DUFF & PHELPS
Protect, Restore and Maximize Value

# The Delaware Court of Chancery Selected Business Valuation Case Summaries

**SELECTED SUMMARIES OF 2018 DECISIONS**

## INTRODUCTION

Duff & Phelps' experts testify on commercial and shareholder disputes across the world, as well as in the Delaware Court of Chancery, which is widely recognized as one of the nation's leading business courts in terms of volume of complex business-related cases. As a result, the Delaware Court of Chancery has developed significant case law in this area.

This high volume of business cases results in the Court issuing numerous opinions, many of which address business and security valuation and economic damages. In this Court Case Update, we focus on seven opinions from 2018 to highlight how certain valuation and damages analysis topics are viewed by the Court. We chose these seven opinions based on the valuation themes they represent and the depth of analysis contained in the Court's opinions. We also note that the Delaware Supreme Court confirmed two 2017 decisions in February 2018 and April 2018, respectively: In re Appraisal of SWS Group, Inc., C.A. No. 10554-VCG (Del. Ch. May 30, 2017) (Del. Supreme Court February 23, 2018) and ACP Master, Ltd., et al. v. Sprint Corporation, et al., C.A. No. 8508-VCL; ACP Master, Ltd., et al. v. Clearwire Corporation, C.A. No. 9042-VCL (Del. Ch. July 21, 2017, corrected August 8, 2017) (Del. Supreme Court, April 23, 2018).

In our review of the cases herein, we have attempted to summarize the salient points related to valuation and damages only. We recommend that interested readers obtain the full Court opinions to gain a complete understanding of all the issues addressed and each judge's position. We have included a hyperlink to each decision below its case caption.

In this Court Case Update, we summarize the following cases:

*Verition Partners Master Fund Ltd. And Verition Multi-Strategy Master Fund Ltd. v. Aruba Networks, Inc.,* C.A. No. 11448-VCL (Del. Ch. February 15, 2018)
Vice Chancellor Laster
Issues: merger price, unaffected stock price, synergies, agency costs, projections
Click here to view the opinion

*In re Appraisal of AOL Inc.,* C.A. No. 11204-VCG (Del. Ch. February 23, 2018; revised August 15, 2018)
Vice Chancellor Glasscock
Issues: merger price, 3-stage DCF, projections, acquisitions/deals, operating cash
February 23, 2018 opinion: Click here to view the opinion.
August 15, 2018 opinion: Click here to view the opinion.

*Blueblade Capital Opportunities LLC and Blueblade Capital Opportunities CI LLC v. Norcraft Companies, Inc.,* C.A. No. 11184-VCS (Del. Ch. July 27, 2018)
Vice Chancellor Slights
Issues: unaffected stock price, merger price, synergies, projections, beta
Click here to view the opinion.

In re Appraisal of Solera Holdings, Inc., C.A. No. 12080-CB (Del. Ch. July 30, 2018)
Vice Chancellor Bouchard
Issues: merger price, efficient market, synergies, reinvestment rate
Click here to view the opinion

*Domain Associates, L.L.C., et al. v. Nimesh S. Shah,* C.A. No. 12921-VCL (Del. Ch. August 13, 2018)
Vice Chancellor Laster
Issues: projections, long-term growth rate, company specific risk premium, excess cash, liquidity risk
Click here to view the opinion.

*In re PLX Technology Inc. Stockholders Litigation,* C.A. No. 9880-VCL (Del. Ch. October 16, 2018)
Vice Chancellor Laster
Issues: projections, beta, damages
Click here to view the opinion.

*Zayo Group, LLC v. Latisys Holdings, LLC,* C.A. No. 12874-VCS (Del. Ch. November 26, 2018)
Vice Chancellor Slights
Issues: damages, use of multiples
Click here to view the opinion.

## CASE SUMMARY

# *Verition Partners Master Fund Ltd. and Verition Multi-Strategy Master Fund Ltd. v. Aruba Networks, Inc.,* C.A. No. 11448-VCL (Del. Ch. February 15, 2018)

Click here to view the opinion

On February 15, 2018, the Delaware Court of Chancery issued an appraisal decision regarding the fair value of Aruba Networks, Inc. in connection with the May 2015 acquisition of Aruba Networks, Inc. by Hewlett-Packard. Vice Chancellor Laster determined that the fair value of Aruba was not the deal price of $24.67 per share, nor did he rely on the valuation analyses of the valuation experts, which ranged from $19.75 to $32.57 per share. Rather, Vice Chancellor Laster concluded that based on the framework established by *DFC* and *Dell*, Aruba's thirty-day average unaffected market price of $17.13 per share provided "persuasive evidence of fair value."

