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## Statutory Appraisal

*“There must be a better way to run a railroad”*

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Recent commentary regarding stockholders seeking a fair price determination under statutory appraisal in the Delaware Court of Chancery established an appraisal checklist, posing basic litmus-test questions in deciding whether to seek statutory appraisal or commence a fiduciary duty action – or both.[2] The decisions in Verition Partners Master Fund Ltd. v. Aruba Networks Inc.,[3] Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.,[4] and DFC Glob. Corp. v. Muirfield Value Partners LP,[5] held that an adequate sale process generally results in fair value being equal to deal price and, if the buyer is a strategic buyer, then synergies generally will be deducted from deal price in determining fair value. If the sale process was inadequate (especially if the corporation adopted a provision in its certificate of incorporation limiting or eliminating the exposure of directors to monetary liability based upon breaches of the duty of care pursuant to Section 102(b)(7) of Delaware’s General Corporation Law), then it was suggested by the authors that appraisal may offer stockholders the opportunity to be awarded monetary relief based upon the position that (because of the tainted sale process) fair value exceeds deal price.

Contrary to such suggestion (which presumes that an inadequate sale process will result in fair value exceeding deal price), the Chancery Court in Jarden, after holding that the sale process was inadequate, twice

concluded that “unaffected market price” (which was approximately 18.41 percent less than deal price) was the most reliable indicator of fair value. According to the guidance offered by Delaware courts, an adequate sale process generally will result in fair value equaling deal price, and an inadequate sale process generally will result in fair value equaling unaffected market price, which probably will be lower than deal price. Based upon this guidance, absent extraordinary facts that may justify a different result, statutory appraisal arguably is appropriate solely in the context of transactions involving (a) a corporation with no public market for its stock, (b) a stock that is illiquid or thinly traded, or (c) a controlling stockholder.

The Final Order and Judgment in Jarden was entered by the Chancery Court on October 2, 2019. A Notice of Appeal to the Delaware Supreme Court was filed by petitioners in Jarden on November 1, 2019. Although the Supreme Court may offer additional guidance regarding the reliance upon unaffected market price if the sale process was inadequate, prior to the additional guidance, the current purpose of statutory appraisal appears to be limited.

### The Appraisal Checklist

According to the appraisal checklist, if appraisal arbitrage is not implicated, then the issues are whether the buyer is a financial sponsor or a strategic buyer, and whether the sale process was adequate or inadequate. Synergies generally are not implicated if the buyer is a financial sponsor. The word “generally” is used because,

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as recognized by Delaware courts, synergies may be implicated (a) from a sale to a financial sponsor based upon companies in the financial sponsor's portfolio and reduced agency costs,[6] and (b) if a financial sponsor outbids a strategic buyer. In contrast, synergies generally are implicated if the buyer is a strategic buyer. In sum, stockholders should commence an appraisal proceeding with caution if synergies are implicated in the transaction because synergies will be deducted from deal price in determining fair value.

An adequate sale process generally results in fair value being equal to deal price. Accordingly, if the buyer is a financial sponsor and if the sale process is adequate, then fair value will equal deal price; if the buyer is a strategic buyer and if the sale process is adequate, then fair value probably will be less than deal price because synergies need to be deducted from deal price. As recognized by the Chancery Court, however, "it is not possible to determine with precision what portion of deal price reflects synergy value." [7] Determining fair value with any precision based upon deal price minus synergies, therefore, will be a challenge because the calculation of synergies may be "tainted by human error." [8] Notwithstanding the challenge, it should suffice to state that a strategic buyer coupled with an adequate sale process will result in fair value being less than deal price, and the magnitude of the reduction in deal price will be determined by the value of synergies calculated by a court.

Although the complexities associated with determining fair value may be numerous, the most difficult task confronting the Chancery Court is determining fair value in the context of an inadequate sale process because the lack of an adequate sale process offers the Chancery Court no benchmark – deal price – to rely upon in determining fair value. The difficulties in determining fair value are magnified if the inadequate sale process is coupled with a strategic buyer, which requires a court to calculate the value of synergies. This is the scenario confronting the Court in *Jarden*.

## **Jarden: The Saga Continues**

In *In re Appraisal of AOL Inc.*, [9] the Delaware Court of Chancery discussed statutory appraisal in an extremely eloquent manner, referencing Michelangelo and William Blackstone, and citing to Blackstone's Commentaries. [10] After read-

ing the various briefs and supporting documents presented to the Court by the parties in *Jarden* (and focusing upon the competing experts' DCF valuations and other financial analyses) two different contemporary commentators come to mind:

Butt-head: Uhhhh . . . I'm, like, angry at numbers.

