May 7, 2015

Delaware Court of Chancery Again Sets Appraisal Value at Merger Price After a "Competitive and Fair Auction"

Merlin Partners LP v. *AutoInfo Inc.*, is the latest in a recent string of opinions by the Delaware Court of Chancery in which the Court held in appraisal proceedings that the merger consideration represented the best estimate of fair value. The Court rejected a DCF model based on optimistic projections created to market AutoInfo to potential acquirers and comparable companies analyses based on companies that were much larger than AutoInfo and employed a less risky business model. Instead, the Court found that because the merger "was negotiated at arm's length, without compulsion, and with adequate information" after "competition among many potential acquirers," the merger consideration of $1.05 per share was the best indication of fair value.

AutoInfo was a "100% agent-based" transportation services company that operated with no assets. The board consisted of two inside and three outside directors. In the first quarter of 2011, AutoInfo's stock was trading thinly over-the-counter on the Nasdaq bulletin board for $0.50-0.60 per share. At the urging of a significant shareholder, the board created a special committee of the three outside directors and retained Stephens Inc., an investment bank "with significant experience in the transportation industry," to explore strategic options to "increase the stagnant stock price."

After examining alternatives "including organic projects, shareholder distributions, and acquisitions," Stephens advised AutoInfo to "alter its strategy." The board elected to reach out to potential purchasers in August 2011 and ultimately entered into a transaction with Comvest Partners in April 2013. In ruling that the merger consideration was a fair value for AutoInfo shares, the Court made the following observations:

- *Stephens and AutoInfo ran an adequate sale process, having contacted 164 potential acquirers, entering into 70 non-disclosure agreements, receiving ten indications of interest, giving nine management presentations and engaging two potential acquirers in due diligence.* Petitioner argued that this approach was "unfocused," but the Court disagreed and noted that " [a]ny real-world sales process may be criticized for not adhering completely to a perfect, theoretical model." Although AutoInfo stock was thinly traded and lacked analyst coverage, the board had "ample information" between Stephens's expert advice and the market canvass.

- *Because "nothing in the record suggests that the outcome would have been a merger price drastically below fair value," the Court placed "full weight" on the merger price as the best indicator of value.* In doing so, the Court rejected arguments by both petitioners and respondent that the Court should deviate from the merger price, including rejecting any reliance on:

    - AutoInfo management's projections due to management's inexperience in preparing such figures and the overly optimistic nature of the projections as a marketing tool to facilitate a sale of the company;

- A comparable companies analysis because the petitioners' expert selected companies that were substantially larger than AutoInfo and used a "company store" model as opposed to AutoInfo's "agent-based" business model; and

- Any adjustments to AutoInfo's Ibbotson small-cap risk premium based on its closing-day market capitalization.

The Court also rejected the respondent's argument that the anticipated cost-savings from the merger (such as any savings in converting from a public to a private company or eliminating executive compensation costs) should be backed-out of the merger price. Relying on the opinion in *Huff Fund Investment Partnership v. CKx. Inc.*, the Court held that allowing a reduction for anticipated cost-savings based on a theory that cost-savings are reflected in the merger price would permit a "near automatic reduction in price" that would "reverse the burden that is on the party arguing that adjustments are warranted." The Court suggested, however, that such a reduction may be appropriate if the record showed that the acquirer had based its bid on and quantified such cost savings and established that the savings could only be realized through the merger.

Ultimately, the Court found that where "the market prices a company as a result of a competitive and fair auction," techniques like comparables methodologies or DCF commonly employed by valuation experts are "necessarily a second-best method to derive value." (emphasis added).

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Edward T. Ackerman
212-373-3310
eackerman@paulweiss.com

Ross A. Fieldston
212-373-3075
rfieldston@paulweiss.com

Justin G. Hamill
212-373-3189
jhamill@paulweiss.com

Stephen P. Lamb
302-655-4411
slamb@paulweiss.com

Toby S. Myerson
212-373-3033
tmyerson@paulweiss.com

Carl L. Reisner
212-373-3017
creisner@paulweiss.com

Taurie M. Zeitzer
212-373-3353
tzeitzer@paulweiss.com

Frances F. Mi
212-373-3185
fmi@paulweiss.com

Laura C. Bower contributed to this memorandum.