The Court leaned on the guidance from the Delaware Supreme Court in *Dell* and *DFC* when reviewing the evidence presented in this case regarding the efficiency of the market for Aruba's stock. In Dell, Vice Chancellor Laster found "widespread and compelling evidence of a valuation gap between the market's perception and the Company's operative reality," leading the Court to rely on a discounted cash flow (DCF) analysis as the basis for his fair value conclusion. However, *Dell* was appealed, and on appeal, the Delaware Supreme Court held that Vice Chancellor Laster's ruling in *Dell* "ignored the efficient market hypothesis long endorsed by this court" and "constituted an abuse of discretion."

Here, Vice Chancellor Laster found that the Petitioners' evidence of market mispricing was "considerably weaker" than the evidence that he had credited (which was later disregarded by the Supreme Court) in *Dell*. In this context, Vice Chancellor Laster determined that the evidence of market mispricing in this matter was "insufficient to undermine the reliability of Aruba's unaffected market price." While the Petitioners raised concerns regarding strong quarterly results that the market only learned about commensurate with the announcement of the merger, the Court concluded that "neither side proved that Aruba's value had changed materially by closing."

Vice Chancellor Laster concluded that the 30-day average unaffected market price ($17.13 per share) was the most persuasive evidence of fair value "at least for a company that is widely traded and lacks a controlling stockholder," which is the case here. In evaluating market efficiency, Vice Chancellor Laster described the pace at which Aruba's stock price would adjust to good and bad news, and considered various market data, including market capitalization, public float, bid/ask spreads, and equity analyst coverage, as viewed within the framework established by the *DFC* and *Dell* cases. Vice Chancellor Laster added that "the price produced by an efficient market is generally a more reliable assessment of fair value than the view of a single analyst," citing *Dell*.

In considering the deal price, Vice Chancellor Laster noted that under a circumstance where the underlying market price is reliable, competition and negotiation become secondary, and an arm's-length deal at a premium over the market price is non-exploitive (i.e., what occurred in the Aruba transaction according to the Court). Vice Chancellor Laster stated such a result gives stockholders "what would fairly be given to them in an arm's length transaction," citing *DFC*.

The Court considered the Aruba transaction to be a "run-of-the-mill, third-party deal." However, Vice Chancellor Laster also explained under the *DFC* decision, it is to be assumed the buyer here (HP) shared some synergies in the deal with Aruba's stockholders. Considering the inclusion of said synergies, as well as the Petitioners' failure to identify a bidder who would pay more than HP's offer, Vice Chancellor Laster concluded "the deal price in this case operates as a ceiling for fair value." The Court explained "the court must exclude 'any synergies or other value expected from the merger giving rise to the appraisal proceeding itself.'" After expressing the difficulties in quantifying such adjustments (see below) he calculated a fair value based on the deal price less synergies of $18.20 per share.

Vice Chancellor Laster noted that the deal-price-less-synergies is an indirect measure with two significant sources of uncertainty. First, he noted the difficulties of estimating the adjustments needed to back out synergies, including various potential sources of error. He then pointed to the Delaware Supreme Court's "expressed preference in *Dell* and *DFC* for

cont'd

## *Verition Partners Master Fund Ltd. and Verition Multi-Strategy Master Fund Ltd. v. Aruba Networks, Inc.,* C.A. No. 11448-VCL (Del. Ch. February 15, 2018)

Click here to view the opinion

market indicators over discounted cash flow valuations," and concluded that backing out synergies is "a similarly judgment-laden exercise." The second source of uncertainty Vice Chancellor Laster identified related to a concern for how to properly account for the reduced agency costs from unitary ownership. He explained that like synergies, "the value created by reduced agency costs results from the transaction and is not part of the going concern value of the firm."

Because the issues of backing out synergies and addressing reduced agency costs are "messy and provide ample opportunities for error," Vice Chancellor Laster concluded that the unaffected market price was the most appropriate indication of fair value. He cited *DFC* in explaining the unaffected market price distills "the collective judgment of the many based on all the publicly available information about a given company and the value of its shares."

Finally, while the Court ultimately determined that the unaffected stock price was the most relevant indication of fair value, the opinion does address the valuation expert opinions provided by both parties. Both the Petitioner and the Respondent experts relied on the income approach, specifically the DCF methodology, to determine fair value. The Petitioner's expert opined the fair value of Aruba was $32.57 per share, while the Respondent's expert ultimately opined the fair value of Aruba was $19.75 per share.

