The Treatment of Synergistic Value

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In Dissenting Shareholder Appraisal Rights Matters (Part II of II)

The Delaware Court of Chancery decisions on the treatment of synergistic value in dissenting shareholder appraisal rights cases provide meaningful guidance to valuation analysts, legal counsel, and other courts. This final part of the article continues the discussion on recent judicial decisions issued by the Delaware Court of Chancery where synergistic value was a consideration in a dissenting shareholder appraisal rights matter. This discussion provides insights related to the treatment of synergistic value within the context of a statutory appraisal rights fair value controversy.

The second part of this article discusses Chancery Court decisions not favoring transaction sales pricing and the impact of *Dell* and *DFC*dictating when synergies are recognized in fair value appraisal actions.

Chancery Court Decisions Not Favoring Transaction Sales Pricing

In contrast to *Verition*, there are instances in which the Chancery Court has deviated from the subject transaction deal price. These instances arise when the Chancery Court determined that the subject transaction deal process was flawed.

For example, in *Blueblade Capital Opportunities LLC v. Norcraft Cos*. (*Norcraft*), sales price was found to be unreliable. In *Norcraft*, Vice Chancellor Slights ruled that the merger price of $25.50 was an unreliable indicator of fair value. That was because the Chancery Court considered the sale process to be flawed for the following reasons:[24]

- Norcraft and its advisors were fixated on one buyer (Fortune Brands) and did not shop for other potential buyers.
- Norcraft's lead negotiator was focused on securing benefits for himself.
- The 35-day post-signing go-shop process was deemed ineffective as deal-protection measures constrained the process.
- *Norcraft* was tried before, but decided after, the *Dell* decision was announced. In *Norcraft*, Vice Chancellor Slights cited consideration for the Delaware Supreme Court decisions in "*DFC* and *Dell*."[25]

Vice Chancellor Slights considered the deal-price-less-synergies method of calculating fair value.

However, in *Norcraft*, the court found that the transaction sales process was a flawed process. Therefore, the court did not rely on the deal-price-less-synergies calculation that the respondents' expert provided. Similarly, the court ruled that it could not rely on the unaffected market price.

Vice Chancellor Slights concluded that, because Norcraft had gone through an initial public offering only 18 months prior to the acquisition transaction, it had limited trading history. In other words, the Norcraft equity market price was not a reliable indicator of value.

In *Norcraft*, the court ultimately relied on a discounted cash flow method using certain components provided in one of the analyst's discounted cash flow analyses. The court was mindful to exclude synergistic value and arrived at an equity value per-share of $26.16. The $26.16 per share price was greater than the transaction deal price of $25.50.

Another example where the Chancery Court did not rely on market indicators is *In re AOL Inc.* (*AOL*). In *AOL*, the Chancery Court relied on the discounted cash flow method. That was because the court concluded that the deal process was not "Dell Compliant."

According to the Chancery Court, "Dell Complaint" means:

(i) Information was sufficiently disseminated to potential bidders so that (ii) an informed sale could take place (iii) without undue impediments imposed by the deal structure itself.[26]

In *AOL*, the Chancery Court agreed with both analysts that the discounted cash flow method was the best indicator of fair value. However, in *AOL*, the petitioners abandoned their analysts' opinion and agreed with the Chancery Court finding that the AOL analysts' opinion would be the starting point. After making some adjustments to the respondent analyst's discounted cash flow analysis, Vice Chancellor Glasscock determined that the fair value per share of AOL, as of the merger date, was $48.70.

A fair value price of $48.70 was less than the $50.00 per share deal price. The court explained the difference by suggesting that the deal price included synergies.[27]

In *Norcraft*, the Chancery Court determined fair value by applying the discounted cash flow method, arriving at share prices greater than the deal price. In *AOL*, the Chancery Court applied the same valuation method but concluded that the fair value was less than the deal price. These matters illustrate the risk shareholders should consider in deciding to enact their appraisal rights as opposed to the receipt of transaction consideration.

In Re Appraisal of Solera Holdings, Inc.

In re Appraisal Solera-Holdings, Inc. (*Solera*), Vice Chancellor Bouchard concluded that synergies can exist even when a financial sponsor is the acquiring firm. In the instant case, the Chancery Court determined the value of Solera as of March 13, 2016. On that date, Solera was acquired by Vista Equity Partners (Vista) for $55.85 per share.[28]

In *Solera*, Vice Chancellor Bouchard concluded that the Supreme Court's emphasis on the efficient market hypothesis, in recent rulings, now requires the Chancery Court to assess whether a transaction is "Dell Compliant." In *Solera*, the court ruled that the sale process was adequate and that the transaction was "Dell Compliant." Therefore, the Chancery Court relied on market indicators as applied in *Dell* and *DFC*.