Beavis: Yeah, there's like, too many of them and stuff. [11]

In *Jarden*, the Chancery Court held that the sale process was inadequate, which resulted in the Court placing "little weight on the deal price less synergies" approach to valuation "beyond considering that evidence as a 'reality check' on my final fair value determination." [12] In determining "deal price less synergies" for the "reality check," the Court held that "[w]hile I have questioned the reliability of the [deal] price less synergies approach, I recognize that the most reliable estimate of fair value under that approach is approximately \$46.21." [13] Based upon this calculation, the Court calculated synergies to equal \$13.00 per share because the difference between the deal price (\$59.21) and this calculation (\$46.21) equals the value of synergies (\$13.00). In the decision, the Court did not offer the detail supporting this calculation of synergies. Interestingly, if the unaffected market price (which the Court determined to equal fair value) is \$48.31, and if the deal price less synergies approach results in a value of a value \$46.21, then, based upon these valuations, the unaffected market price contained \$2.10 of the value of synergies. There is no explanation in the decision for concluding that \$2.10 of the value of synergies generated by the merger was contained in the market price prior to the announcement of the merger.

Notwithstanding the issues associated with the deal price less synergies approach, the Court continued with its calculation of fair value, by stating (and lamenting):

The parties have reveled in the statutory mandate that the court consider "all relevant factors." Indeed, they have joined issue on nearly every possible indicator of fair value imaginable, including market indicators (unaffected market price, deal price less synergies, *Jarden* stock offerings shortly before the Merger) and traditional valuation methodologies (comparable companies and DCF analyses). The result: an unfortunately long opinion, made so by a sense that I needed to traverse every road the parties waived me down right to the bitter end,

even if that road did not lead to the desired fair value destination. Appraisal litigation can be unwieldy. This is one of those cases. Apologies in advance to those who read on.[14]

After making such statement, the Court concluded:

Insofar as I am obliged to articulate a principled, evidence-based explanation for the delta between the Unaffected Market Price and the DCF valuation (here, \$0.18 per share), I am satisfied the difference reflects the subjective imperfections of the DCF methodology.[15]

In response to this decision, Petitioners filed a Motion for Reargument (the “Motion”), asserting (among other things) that the Court’s DCF valuation had six mathematical errors or omissions that, if corrected, then results in a valuation range of \$61.59 to \$64.01 per share, and, thus, the Court should reconsider its determination of fair value “[b]ecause the corrected DCF valuation does not corroborate Jarden’s stock price.”[16] Further, as argued by Petitioners:

[B]ecause the Court concluded that the deal process was problematic and tainted with negotiator self-interest and that there was no reliable evidence as to the amount of synergies, if any, that were paid to Jarden stockholders, the only reasonable conclusion is that the deal price of \$59.21 should serve as the floor to the Court’s fair value determination because a “good” process would have logically resulted in a better deal price for Jarden, not worse.[17]

Jarden opposed the Motion, asserting (among other things) that the Motion does not identify any issue with the Court’s acceptance of unaffected market price as the most reliable indicator of fair value.

The Court granted the Motion in part as it relates to the Court’s DCF valuation, and denied the Motion in part as it relates to the Court’s final determination of fair value. Specifically, the Court agreed with Petitioners that the Court’s “DCF analysis must be corrected as the result of errors made in structuring the DCF model and calculating value.”[18] The Court, however, disagreed with Petitioners “that the corrected DCF yields a fair value in the range of \$61.59 and \$64.01 per share,”[19] and implicitly rejected Petitioners’ position that “the deal price of \$59.21 should serve as the floor to the Court’s fair value determination.” Indeed, after correcting its errors, the Court held that its DCF analysis “yields a fair value of Jarden of \$48.23 per share,”

which “corroborates the Court’s appraisal based upon the [u]naffected [m]arket [p]rice of \$48.31 per share.”[20]

In so holding, the Court stated:

Ironically, in the Opinion, I cautioned that our courts should not wade “deep into the weeds of economics and corporate finance” without “the guidance of experts trained in these disciplines.” Yet that is precisely what I did when I endeavored to conduct my own DCF analysis upon concluding that the credible evidence did not support certain aspects of both of the competing experts’ DCF valuations. . . . In view of the fact that the parties’ experts could not agree on any of the significant inputs for the DCF analysis, I am more convinced than ever that the experts’ inability to agree on inputs is evidence that DCF is not reliable here, particularly given the presence of a reliable “market-based metric.” The better approach, therefore, would have been to leave it at that rather than “parse through the inputs and hazard semi-informed guesses about which expert’s view was closer to the truth.”[21]

This statement is consistent with previous statements by the Court regarding its frustration with experts in appraisal proceedings.[22] As the authors suggested in a prior article, parties and their advisors should keep this frustration in mind and consider presenting positions to Delaware courts regarding fair value closer to deal price (if the transaction is the result of arms-length negotiation with a third party), which the Court may rely upon with little or no adjustment in determining fair value.[23]

### **Appraisal: Where Are We Now?**

The decisions in *Aruba*, *Dell*, and *DFC* held that an adequate sale process generally results in fair value being equal to deal price and, if the buyer is a strategic buyer, then synergies generally will be deducted from deal price in determining fair value. The decision in *Jarden* offers the Delaware Supreme Court the opportunity to explain the analysis that should be applied if the sale process is inadequate. The Chancery Court applied the unaffected market price in determining fair value, which appears to be consistent with Delaware law and the view of certain commentators.[24]