Vice Chancellor Laster identified concerns with both experts' analyses. Regarding the Petitioner expert's opinion, he noted the divergence of the expert's results from Aruba's market indications, such as the deal price and unaffected market price. Vice Chancellor Laster also found concern with the beta (an input to the analysis) used, noting that while the data supported the beta used by the expert, "no one could offer a good explanation as to why the number was so low."

Regarding the Respondent expert's analysis, Vice Chancellor Laster described the "meandering route" to an opinion along with the "unstructured approaches to valuation inputs" as causes for concern. The Court noted that the expert "punted" on the issues of beta and size premium and "made a significant judgment call by selecting a WACC from a menu of possibilities, rather than calculating a beta to generate a WACC as contemplated by CAPM." Finally, the Respondent's expert relied on a set of projections that he had created using industry growth rates and subsequently testified at trial that he did not have any independent expertise to determine whether the industrywide growth rates were a reasonable proxy for Aruba's expected future performance.

On April 16, 2019, the Delaware Supreme Court reversed the ruling of the Court of Chancery and established the fair value to be $19.10 per share, reflecting "the deal price minus the portion of synergies left with the seller."

## CASE SUMMARY

# *In re Appraisal of AOL Inc.,* C.A. No. 11204-VCG (Del. Ch. February 23, 2018; revised August 15, 2018)

Click here to view the opinion.
Click here to view the opinion.

On February 23, 2018, Vice Chancellor Glasscock issued an opinion in the appraisal of AOL, Inc., finding the fair value of AOL to be $48.70 per share, below the $50.00 per share merger price paid by Verizon. The experts were in agreement that a discounted cash flow method was the most appropriate valuation method in this matter, and the Court placed 100% weight on its own DCF valuation, made up of inputs from each party. Nonetheless, the Court considered the merger price, and discussed in considerable detail whether the deal process was "Dell Compliant." Despite the Court's conclusion that the deal process was not Dell Compliant, and therefore was "not entitled to deference as a reliable indicator of fair value," the Court did use the deal price as confirmation of its own DCF valuation.

Before explaining its DCF valuation, the Court first addressed the reliability of the merger price as an indicator of fair value. Referencing the Delaware Supreme Court decisions in DFC and Dell, Vice Chancellor Glasscock explained that although there is no presumption in favor of the deal price, there are certain instances in which the Court must give "particular and serious consideration" to the deal price as evidence of fair value. Vice Chancellor Glasscock used the term Dell Compliant to refer to such transactions where "(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." Summarizing the Court's view of the merger price in Dell Compliant situations, Vice Chancellor Glasscock stated, "a transaction that demonstrates an unhindered, informed, and competitive market value is at least first among equals of valuation methodologies in deciding fair value."

In this instance, the Court concluded the transaction process was not Dell Compliant, and the deal price was not the best evidence of fair value. This conclusion was based on a combination of factors, including: (i) the statement made by AOL's acting CEO indicating the intent to complete the Verizon transaction, which in the Court's view signaled to the market that the deal was "done"; (ii) the prospect of the CEO's post-merger employment with Verizon; (iii) Verizon's unlimited three-day matching rights; (iv) Verizon's head start over any competing bidder, including more than two months of data room access; and (v) a no-shop provision. While not placing explicit weight on the deal price in determining fair value, the Court concluded that the process was "sufficiently robust" to use as a check on the value derived from its own DCF analysis.

Consistent with the approach taken by both experts in this case, the Court relied on the discounted cash flow method in determining fair value. In performing the DCF analysis, the parties only disputed four components: (i) the proper projections to be used; (ii) the "operative reality" regarding three potential deals involving AOL; (iii) the projection period and terminal growth rate; and (iv) the treatment of AOL's cash balance in the valuation. The Petitioners' expert concluded on a value of $68.98 per share, and the Respondent's expert estimated a value of $44.85 per share.

