

# Clients&FriendsMemo

## Delaware Supreme Court Reaffirms Primacy of Market Evidence in Determining Fair Value in Appraisal Proceedings

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On July 9 and October 12, 2020, the Delaware Supreme Court added two more opinions to its growing suite of recent appraisal decisions underscoring the prominence of market-based factors in determining fair value. In *Fir Tree Value Master Fund, LP v. Jarden Corp.*,<sup>1</sup> the Delaware Supreme Court affirmed Vice Chancellor Slight's finding that Jarden's unaffected stock market price was the most reliable indicator of fair value under the facts presented there.<sup>2</sup> In *Brigade Leveraged Capital Structures Fund and Brigade Distressed Value Master Fund Ltd. v. Stillwater Mining Co.*, the Delaware Supreme Court affirmed the lower court's reliance on deal price for its fair value determination and confirmed that deal price remains the most reliable indicator of fair value if the seller runs an appropriate, conflict-free sales process.<sup>3</sup>

After *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*,<sup>4</sup> in which the Delaware Supreme Court reversed the lower court's reliance on the unaffected stock price for fair value and found instead that the merger consideration minus deal-specific synergies was the more reliable indicator of fair value, many speculated that transaction price would be the primary source of fair value evidence going forward. In *Jarden*, however, the Delaware Supreme Court agreed with the Court of Chancery's decision that deficiencies in Jarden's sales process undermined the reliability of the deal price as evidence of fair value, which in turn supported the Court of Chancery's determination to consider other evidence. The Court of Chancery found—and the Delaware Supreme Court agreed—that in light of a sub-par sales process, Jarden's pre-announcement market price was the most reliable

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<sup>1</sup> No. 454, 2019, 2020 WL 3885166 (Del. July 9, 2020).

<sup>2</sup> See J. Halper, *et al.*, Delaware Court of Chancery Confirms Market-Based Factors Constitute the Best Indicators of Fair Value, Cadwalader, Wickersham & Taft LLP (September 6, 2019), <https://www.cadwalader.com/resources/clients-friends-memos/delaware-court-of-chancery-confirms-market-based-factors-constitute-the-best-indicators-of-fair-value>.

<sup>3</sup> No. 427, 2019, 2020 WL 6038341 (Del. Oct. 12, 2020).

<sup>4</sup> 210 A.3d 128 (2019); see also J. Halper, *et al.*, M&A Update: The Delaware Supreme Court's Decision in *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*—Calculating Fair Value in Statutory Appraisal Cases, Cadwalader, Wickersham & Taft LLP (April 22, 2019), <https://www.cadwalader.com/resources/clients-friends-memos/ma-update-the-delaware-supreme-courts-decision-in-verition-partners-master-fund-ltd-v-aruba-networks-incalculating-fair-value-in-statutory-appraisal-cases>.

indicator of fair value given that Jarden stock traded in an efficient market and in the absence of material, non-public information.

On the other hand, the Delaware Supreme Court's decision in *Stillwater*<sup>5</sup> confirms—with caveats—pre-*Jarden* speculations that transaction price will often be found to provide the most reliable indicator of fair value. Unlike the deficient sale in *Jarden*, the Delaware Supreme Court agreed with Vice Chancellor Laster that Stillwater's sale process presented “objective indicia” to support the conclusion that the merger consideration reliably indicated fair value in this instance. In affirming, the Delaware Supreme Court observed that the lower court had discretion in selecting the valuation model best tailored to the circumstances. Quoting *Jarden*, it stated that “[i]n the end, the trial judge must determine fair value, and fair value is just that, fair. It does not mean the highest possible price that a company might have sold for.”<sup>6</sup> However, this was the Court's only mention of *Jarden*, suggesting that the facts there that led the Court to reject merger consideration as evidence of fair value were not present in *Stillwater*.