In sum, unless the parties and their advisors present DCF analyses and/or other analyses to Delaware courts regarding fair value closer to deal price (if the transaction is the product of arms-length negotiation with a third party),

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there is a possibility that courts will reject the analyses as unreliable and will no longer conduct the detailed analyses that was conducted by the Chancery Court in *Jarden*. Lacking reliable analyses, the Court simply may apply the deal price as the benchmark in determining fair value if the sale process is adequate and, according to the Chancery Court in *Jarden* (subject to Supreme Court review), the Court simply may apply unaffected market price as the benchmark in determining fair value if the sale process is inadequate. Although there may be exceptions to these general guidelines, absent any exception, statutory appraisal may be appropriate primarily (if not exclusively) with respect to transactions involving (a) a corporation with no public market for its stock, (b) a stock that is illiquid or thinly traded, or (c) a controlling stockholder.

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## Endnotes

- [1] *In re: Appraisal of Jarden Corp.*, 2019 WL 4464636, at \*1 n.4 (Del. Ch. Sept. 16, 2019).
- [2] See Maimone & Schoell, *Chancery Decision Demonstrates When To Skip Appraisal, Law 360* (Aug. 14, 2019); Maimone & Schoell, *Revisiting When – And When Not – To Seek Appraisal, Law 360* (May 20, 2019); Maimone & Schoell, *When To Seek Appraisal: A New Checklist, Law 360* (May 2, 2019).
- [3] 210 A.3d 128 (Del. 2019).
- [4] 177 A.3d 1 (Del. 2017).
- [5] 172 A.3d 346 (Del. 2017).
- [6] See, e.g., *In Re Appraisal of Petsmart, Inc.*, 2017 WL 2303599, at \*31 n.364 (Del. Ch. May 26, 2017).
- [7] *In re Appraisal of DFC Global Corp.*, 2016 WL 3753123, at \*2 (Del. Ch. July 8, 2016) (“[e]stimating synergies

requires exercises of human judgment analogous to those involved in crafting a discounted cash flow valuation”), rev’d on other grounds, *DFC Glob. Corp. v. Muirfield Value Partners LP*, 172 A.3d 346 (Del. 2017).

- [8] *Id.*
- [9] 2008 WL 1037450 (Del. Ch. Feb. 23, 2018)
- [10] *Id.* at \*1 (citing 1 William Blackstone, *Commentaries*, \*38-62).
- [11] *Beavis & Butt-head* (Mike Judge) *Beavis and Butt-head Season 5, Episode 1: Held Back*.
- [12] *In re Appraisal of Jarden Corp.*, 2019 WL 3244085, at \*3, \*23-\*26 (Del. Ch. July 19, 2019) (the “Opinion”).
- [13] *Id.* at \*50.
- [14] *Id.* at \*2.
- [15] *Id.* at \*50.
- [16] Motion at 1, ¶ 1.
- [17] *Id.* at 1, ¶ 2 (emphasis added).
- [18] *Jarden*, 2019 WL 4464636, at \*1.
- [19] *Id.*
- [20] *Id.* at \*4.
- [21] *Id.* at \*1 n.4 (citations omitted).
- [22] *Jarden*, 2019 WL 3244085, at \*1; see also *PetSmart*, 2017 WL 2303599, at \*2.
- [23] See Maimone & Schoell, *Chancery Decision Demonstrates When To Skip Appraisal, Law 360* (Aug. 14, 2019).
- [24] See, e.g., *Aruba*, 210 A.3d at 137-38 nn. 53-56; *In re Appraisal of Stillwater Mining Co.*, 2019 WL 3943851, at \*51 (Del. Ch. Aug. 21, 2019) (“For purposes of determining fair value in an appraisal proceeding . . . the trading price has a lot going for it.”); see also, e.g., *Richard A. Booth, Minority Discounts and Control Premiums in Appraisal Proceedings*, 57 *Bus. Law.* 127, 151 n.130 (2001) (“[M]arket price should ordinarily equal going concern value if the market is efficient.”); *William J. Carney & Mark Heimendinger, Appraising the Nonexistent: The Delaware Court’s Struggle with Control Premiums*, 152 *U. Pa. L. Rev.* 845, 879 (2003) (noting that the appraisal statute requires consideration of all relevant factors and stating that “in an efficient market, absent information about some market failure, market price is the only relevant factor”); *Lawrence A. Hamermesh & Michael L. Wachter, The Short and Puzzling Life of the “Implicit Minority Discount” in Delaware Appraisal Law*, 156 *U. Pa. L. Rev.* 1, 52 (2007) (“Take the case of a publicly traded company that has no controller. Efficient market theory states that the shares of this company trade at the pro rata value of the corporation as a going concern.”).

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