The Court was presented with three sets of projections and ultimately concluded that the management projections, prepared in the ordinary course of business, were the best estimates of forecasted performance in this case. The Court then evaluated whether three potential deals were "part of the 'operative reality' of the Company as of the Valuation Date," and if so, what impact the deals would have on the fair value of AOL. The three potential deals related to (i) the acquisition of a mobile advertising platform; (ii) the replacement of Google with Microsoft Bing for powering search results; and (iii) a 10-year commercial partnership for AOL to run the sales of display, mobile, and video ads on Microsoft properties. Based in part on the relative certainty of each of the potential deals, the Court concluded that the two Microsoft deals should be considered in determining the fair value of AOL. Based on the evidence available, the Court added the estimated incremental value associated with one of the two Microsoft deals, concluding that the value associated with the other was too speculative to include.

cont'd

## *In re Appraisal of AOL Inc.,* C.A. No. 11204-VCG (Del. Ch. February 23, 2018; revised August 15, 2018)

Click here to view the opinion.
Click here to view the opinion.

Regarding the projection period and long-term growth rate, the Court rejected the Petitioners' argument for a three-stage DCF, which assumed that the growth rate would be high in the short term (stage 1), and would decline over a period of several years (stage 2) until it reached a sustainable long-term growth rate (stage 3). The Court adopted a two-stage model, with a short-term high growth period (stage 1) followed immediately by a sustainable long-term growth rate (stage 2). Finally, the Court concluded that adding back AOL's entire cash balance was not appropriate in this case, reserving $150 million as part of the Company's working capital.

After reargument, the Court subsequently amended its fair value decision downward, from $48.70 to $47.08 per share, reflecting revisions to the value ascribed to the Microsoft deal. This revision was necessary because the deal value incorporated in the original decision "was based on an incorrect assumption of fact."

**CASE SUMMARY**

## *Blueblade Capital Opportunities LLC and Blueblade Capital Opportunities CI LLC v. Norcraft Companies, Inc.,* C.A. No. 11184-VCS (Del. Ch. July 27, 2018)

Click here to view the opinion.

In a July 27, 2018 ruling, Vice Chancellor Slights determined the fair value of Norcraft Companies, Inc. to be $26.16 per share, approximately 2.6% higher than the $25.50 per share merger price paid by Fortune Brands Home & Security, Inc. to acquire the Norcraft on May 12, 2015. The Court concluded that neither the merger price nor the unaffected market price could be relied on as indicators of fair value in this case, and therefore placed 100% weight on its own DCF valuation, using the merger price only as a "reality check" on the DCF.

The Petitioners' expert opined that the merger price did not reflect fair value, due to the lack of a competitive process prior to signing the merger agreement, and an ineffective post-signing go-shop process. The Respondent's expert concluded that the merger price was the most reliable starting point for determining fair value and adjusted the merger price to remove $3.60 per share of synergies. In rejecting the merger price, the Court identified "significant flaws in the process leading to the Merger," including no pre-signing market check, a focus on Fortune rather than considering other potential buyers, conflicts of interest relating to Norcraft's lead negotiator, and an ineffective post-signing go-shop period. Considering the unaffected market price, Vice Chancellor Slights concluded there was no rationale for using the unaffected price as an indication of value, as Norcraft had recently gone public, was relatively thinly traded, and was not widely covered by analysts. The Court also rejected the comparable Company and precedent transaction analyses, concluding the companies and transactions were not sufficiently comparable to use as indicators of value for Norcraft.

Regarding the DCF valuation, the Court stated, "as we have come to expect in appraisal litigation, the experts' DCF analyses yielded valuations that are miles apart. Neither expert walked the high road from start to finish during their respective DCF journeys. That is to say, both experts, at times, made choices in their analyses that were not supported by the evidence or not supported by 'accepted financial principles' in order to support a desired outcome." Rather than accepting either expert's valuation entirely, the Court constructed its own DCF analysis based on an assessment of each component of the DCF individually.

The Petitioners' expert's DCF resulted in a value of $34.78 per share, while the Respondent's expert reached a value of $23.74 per share. The primary differences between the two experts' DCF models related to (i) whether to extend the management projections by an additional five years, and (ii) differences in estimating beta for use in developing Norcraft's cost of capital.

The Court found insufficient support for extending the projections, considering several factors, including the cyclicality of the cabinetry industry (Norcraft's industry), and the fact that Norcraft's own management was not inclined to project its financial results any further.

