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Delaware Court of Chancery Relies Exclusively on Merger Price Less Net Synergies to Determine Fair Value in Appraisal Action

In a recent appraisal proceeding, the Delaware Court of Chancery concluded that the company had engaged in a thorough sales process, and therefore found that it was appropriate to determine fair value of the company's stock by relying exclusively on the merger price less net synergies. The court found that a discounted cash flow (or "DCF") analysis was an inappropriate method to value the company's stock in this instance, as the DCF analyses relied upon by the parties were derived from unreliable management projections.

In *Longpath Capital, LLC* v. *Ramtron International Corporation*, Cypress Semiconductor Corporation ("Cypress") issued a bear hug letter to acquire all of the shares of Ramtron International Corporation ("Ramtron"), a semiconductor company, for $2.48 per share. After the Ramtron board rejected this offer as inadequate, Cypress initiated a tender offer for Ramtron's shares at $2.68 per share (which it later raised to $2.88 per share). During the time that Cypress pursued its tender offer, Ramtron authorized its financial advisor to market the company. The advisor contacted twenty-four potential buyers and Ramtron executed nondisclosure agreements with six of those potential buyers. Ultimately, however, none of the potential buyers made a firm bid for Ramtron. Eventually, Ramtron and Cypress engaged in active negotiations, which resulted in Cypress raising its offer price twice before the parties settled on a final transaction price of $3.10 per share. Approximately two months following the signing of the merger agreement, the merger was approved by a vote of Ramtron's stockholders. Longpath Capital, LLC ("Longpath"), a Ramtron stockholder, properly demanded appraisal of the fair value of its Ramtron stock under Section 262 of the General Corporation Law of the State of Delaware and filed an appraisal action in the Court of Chancery against Ramtron.

In its post-trial opinion, the Court of Chancery noted that there are four recurring valuation techniques generally presented in an appraisal action: a DCF analysis, a comparable companies approach, a comparable transactions approach, and an examination of the merger price itself, less synergies. Here, the parties agreed that no comparable companies existed, and the court found that the two-observation data set comprising the comparable transactions analysis relied upon in part by Longpath did not form a reasonable basis to determine fair value. Thus, the court's fair value determination focused on reliability of the DCF analyses presented by the parties and of the merger price as a determination of fair value. The court held that:

- *The parties' DCF analyses were based on management projections that were inherently unreliable, thereby making a DCF analysis an inappropriate method to determine fair value –*

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Management projections were prepared by a new management team in anticipation of future disputes and shopping Ramtron to potential white knights, used a new methodology, and were for a significantly longer period than previous forecasts. In addition, the evidence suggested that management exhibited a questionable track record at forecasting, and that the final projections incorporated unrealistic assumptions relating to a manufacturing agreement with a third party, relied on base year figures that were distorted due to customer allocation issues and revenue manipulation, and predicted growth out of line with historical trends. Management itself had also provided "more accurate" projections to Ramtron's bank.

- *Instead, because the evidence suggested that the sales process was thorough, the merger price less net synergies provided the most reliable method of determining fair value* – During the three months that Cypress sought to acquire Ramtron through its bid, the Company actively shopped itself to numerous conceivable buyers, with several indicating a serious interest (though none submitting a firm offer). In addition, Ramtron's negotiations with Cypress caused Cypress repeatedly to raise its price. The court noted that the "lengthy, publicized process was thorough" and gave the court confidence that "if Ramtron could have commanded a higher value, it would have." In addition, the court determined that it was appropriate to subtract Longpath's estimate of net synergies of $0.03 per share (which was reached by netting negative revenue synergies and transaction costs from Ramtron's estimate of positive synergies) from the merger price to reach a fair value determination of $3.07 per share.

This opinion highlights that, even though Delaware courts "tend to favor a DCF model over other available methodologies in an appraisal proceeding," they will be willing to reject a DCF analysis as an indication of fair value where there is reason to question the reliability of the underlying management projections. Moreover, *Longpath* demonstrates that where there is a thorough sales process, the court will be willing to rely entirely on the merger price less synergies in its determination of fair value in an appraisal proceeding.[1]

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1 Paul, Weiss represented the respondent corporation in *Huff Fund Investment Partnership* v. *CKx, Inc.* where the Court of Chancery reached a similar holding as that reached by the court in *Longpath*. In *Huff Fund*, the Court of Chancery's holding was affirmed by the Delaware Supreme Court.

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