The Delaware Supreme Court's decisions serve as a reminder that the judicial valuation process demands a case-specific inquiry in which a single factor, such as a deficient sales process, can be outcome determinative. It also confirms that market-based factors remain the best indicators of fair value.

## Background

### *Jarden*

Jarden was an American consumer products company. In 2016, Newell Rubbermaid, Inc., another consumer products company, acquired Jarden after Jarden's CEO negotiated a price of \$59.21 per share in cash and stock. Certain Jarden stockholders sought appraisal, contending that other valuation methods demonstrated that Jarden's fair value was \$71.35 per share. Because of a flawed sales process, the Court of Chancery declined to adopt the deal price less synergies approach applied in *Aruba* and other recent decisions,<sup>7</sup> concluding instead that the unaffected market price constituted the most reliable evidence to determine fair value. The stockholders appealed to the Delaware Supreme Court, which affirmed.

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<sup>5</sup> 2020 WL 6038341.

<sup>6</sup> *Id.* at \*4 (quoting *Jarden Corp.*, 2020 WL 3885166, at \*7 (Del. Jul. 9, 2020)).

<sup>7</sup> *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd*, 177 A.3d 1 (Del. 2017); *DFC Glob. Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017).

**Stillwater**

On the coattails of *Jarden*, the Delaware Supreme Court decided *Stillwater* and took the opportunity to highlight its decisions in *DFC Glob. Corp. v. Muirfield Value Partners, L.P.*, *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, and *Aruba* (each of which found that merger consideration was the most reliable evidence of fair value), but, notably, not *Jarden*.<sup>8</sup> In *Stillwater*, Sibanye Gold Ltd. acquired Stillwater Mining Co. in a reverse triangular merger. The stockholders approved the merger, which closed on May 4, 2017. However, in the 138 days between the signing of the merger agreement and the stockholder vote, “the spot price of [Stillwater’s] weighted basket of . . . products increased by 5.9%” due to a 9% increase in the price of palladium, which Stillwater mined and processed as its primary business.<sup>9</sup> Stockholders initiated the appraisal litigation, contending that the deal price of \$18 per share cash did not reflect fair value at closing and the deal price required an upward adjustment to account for palladium’s price increase. In a fact-intensive analysis, the Court of Chancery concluded that the merger price constituted the most reliable indicator of fair value and declined to make an upward adjustment. The stockholders appealed to the Delaware Supreme Court, which affirmed.

**Takeaways**

1. Unaffected market price is still on the table, but courts will continue to look to transaction price for fair value. *Jarden* and *Stillwater* confirm the primacy of market-based factors as indicia of fair value, including deal price and unaffected market price. But *Stillwater* makes clear that the Court’s decision in *Jarden* does not signal a departure from recent appraisal action jurisprudence favoring transaction price, as developed in *Aruba*, *Dell*, and *DFC*. Rather, *Jarden* affirms the Court’s commitment to the appraisal statute’s guidance to consider “all relevant factors”—according more weight to market-based factors—by deciding the methodology applied to each case based on the record before it and the importance of a well-run sales process to the reliability of merger consideration in the fair value determination. As articulated in *Stillwater*, Delaware courts will rely on objective factors that “bolster[] the reliability of the sale process[.]”<sup>10</sup>

While the Delaware Supreme Court has declined to adopt a presumption that the merger consideration is the best evidence of fair value, it added that the absence of a presumption “does not in any way signal our ignorance to the economic reality that the sale value resulting from a robust market check will often be the most reliable evidence of fair value . . .”<sup>11</sup> As

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<sup>8</sup> *Stillwater*, 2020 WL 6038341 at \*5.

<sup>9</sup> *Jarden Corp.*, 2019 WL 3244085 at \*17.

<sup>10</sup> *Id.* at \*5.