Regarding beta, the experts agreed that Norcraft's own trading history was insufficient to rely on as an estimate of beta. Therefore, both experts relied on guideline Company betas. The Court considered the experts' selected guideline companies. Then based on a combination of size, geography, and industry, relied on the two-year weekly betas of four companies relied on by both experts, plus two of the additional 12 relied on by the Respondent's expert (though not by the Petitioner's expert). The Court also considered the issue of whether unlevering the guideline Company betas should be performed using gross debt or net debt. Vice Chancellor Slights explained that based on the finance literature cited by the experts in this case, gross debt is the more generally accepted approach when applying the Hamada formula for the calculation of beta. Additionally, the Court found there was not a reliable way to evaluate the excess cash estimate for each of the guideline companies in this case (which is a necessary input to determining net debt). Finally, the experts disagreed about whether to use Norcraft's actual capital structure (as of the merger) or a target capital structure (based on the capital structure of guideline companies). The Court found that while a target capital structure may be appropriate in some cases, such as "where the target's capital structure is in flux," there was no indication management intended to change Norcraft's capital structure. Therefore, the Court adopted Norcraft's actual capital structure as of the merger in its analysis.

## CASE SUMMARY

# *In re Appraisal of Solera Holdings, Inc.*, C.A. No. 12080-CB (Del. Ch. July 30, 2018)

Click here to view the opinion

In an appraisal decision on July 30, 2018, Chancellor Bouchard ruled the fair value of Solera was $53.95 per share, based on the merger price of $55.85 per share paid by Vista Equity Partners, less the estimated synergies incorporated in the merger price.

The Court concluded that in this case, the merger price (less synergies) was "the best evidence of fair value and deserve[d] dispositive weight." Supporting this determination, the Court pointed to the evidence that many potential buyers had an opportunity to bid on Solera. Solera directly reached out to 18 potential bidders, including strategic and financial firms. Additionally, there were public disclosures regarding the sales process, so other potential bidders would have been aware that Solera was exploring a sale. Any interested bidder could have come forward with a topping offer, but none did. The Court also noted that IHS Inc., one of Solera's competitors, was involved as a strategic bidder in the sales process, which created a more competitive bidding process.

The Court determined that Solera's Special Committee was "both competent and effective," improving the reliability of the merger price as evidence of fair value. Chancellor Bouchard found that the Special Committee was independent and experienced, actively engaged with the bidders without favoring one over another, and demonstrated a willingness to decline insufficient bids, twice rejecting bids it considered inadequate.

Chancellor Bouchard also referenced the decisions in DFC and Dell regarding market efficiency, and explained that "the price of a widely dispersed stock traded in an efficient market may provide an informative lower bound in negotiations between parties in a potential sale of control." Based on a review of market capitalization, weekly trading volume, bid-ask spreads, short interest, analyst coverage, and market reactions to rumors of the transaction, the Court concluded that the market for Solera's stock was efficient, which provided further support for the merger price as an indication of fair value.

To account for merger synergies, the Court applied the methodology put forward by the Respondent's expert. This approach relied on empirical studies to estimate the portion of the expected merger synergies that would remain with the seller. Deducting $1.90 per share, or 31% of the total expected synergies of $6.12 per share, resulted in a fair value conclusion of $53.95.

Finally, Chancellor Bouchard discussed the DCF models put forward by the experts. The models produced values ranging from $53.15 to $84.65. The Court noted it was comforted that the Respondent's expert's DCF resulted in a value "in the same ballpark as the deal price less estimated synergies." Conversely, the Court found the Petitioners' DCF conclusion of $84.65 to be "facially unbelievable," as it implied potential buyers "left almost $2 billion on the table by not outbidding Vista."

After stating general concerns regarding the speculative nature of making assumptions about the business into perpetuity, Chancellor Bouchard reviewed some of the key differences in the experts' DCF analyses. Key areas of disagreement between the experts included the reinvestment rate and return on invested capital assumed in the terminal period, treatment of stock-based compensation and contingent tax liabilities, and the amount of operating cash needed to run the business. Given his conclusion regarding the reliability of the merger price, Chancellor Bouchard did not address the relative positions of the experts on these areas of disagreement. He stated that due to the gap between the Petitioners' DCF and the merger price, he found the DCF not credible and gave it no weight. Chancellor Bouchard further declined to rely on Respondent's DCF, based on the expert's own opinion that his DCF was less reliable than the merger price less synergies calculation.

Finally, the Court rejected the Respondent's post-trial argument that the best evidence of Solera's fair value is its unaffected stock price. The Court noted that Respondents only put forward this new position after trial, apparently in response to the decision in Aruba, which relied on the unaffected 30-day stock price as the best evidence of fair value. Regardless of relevance in this case, the Court stated that Solera's true unaffected market price was not an issue litigated by the parties, and the Court was not in a position to make a determination on the issue.

