publicly traded Pennsylvania corporation;

- Pursuant to this agreement, all of the NCS creditors would be paid in full and the corporation's stockholders would exchange their shares for the shares of Genesis;

- Prior to the date the stockholder vote was scheduled, NCS received a competing bid from Omnicare, Inc. ("Omnicare") a Delaware Corporation;

- The Omnicare offer would pay the stockholders twice the amount of the Genesis offer and treat all other stakeholders in NCS the same as the Genesis offer;

- The NCS board of directors withdrew their recommendation to proceed with the Genesis merger; and recommended the Omnicare offer as a superior offer;

- The merger agreement with Genesis contained a provision authorized by Section 251(c) of Delaware's corporation law requiring the Genesis agreement be voted on by stockholders even if the NCS board of directors no longer recommended it;

- Additionally,(1) the NCS board of directors also agreed to omit any effective fiduciary clause from the merger agreement and (2) two stockholders of NCS, who held a majority of the voting power, agreed unconditionally to vote all of their shares in favor of the Genesis merger;

- The Court of Chancery ruled that the voting agreements constituted defensive measures within the meaning of *Unocal Corp. v. Mesa Petoleum Co., 493 A.2d 946 (Del.1985)* and were reasonable; however,

- Upon appeal, it was found that those defensive measures were both preclusive and coercive and therefore invalid and unenforceable.

In re Cysive, Inc. Shareholders Litigation, C.A. No. 20341 (Del. 2003)

BURDEN OF PROOF SHIFTED TO MINORITY SHAREHOLDERS WITH THE USE OF A SPECIAL COMMITTEE AND INDEPENDENT LEGAL COUNSEL AND FINANCIAL ADVISORS.

In re Cysive Inc. demonstrates how the use of an independent special committee to the board of directors and independent legal counsel to negotiate and structure a transaction can shift the burden of proof to the dissenting shareholders. In this case, the Court opined that the board of directors acted properly in allowing an independent special committee to the board of directors and independent legal counsel to negotiate and structure a transaction and hire an independent appraiser to determine the liquidation value of Cysive Inc.'s common shares.

Background of the Court Case

- Cysive Inc. ("Cysive") began to struggle after the technology bubble burst. At that time, the company's board of directors began to look for a potential buyer as a means of adding value to shareholders;
- Cysive hired an investment banking firm specializing in the technology industry to as a financial advisor;
- When the financial advisor's efforts to find a willing buyer failed, the chairman, CEO and largest shareholder ("Carbonell") made an offer to purchase all the shares he did not own;
- The board set up an independent committee of disinterested board members, hired an independent financial advisor and legal counsel and continued to seek out potential buyers;
- As negotiations continued, an independent appraiser was hired to determine the liquidation value of Cysive's shares;
- At the time the board recommended the merger, Cysive had contacted 37 potential buyers in all, with none bidding higher for the company's shares than Carbonell;
- The plaintiff's brought suit seeking to enjoin the merger, and the court conducted an expedited trial, denied the request for injunctive relief and dismissed the case;
- The court cited the following reasons for determining fair dealing on the party of Cysive;
    1. The decision to enter into an agreement with Carbonell was preceded by an active and aggressive search for a third-party buyer;
    2. Once Carbonell made an offer, a special committee was set up to negotiate the transaction on Cysive's behalf;
    3. The presence of an independent board majority; and
    4. The process provided for a post-signing market check, where Broadview could continue to seek out third-party buyers up until the merger agreement was signed;

Additionally, the Court found the agreement to be financially fair to the minority shareholders and that the appraiser's liquidation value was the correct benchmark against which to assess financial fairness.

In re Pure Resources, Inc. Shareholders Litigation, 808 A. 2d. 421, 438 (Del. Ch. 2002)

CONTROLLING SHAREHOLDERS HELD TO STRINGENT DISCLOSURE REQUIREMENTS FOR FAIRNESS OPINIONS

In re Pure Resources, Inc. Shareholders Litigation, suggests that controlling shareholders as well as their board of directors and special committees will be held to more stringent disclosure requirements for fairness opinions. The Delaware Court held that, as a matter of state corporate law, a corporation must provide its shareholders with full disclosure of the financial analyses underlying any fairness opinion received by the target's board of directors or special committee in connection with an acquisition by a controlling shareholder, even in tender offer transactions where this disclosure is not required by the federal securities law.