<sup>11</sup> *Jarden Corp.*, 2020 WL 3885166 at \*8 (citing *DFC*, 172 A.3d at 366).

stated in *Jarden*, the *Aruba* Court stressed the “‘considerable weight’ a court should give to the deal price ‘absent deficiencies in the deal process.’”<sup>12</sup> Where a sales process undercuts the reliability of the transaction price, courts can look to unaffected market price, the reliability of which depends on an informationally efficient market in which “the market’s digestion and assessment of all publically available information concerning [the Company] [is] impounded into the Company’s stock price.”<sup>13</sup> The existence of material, non-public information, however, most likely renders the unaffected market price an unreliable indicator of fair value. In *Aruba*, for instance, the Delaware Supreme Court observed that material, nonpublic information existed such that the pre-announcement public trading price did not reliably reflect fair value. In instances where both the deal price and unaffected market price are reliable, *Stillwater* at least suggests that transaction consideration will be considered more reliable than unaffected market price.<sup>14</sup> The common thread underlying these decisions is the courts’ continued affirmation that market-based factors are the gold standard in determining fair value.

2. Other market evidence can serve to corroborate the fair value determination. As part of the *Jarden* analysis, the Court relied on other market evidence in assessing the reliability of market price as evidence of fair value, including market analysts’ reports, contemporaneous (*i.e.*, not prepared for litigation) valuations by financial advisors, *Jarden*’s equity offering six months before the Newell transaction at \$49/share (*i.e.*, close to the unaffected market price), and *Jarden*’s stock buyback program at \$49/share (also quite close to the unaffected market price).<sup>15</sup> While there was a lack of consensus among analysts and *Jarden*’s management as to *Jarden*’s value, the Delaware Supreme Court found that the lower court did not abuse its discretion in finding that the disagreement was not due to information asymmetry, but rather due to differing opinions about *Jarden*’s future prospects based on access to the same underlying information. In addition, the Court did not place any weight on contemporaneous valuations prepared by *Jarden*’s financial advisor, which were in the \$60-\$68/share range, because the advisor prepared those materials in a result-oriented fashion in response to *Jarden*’s CEO instructing his personal banker, as the financial advisor, to start developing analyses supporting a transaction in that higher range.<sup>16</sup>

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<sup>12</sup> *Id.* at \*9 (citing *Aruba*, 210 A.3d at 137).

<sup>13</sup> *Id.*

<sup>14</sup> *Stillwater*, 2019 WL 3943851, at \*9 (concluding that flaws early in the sale process did not undermine the reliability of the deal price because the board implemented protections to correct the issues).

<sup>15</sup> *Jarden Corp.*, 2019, 2020 WL 3885166, at \*3.

<sup>16</sup> *Id.* at \*13.

3. A CEO's domination of the sales process poses significant risks to a court's assessment of the quality of that process, whether due to insufficient board oversight, failure to inform the board of developments, or putting personal interests first. The takeaway from our analysis of the Court of Chancery's 2019 decisions still stands: directors must be proactively involved in, and act on an informed basis throughout, a sales process.<sup>17</sup> In negotiating with Newell, Jarden's CEO repeatedly acted without Board authorization and failed to disclose key information to the Board during critical stages in the negotiating process. For instance, the CEO acted without authority in meeting twice with Newell's CEO and suggesting a transaction price without prior Board approval. Both courts criticized Jarden's CEO's negotiations, positing that the CEO "may well have set an artificial ceiling on what Newell was willing to pay" when the CEO stated in an initial, unauthorized discussion with Newell representatives that the offer "would have to start with a six."<sup>18</sup> Jarden's CEO also made unauthorized counteroffers in response to Newell's proposals and negotiated change-in-control payments for himself and other senior executives without Board knowledge or authorization.
4. A seller's financial advisor needs to be conflict-free, or any conflicts need to be disclosed, in order for a court to find that the sales process yields a price that reliably indicates fair value. In *Jarden*, the CEO recommended a financial advisor for Jarden without disclosing his "longstanding, fruitful relationship" with the bank and that the financial advisor had participated in early unauthorized discussions between Jarden and Newell about a potential sale. The Court of Chancery considered the CEO's failure to disclose the financial advisor's conflict a flaw in the sales process and concluded that "these flaws in the sale process, coupled with the fact that there was no effort to test the Merger Price through any post-signing market check, raise legitimate questions regarding the usefulness of the Merger Price as an indicator of fair value."<sup>19</sup> Delaware courts consistently have recognized the important "gatekeeper" function that financial advisors serve in a sale process, and any conflicts involving a financial advisor must necessarily be disclosed.<sup>20</sup>
5. Not every perceived flaw in the sales process necessarily dooms reliance on deal price as evidence of fair value. While Stillwater's sales process was not perfect, it did not suffer the major deficiencies evident in Jarden's sales process and, ultimately, was not sufficiently