## CASE SUMMARY

# *Domain Associates, L.L.C., et al. v. Nimesh S. Shah,* C.A. No. 12921-VCL (Del. Ch. August 13, 2018)

Click here to view the opinion.

On August 13, 2018, Vice Chancellor Laster issued an opinion in the breach of contract/damages action, determining an expelled member, Shah ("Defendant" or "Counterclaim Plaintiff"), was entitled to the fair value of his interest within Domain Associates, LLC ("Domain," "Plaintiff," or "Counterclaim Defendant"), a venture capital fund. Shah was awarded damages calculated as the difference between the fair value of his interest in the fund and the amount received, plus pre- and post-judgment interest. The decision focused on Shah's counterclaim for breach of contract.

After Shah was forced to withdraw from Domain, he was paid the value of his capital account. Shah claimed this amount was a breach of contract, and he should be entitled to the fair value of his interest. Vice Chancellor Laster agreed.

Both parties presented experts who opined on the fair value of Shah's interest, and both experts relied on the DCF method under the income approach to determine Shah's interest. Shah's expert opined that the fair value of Shah's interest was between $4.299 million and $6.067 million, while Domain's expert opined that the fair value was approximately $531 thousand. Vice Chancellor Laster detailed the differences in the DCFs and instructed the parties to revise Domain's expert's DCF model to reflect the rulings.

Both experts started with management's projections, but Shah's expert incorporated "major alterations" to management's projections that the Court disagreed with, including: (i) accelerating the formation of two funds, "ignoring the operative reality of Domain's recent fundraising experience" and ignoring limitations in fund documents that made the projected timing "virtually impossible"; and (ii) holding management fees flat at 2% of assets under management ("AUM") over the 10-year life of a fund when fund documents incorporate a fee reduction over time.

The Court noted that "Delaware law clearly prefers valuations based on contemporaneously prepared management projections," (quoting Doft & Co. v. Travelocity.com Inc., 2004 WL 1152338) and noted that "Domain prepared projections yearly, in the ordinary course of business, using a consistent process." The Court noted that the unadjusted management projections used by Domain were not prepared for litigation purposes, in connection with a pending transaction, or "under other circumstances that could undermine their reliability." The Court further noted that the projections included a 10-year forecast, were generally accurate over the short term, and were somewhat bullish over the long term, favoring Shah.

The Court did agree with some of Shah's expert's "less significant issues" in the projections including incorporating as revenues to the Company: (i) director fees earned by members for serving on the Boards of portfolio companies; (ii) "Fund GP Interest Net Distributions"—distributions from future investments made by funds (stating "if Shah had remained a member of the Company, he would have received additional cash flows equal to 12.1% of these distributions."); and (iii) "Gains on Securities"—securities in underlying portfolio companies received by the Company, which were reported as income and regularly distributed to its members.

The Court adopted Shah's expert's perpetuity growth rate of 3%, noting that "when applying a perpetuity growth rate, 'the rate of inflation is the floor for a terminal value estimate for a solidly profitable company that does not have an identifiable risk of insolvency.'" According to the decision, Domain's expert did not apply a perpetuity growth rate, though the decision also states that the same expert instead projected that Domain "would continue operating, without winding down, going insolvent, or dipping into cash reserves. " Vice Chancellor Laster noted that Domain's expert offered no reason to anticipate business failure, and the expert's explanation regarding no perpetuity growth rate "was not convincing."

The experts disagreed over three inputs in the discount rate used for the DCF analysis: (i) a company-specific risk premium; (ii) additional premium for liquidity risks; and (iii) the beta peer group selections:

- Company-Specific Risk Premium—While the Court noted that "[w]hether to include 'a company-specific risk premium

cont'd

## *Domain Associates, L.L.C., et al. v. Nimesh S. Shah,* C.A. No. 12921-VCL (Del. Ch. August 13, 2018)

Click here to view the opinion.

'remains largely a matter of judgment, without a commonly accepted set of empirical support evidence,''" Vice Chancellor Laster noted that in this matter, both experts stated a 3% premium should be added and adopted a 3% premium. While Shah's expert had actually applied a 2% premium—and testified that 3% was a typo—Vice Chancellor Laster's conclusion relies on the premium stated by both experts of 3%.

- Liquidity Risks—The Court rejected Domain's expert's additional 0.6% premium for "liquidity risks" relating to sector concentration and an aging management team, noting that these risks should not be treated as distinct from other company-specific risks already captured in the 3% premium discussed above.
- Beta—The Court found that Shah's expert included Oaktree Capital Management in its beta peer group selection, without justification. Domain contended that Oaktree Capital Management was an outlier, and the Court agreed, stating "when a party does not justify the use of the companies it selected as comparable, the court will not accord weight to the analysis."