Background of the Court Case

- The lead plaintiff in this case held a large block of shares in Pure Resources, Inc. ("Pure"), 65% of the shares of which are owned by Unocal Corporation ("Unocal");

- Unocal sought to acquire the rest of Pure's shares in exchange for Unocal shares;

- The plaintiffs believed the offer was inadequate and was subject to entire fairness review. Additionally, they claimed that the defendants had not made adequate and non-misleading disclosure of the material facts necessary for Pure's shareholders to make an informed decision of whether to tender into the offer; and

- The plaintiffs believed the offer was inadequate and was subject to entire fairness review. Additionally, they claimed that the defendants had not made adequate and non-misleading disclosure of the material facts necessary for Pure's shareholders to make an informed decision of whether to tender into the offer; and

- The Court concluded that the offer was not subject to the entire fairness standard, rather to the *Solomon* standards, however, preliminarily enjoined the offer because material information relevant to the Pure stockholders' decision-making process had not been fully disclosed.

Glassman v. Unocal Corporation, 777 A.2d242 (Del. 2001)

IN THE CASE OF A SHORT-FORM MERGER, A DISSATISFIED SHAREHOLDER'S ONLY RECOURSE, ABSENT FRAUD OR ILLEGALITY, IS APPRAISAL

In Glassman v. Unocal Corporation, the Delaware Supreme Court ruled that a majority shareholder need not establish entire fairness in a short-form merger. Instead, the opinion of the Court suggests majority shareholders can freeze out minority shareholders by simply paying them for the "fair value" of their shares. Therefore, a dissatisfied shareholder's only recourse, absent fraud or illegality, is appraisal.

Background of the Court Case

- Unocal Corporation ("Unocal") owned 96% of the stock of Unocal Exploration Corporation ("UXC") and sought to conduct a short-form merger with UXC;
- At the time of the contemplated merger, low natural gas prices caused a decrease in both revenue and earnings of both companies;
- Unocal believed that by eliminating the UXC minority, taxes and overhead could be reduced;
- The board of directors of both companies appointed special committees to consider a possible merger;
- The UXC committee agreed to a merger exchange ratio of .54 shares of Unocal stock for each share of UXC stock;
- The merger was announced, with the Notice of Merger and Prospectus stating the terms of the merger and advising the minority UXC stockholders of their appraisal rights;
- The plaintiffs filed a class action suit on behalf of the UXC minority shareholders asserting, among other things, that Unocal and its board of directors breached their fiduciary duties of entire fairness and full disclosure; and
- The Court of Chancery held that:
    1. The prospectus did not contain any material misstatements or omissions;
    2. The entire fairness standard does not apply in a short-form merger; and
    3. The Plaintiffs' exclusive remedy in this case was appraisal.

Crescent/Mach I Partners v. Turner, C.A. No. 17455 (Del. 2000)

SEEKING OF INDEPENDENT FAIRNESS OPINION DISMISSES PLAINTIFF'S CLAIM OF GROSS NEGLIGENCE BY A BOARD OF DIRECTORS UNDER ITS DUTY OF CARE

Under its fiduciary duties, a board of directors owes a duty of loyalty and a duty of care to the shareholders of the corporation. In Crescent/Mach I Partners v. Turner, the Court dismissed a plaintiff's allegation of gross negligence where claims asserted, among other things, that the director defendants acted with gross negligence in (1) failing to secure an independent fairness opinion and (2) approving an allegedly interested and defective fairness opinion. The Court found no evidence of either of these claims and accepted the fairness opinion as independent.

Background of the Court Case

- The Plaintiffs brought action alleging that the directors of Dr. Pepper Bottling Holdings, Inc. ("Holdings") breached their fiduciary duties of loyalty, care and "good faith" in approving the merger of Tosca Acquisition Corporation, into Holdings;
- Plaintiffs also alleged that many of the defendants aided and abetted the directors' breaches of fiduciary duty;
- One of the director defendants was also a managing director of an investment banking firm retained by Holdings, which also prepared a fairness opinion for the transaction;
- The negotiated plan of merger proposed to convert certain shares of Holdings' class A common stock not owned by the majority shareholder into the right to receive the cash-out price, terminating the equity interest of all pre-merger stockholders in Holdings;
- The plaintiffs alleged many "side-deals" on the part of the director defendant for himself and his affiliates, 10 of which were specifically mentioned in the opinion;
- The financial advisor delivered its opinion to the Holdings board of directors, noting that it performed three principal valuation analyses:
    1. A comparable publicly traded company analysis;
    2. A comparable merger transaction analysis; and
    3. A discounted cash flow analysis;
- The board of directors unanimously approved the plan of merger and recommended it to the stockholders who were sent out a proxy statement 26 days prior to a vote on the merger and informed of their appraisal rights;
- Plaintiff's sought rescission of the merger; and
- The Court partially granted the defendant's motion to dismiss and partially denied the motion.