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<sup>17</sup> *Halper, et al., supra* note 2.

<sup>18</sup> *Jarden Corp.*, 2020 WL 3885166, at \*2 (quoting *Jarden*, 2019 WL 3244085, at \*24–25).

<sup>19</sup> *Jarden Corp.*, 2019 WL 3244085, at \*25.

<sup>20</sup> See *In re Rural Metro Corp.*, 88 A.3d 54 (Del. Ch. 2014); *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011); see also J. Halper et al., *M&A Update: The "Gatekeepers": Delaware Court Holds Conflicted Financial Advisor Liable for Aiding and Abetting Breach of Fiduciary Duty*, Cadwalader, Wickersham & Taft LLP (May 23, 2019), <https://www.cadwalader.com/resources/clients-friends-memos/delaware-court-holds-conflicted-financial-advisor-liable-for-abiding-and-abetting-breach-of-fiduciary-duty>.

flawed as to render the transaction price unreliable. As in *Jarden*, the Stillwater CEO engaged in communications regarding a potential merger with Sibanye's CEO without the Board's knowledge or approval, but to a far lesser extent than Jarden's CEO. In fact, the CEO advised the Board to reject Sibanye's initial offer, and the Delaware Supreme Court highlighted the Court of Chancery's determination that Stillwater's CEO pursued the merger to extract maximum value, in line with the interests of all stockholders. Moreover, Stillwater's Board was far more proactive and involved, and it ultimately cured the CEO's conduct based on ample objective evidence of reliability of the sales process, which included: "(1) the Merger was an arm's length transaction with a third party; (2) the Board did not labor under any conflicts of interest; (3) the buyer conducted due diligence and received confidential information about Stillwater's value; (4) Stillwater negotiated . . . multiple price increases; and (5) no bidders emerged during the post-signing phase."<sup>21</sup>

6. While not mandatory, an appropriate sales process more often than not requires some type of market check. *Stillwater* underscores the significance of a market check in relying on deal price for fair value. Indeed, the Court of Chancery posited that a single bidder sales process could yield a deal price that is reliable evidence of fair value where the agreement allows for a passive post-signing market check and no other factors undermine the sales process. The Stillwater Board asked its financial advisor to conduct a condensed pre-signing market check, which the Court of Chancery found helpful because it still established several meaningful contacts and, at the very least, it did not damage the sales process. The post-signing market check was also effective because interested bidders had a fair opportunity over 138 days between the merger agreement signing and closing to present a higher-value alternative (and no alternative bidder in fact emerged in that time), and the Board had the flexibility to cancel the initial transaction and accept the higher-value deal. Therefore, although not necessarily mandatory, the absence of some form of market check will pose a difficult hurdle to overcome for a proponent of the reliability of deal price arrived at through such a sales process. That is apparent from *Jarden*, where the Court, in criticizing the seller's process, viewed negatively the fact that the board signed an exclusivity agreement, barring any pre- or post-signing market check. According to the Court, the absence of a market check was "critical" when coupled with "the difficulty in assessing the extent to which Newell ceded synergies to Jarden in the Merger."<sup>22</sup>
7. Ordinary deal protection mechanisms do not necessarily undermine the reliability of deal price as evidence of fair value. In *Stillwater*, the merger agreement contained a no-solicitation provision and five-day matching rights. But the Court of Chancery found that these deal protections did not inhibit other opportunities because any party could submit a

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<sup>21</sup> *Stillwater*, 2020 WL 6038341, at \*6.