Vice Chancellor Laster stated, "excess cash on hand is a non-operating asset that should be added after a DCF valuation has been performed." Domain's expert argued this cash balance was necessary to fund future cash deficits, an argument the Court found unconvincing given that the expert's model projected positive cash flow. Shah's expert assumed Domain's working capital cash needs totaled approximately three months of operating expenses and assumed the remaining cash balance was in excess of operational needs. The Court adopted this approach.

## CASE SUMMARY

# *In re PLX Technology Inc. Stockholders Litigation,* C.A. No. 9880-VCL (Del. Ch. October 16, 2018)

Click here to view the opinion.

In August 2014, Avago closed the acquisition of PLX Technology at a price of $6.50 per share. Following the close, the Plaintiffs sued the directors of PLX, claiming they had breached their fiduciary duties in approving the merger and their duty of disclosure in relation to the directors' recommendation of the merger to stockholders. In addition, the Plaintiffs sued Potomac (an activist investor advocating for the sale of PLX), Deutsche Bank (PLX's financial advisor), and Avago for aiding and abetting the directors' breaches.

In a ruling in October 2018, Vice Chancellor Laster found that despite the Plaintiffs proving the alleged breaches, the Plaintiffs failed to prove any causally-related damages relating to the directors' breaches of their fiduciary duties and their duty of disclosure. At trial, Plaintiffs argued the Company should have remained a stand-alone entity. The Plaintiffs' expert put forward a stand-alone valuation of the Company based on a DCF analysis of $9.86 per share, more than 50% higher than the merger consideration. However, the Court concluded that the DCF analysis was "not sufficiently persuasive to undergird a damages award exceeding half the deal price." Despite the deficiencies identified in the merger process, the Court concluded "the details of the sale process that the Board conducted and the nature of the synergistic deal with Avago that it generated means that the Plaintiffs received consideration that exceeded the value of the Company on a stand-alone basis." As discussed below, the Court concluded the merger price exceeded the stand-alone value of the company based on its own analysis of projections and deal dynamics.

In concluding the Plaintiffs established the directors breached their duty of disclosure and fiduciary duties, the Court pointed to the failure to disclose material information leading up to the merger. This information included a tip from an Avago executive in December 2013, indicating that Avago was interested in buying PLX for approximately $300 million, and other details regarding the negotiation of the merger consideration. The Court also found the PLX Board's characterization of certain projections used in the fairness opinion was misleading. The Recommendation Statement sent to stockholders by the Board claimed the projections "were prepared in the ordinary course of business for operating purposes," when in fact, they were prepared after Avago made its bid so that Deutsche Bank could use them in its fairness opinion. Additionally, the Court identified conflicts of interest, including Potomac's interest in a quick sale of the Company, and Deutsche Bank's financial incentive to favor a sale of PLX over remaining an Independent Company.

However, despite these findings, the Court concluded—without determining a specific value—the result of the sales process was a deal price in excess of the Company's stand-alone fair value. The projections relied on by the Plaintiffs' expert played a key role in the valuation analysis. The five-year plan prepared by management described the projections as "aggressive," and the Court concluded that management thought the projections "were a stretch, but that they were attainable." In analyzing the three primary components of the revenue projections, the Court determined there was insufficient support for the third revenue component—relating to a new line of business involving a new set of customers—to rely on for a damages award. In addition, the Court (i) noted that PLX had a history of failing to meet its projections; and (ii) identified a new market entrant that would make it even more difficult for PLX to achieve its projections going forward.

Vice Chancellor Laster was critical of the Plaintiffs' expert's selection of beta, including criticisms that: (i) the time period used was not representative of the Company's fundamentals; (ii) the use of daily returns, rather than weekly or monthly returns, lowered the beta estimate due to "instances of nontrading"; and (iii) the resulting beta of less than one appeared unreasonable for a Company operating in a cyclical industry.

In further support of this decision not to award damages, the Court noted the transaction involved two companies in the same industry, and documents showed synergies were contemplated in the deal. The Court concluded the price likely included synergies, thus, the deal price was likely to exceed the stand-alone value of the Company. For these reasons, the Court found that despite the flaws identified, the sale process was "sufficiently reliable to exclude the Plaintiffs' damages contention."

