Securities Litigation Alert

Weil

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Delaware Court Issues Two Post-Trial Appraisal Decisions:

- In *PetSmart*, Determines That Merger Price Equals Fair Value In Private Equity Leveraged Buyout Transaction
- In *SWS Group*, Holds That Fair Value Is Below Merger Price

By John Neuwirth, Evert Christensen and Thomas James

On May 26, 2017, the Delaware Court of Chancery issued its post-trial decision in *In re Appraisal of PetSmart, Inc.*, C.A. No. 10782-VCS (Del. Ch.), an appraisal proceeding arising out of a private equity buyer's acquisition of PetSmart, Inc. The petitioners' expert advanced a litigation-driven discounted cash flow (DCF) analysis, based on management's projections prepared specifically for the sale process (and not in the ordinary course), implying that the merger price of $83.00 per share undervalued the company by nearly $4.5 billion.

Relying in part on Vice Chancellor J. Travis Laster's December 2016 post-trial appraisal decision in *Merion Capital, L.P. v. Lender Processing Services, Inc.*, C.A. No. 9320-VCL (Del. Ch.), in which Weil successfully represented the respondent corporation and convinced the Court that the merger price was the best evidence of the fair value of the company after a competitive sale process, Vice Chancellor Joseph R. Slights III held that "[i]n the wake of a robust pre-signing auction among informed, motivated bidders, and in the absence of any evidence that market conditions impeded the auction, [the Court] can find no basis to accept Petitioners' flawed, post-hoc valuation and ignore the deal price." In reaching its decision, the Court determined that management's long-term projections were "saddled with nearly all of the [ ] telltale indicators of unreliability," including a lack of history of creating long-term projections, frequently missed short-term projections, and projections prepared for the purpose of the sale process, rather than in the ordinary course.

The Court also rejected petitioners' argument that a private equity "'LBO model' will rarely if ever produce fair value because the model is 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." The Court held 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."

As appraisal continues to be a significant litigation battleground arising out of M&A transactions, *PetSmart* reinforces that a merger price "'forged in the crucible of objective market reality,' meaning that it was 'the product of not only a fair sales process, but also of a well-functioning market,'" will often be the best evidence of fair value—regardless of whether the buyer is a strategic or financial buyer.

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On May 30, 2017, Vice Chancellor Sam Glasscock III issued his post-trial decision in *In re Appraisal of SWS Group, Inc.*, C.A. No. 10554-VCG (Del. Ch.), an appraisal proceeding arising out of the acquisition of SWS, a small bank holding company, by one of its principal creditors, Hilltop Holdings, Inc.

Although acknowledging that "a public sales process that develops market value is often the best evidence of statutory 'fair value,'" the Court held that SWS's sale process was not a reliable proxy for statutory fair value because of, among other things, "the probable effect on deal price of the existence of the [Hilltop] Credit Agreement under which the acquirer exercised a partial veto power over competing offers." (The Court also noted that neither party relied on the merger price to demonstrate fair value.) Instead, the Court employed a DCF analysis that derived a fair value of $6.38 per share, approximately 8% below the final merger consideration value of $6.92 per share in cash and Hilltop stock. The Court noted that its value below the merger price "is not surprising" because the transaction was driven by synergies "whereby the acquirer shared value arising from the merger [excluded from the fair value calculation under the Delaware appraisal statute] with SWS."

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