<sup>22</sup> *Jarden Corp.*, 2020 WL 3885166 at \*5 (quoting *Jarden Corp.*, 2019 WL 3244085, at \*25.).



*bona fide* written bid that the Board could negotiate, the Board could provide information in response to a *bona fide* offer, and the Board retained a fiduciary out. Therefore, the Court of Chancery determined that the deal protections did not undermine the integrity of the post-signing market check. Importantly, potential buyers had 138 days to submit higher bids and none did. The Supreme Court upheld the Court of Chancery's ruling, finding the court did not abuse its discretion.

8. Directors must ensure proxy statement disclosures are accurate. In *Stillwater*, the Court of Chancery held, and the Delaware Supreme Court agreed, that the Board should have disclosed its CEO's conflicting incentives, including that he was interested in retiring and had negotiated change-in-control payments triggered by the merger to himself and one other employee. The proxy also should have disclosed that Stillwater's general counsel resigned during the sale process due to his view that the CEO was acting inappropriately in the sale process. Stillwater's general counsel had disclosed to the Board that he believed the CEO was self-dealing. However, the Board never addressed these concerns, and general counsel resigned a month later, stating that he had been "removed . . . from all legal conversations and decision making." Given these flaws, the Court of Chancery did not afford significant weight to stockholder approval of the transaction in concluding that the transaction price reliably indicated fair value.
9. Courts continue to reject reliance on expert discounted cash flow calculations presented as evidence of fair value given typically widely divergent calculations advanced by experts. In both *Jarden* and *Stillwater*, the Supreme Court affirmed the lower court's refusal to consider expert discounted cash flow calculations, which were "wildly divergent" and, thus, irreconcilable. For example, in *Jarden*, there was an 87% differential between the parties' experts' discounted cash flow analyses. Likewise, in *Stillwater*, the Court of Chancery found (and the Delaware Supreme Court agreed), that the parties disagreed on too many inputs, causing a similarly wide divergence between the competing discounted cash flow values. Therefore, the courts in both actions declined to consider the discounted cash flow calculations presented.<sup>23</sup>
10. Appraisal arbitrage in Delaware will likely continue its downward trend. As we have previously discussed,<sup>24</sup> decisions in *Dell*, *DFC*, *Aruba*, and now *Stillwater* are likely to

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<sup>23</sup> See also *Smith v. Promontory Fin. Grp., LLC*, No. CV 11255-VCG, 2019 WL 1934854, at \*12 (Del. Ch. Apr. 30, 2019) (rejecting plaintiffs' discounted cash flow model); see also *ACP Master, Ltd. v. Sprint Corp.*, C.A No. 8508-VCL, 2017 WL 3421142 (Del. Ch. July 21, 2017) (applying its own discounted cash flow model to find fair value because the "divergent opinions of the parties' experts" could not be reconciled).

<sup>24</sup> J. Halper, *et al.*, M&A Update: The Delaware Supreme Court's Decision in Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.—Calculating Fair Value in Statutory Appraisal Cases, Cadwalader, Wickersham & Taft LLP (April 22, 2019),

continue to deter the attractiveness of appraisal arbitration absent persuasive reasons to believe that the merger consideration is not reliable evidence of value. *Jarden* may further chill appraisal arbitration. The *Jarden* Court found the flawed sale was a persuasive reason to conclude that the merger consideration was unreliable evidence of value. However, rather than adopting valuation methods advanced by the petitioners to find a fair value above the merger price, it relied on the unaffected market price to find the fair value was 18% lower than the merger price.

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