Finally, the Court found that if the projections supported a valuation of $9.82 per share, as the Plaintiffs claimed, it would have been likely that another buyer would have come forward with a competing bid. However, no such buyer emerged.

## CASE SUMMARY

# *Zayo Group, LLC v. Latisys Holdings, LLC,* C.A. No. 12874-VCS (Del. Ch. November 26, 2018)

Click here to view the opinion.

On November 26, 2018, Vice Chancellor Slights issued an opinion related to Zayo Group, LLC's ("Zayo") acquisition of Latisys Holdings, LLC ("Latisys") that closed in February 2015.

The Plaintiff filed a complaint on November 4, 2016 seeking damages for breach of representations, warranties and covenants contained in the purchase agreement. This complaint alleged that Latisys failed to disclose that five customers with material contracts "had notified Latisys of their intent not to renew the contracts or to renew on different terms."

The Court considered two questions in deliberating whether Zayo met its burden of proof: (i) "did Zayo prove that Latisys breached the SPA"? and (ii) "if so, did Zayo prove that it is entitled to damages?"

The Court determined that Latisys did not breach the stock purchase agreement ("SPA"), as the SPA only required that Latisys disclose whether parties to material contracts intended to "cancel, terminate, materially modify or refuse to perform such Material Contract." The SPA did not specifically require Latisys to disclose customers that "elected not to renew Material Contracts, or bargained for different terms in new contracts with existing customers."

Because the Court found that Latisys did not breach the SPA, there was no need to determine damages. However, in the decision, Vice Chancellor Slights reviewed the damages analysis of each party's expert, "for the sake of completeness."

The Court first noted that Zayo's expert's "lack of experience in valuing going concern businesses proved a disadvantage to her and ultimately rendered her opinions in this case unpersuasive."

The Court criticized Zayo's expert's sole use of an Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") multiple in calculating expectancy damages of $22 million. The Court described benefit of the bargain (or expectancy) damages as "the difference between the as-represented value of a transaction (typically the purchase price) and the value the purchaser actually received. The actual value the purchaser received, in turn, must assume, and account for, a diminution of the company's earnings into perpetuity."

The Court criticized Zayo's expert's methodology as it implied the business was permanently impaired, when the contracts at issue were short-term in nature. The Court commented that, as the Defendant's expert "testified, and as the AICPA Practice Aid confirms, using a multiple to calculate damages is appropriate only where there is a permanent impairment to the value of the business and the value the buyer receives is less than the value for which the buyer bargained." The Court noted that "[n]ot only did Zayo make no effort to prove a diminution of value into perpetuity, Zayo did not perform a post-Closing valuation of the company it had acquired."

Additionally, Vice Chancellor Slights pointed out that there was "no evidence that Zayo actually based its purchase price on a multiple of EBITDA" given the due diligence pricing evidence included a discounted cash flow ("DCF"), internal rate of return ("IRR"), and net present value ("NPV") sensitivity table analysis. For these reasons, Vice Chancellor Slights determined the Plaintiff's damages expert's methodology did not apply.

The Court described the Defendant's damages expert's out-of-pocket cost analysis methodology as the "most appropriate (and credible) measure." This calculation assumed "Zayo (and each of the five customers) would re-negotiate contracts at the end of the contract term consistent with the market." The resulting total damages was approximately $2.1 million. However, as discussed above, no damages were assessed because the Court found Latisys did not breach the SPA.

DUFF & PHELPS

Protect, Restore and Maximize Value

**We hope that you will find this publication informative and that you look to Duff & Phelps for your Disputes Consulting solutions.**

For further information regarding our services or issues discussed in this publication, please contact:


**Jaime d'Almeida**
Expert Affiliate
1-617-378-9445
jaime.dalmeida@duffandphelps.com

**Rebecca Levy**
Director
1-617-378-9461
rebecca.levy@duffandphelps.com

**Matthew Root**
Vice President
1-617-378-9471
matthew.root@duffandphelps.com


**Duff & Phelps Contributing Authors**


**John Kanto,** Analyst

**Chen Luo,** Analyst

**Daniel Patiño,** Vice President


**About Duff & Phelps**

Duff & Phelps is the global advisor that protects, restores and maximizes value for clients in the areas of valuation, corporate finance, investigations, disputes, cyber security, compliance and regulatory matters, and other governance-related issues. We work with clients across diverse sectors, mitigating risk to assets, operations and people. With Kroll, a division of Duff & Phelps since 2018, our firm has nearly 3,500 professionals in 28 countries around the world. For more information, visit www.duffandphelps.com.