After the *Solera* trial, and before the Chancery Court made its ruling, the *Verition* case was decided. As a result of that decision, the analysts in the instant case were given the opportunity by Vice Chancellor Bouchard to adjust their fair value analyses. The Solera analyst prepared an analysis based on the company's 30-day unaffected stock price as the "best evidence"[29] of fair value.

Ultimately, Vice Chancellor Bouchard dismissed the unaffected share price because, among other reasons, it had not been introduced or argued as fair value by either side prior to the *Verition* decision being made public.

Vista owned four other portfolio companies that were similar to Solera. This ownership provided a basis for the acquisition of Solera because Vista had significant "touch points" (i.e., synergies) with Solera. These perceived "touch points" were quantified into synergies by the respondents' analyst.

Because the Chancery Court concluded that the transaction had been "Dell Compliant" and the Supreme Court guidance endorses the use of market efficiency principles in appraisal actions,[30] Vice Chancellor Bouchard determined that the deal price less estimated synergies value of $53.95 provided by the respondents' analyst, was the Solera fair value at the time of the acquisition.

In *Solera*, the Chancery Court again invoked the guidance provided by the *DFC* and *Dell* decisions to determine fair value. However, the courts analysis in the instant case differs from the previously discussed cases presented in this discussion. For example, in the instant case, the Chancery Court decided to go with the respondents' analyst and use the deal price less estimated synergies calculation. It is noteworthy that, in this instance, much of the analysis performed by the respondents' analyst went largely uncontested by the petitioners.

Another major take-away from the Chancery Court's decision in *Solera* is that Vice Chancellor Bouchard dismissed Vice Chancellor Laster's finding that the deal price less synergies calculation is prone to "human error" because fair value should account for reduced agency costs. Vice Chancellor Bouchard found that Vice Chancellor Laster did not interpret the *DFC* and *Dell* decisions to suggest that agency costs had a separate value attributable to the merger price and should be excluded.

Vice Chancellor Bouchard goes on to say that "had that been the Supreme Court's intention, I believe it would have said so explicitly."[31]

The Chancery Court applies this reasoning to support its use of the deal price less estimated synergies in this case.

Finally, it is noteworthy that, in the instant case, perceived synergies were considered in matters involving a financial-buyer and not a pure synergistic-type buyer. Vista was able to demonstrate that Solera had what it called "touch points" with Vista's other portfolio companies and that its expert was able to quantify them. In this case, the Chancery Court said that "synergies do not only arise in the strategic-buyer context."[32]

Here the Chancery Court confirmed that it believes synergies may also exist in a financial buyer context.

Summary and Conclusion

Due to the court's extensive experience in deciding valuation-related matters, the decisions of the Chancery Court are closely followed by counsel, analysts, and other courts. The Chancery Court has repeatedly addressed issues related to the treatment of synergistic value in a transactional context.

The court may consider and determine if a transaction is deemed "Dell Compliant." This determination is an important variable that may have fair value implications. The Chancery Court appears to be favoring market indicators when there is:

1. An efficient market for a company's stock, and
2. A robust sales process in its recent decisions.

However, with each fair value decision, the Chancery Court provides more information about its interpretation of *DFC* and *Dell* decisions. Analysts involved in fair value matters should be aware of the recent Chancery Court decision and should be mindful of future decisions related to these issues.

This discussion provided insight as to how the Chancery Court adopted the guidance provided by the *Dell* and *DFC* decisions.
The *Dell* and *DFC* decisions are relevant to and should be considered in Chancery Court fair value case matters. While the consideration of the transaction deal price is an important consideration in fair value matters, the analyst should also consider how synergistic value may be included in the transaction deal price.

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Notes

1. *Blueblade Capital Opportunities LLC v. Norcraft Companies, Inc*., C.A. No. 11184-VCS 1, 2018 WL 3602940 (Del. Ch. July 27, 2018).
2. *Ibid*.
3. "Chancery Relies on DCF Where Deal Process Is Not 'Dell Compliant'," BVLAW Case Update (May 2018), accessed December 5, 2018. www.bvresources.com
4. *Ibid*.
5. *In re Appraisal of Solera Holdings*, 2018 WL 3625644.
6. *Ibid*.
7. *Ibid*.
8. *Ibid*.
9. *Ibid*.