CORPORATE FINANCE/M&A - USA

Court more likely to equate deal price with fair value following appropriate sales process

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A Delaware appraisal decision issued during the fourth quarter of 2016 reinforces that the Delaware courts are more likely to give substantial evidentiary weight to the deal price as an indicator of fair value where the transaction was the product of an appropriate arm's-length sales process between two independent parties.(1)

In *Dunmire v Farmers & Merchants Bancorp of Western Pennsylvania, Inc* Chancellor Bouchard considered an appraisal petition arising from an October 2014 merger between two community banks in western Pennsylvania – NexTier, Inc and Farmers & Merchants Bancorp of Western Pennsylvania, Inc – whereby NexTier acquired Farmers in a stock-for-stock transaction at an exchange ratio that implicitly valued Farmers at $83 per share. A group of Farmers shareholders brought an appraisal petition, arguing that the merger price of $83 per share was too low.

Each party's expert offered significantly differing estimates of the appropriate value of Farmers' share price. The Farmers shareholders' expert estimated the value of Farmers at $137.97 per share, while the NexTier's expert estimated the value of Farmers at $76.45 per share. Similar to prior appraisal cases, Bouchard was unimpressed with either valuation, stating: "This Court has remarked before on the tendency of litigants to submit wildly divergent valuations of the same company even when using similar methodologies. This case is no different."

Bouchard was particularly critical of NexTier's assertion that the actual merger price ($83 per share) should be considered as an indicator of fair value, noting that:

- there was no true auction because no other bids were solicited or received;
- the special committee was not truly independent; and
- the transaction was not conditioned on the approval of a majority of Farmers' minority shareholders.

The Snyder family owned a majority of the stock of both banks involved in the merger and stood on both sides of the transaction. While the Farmers board created a special committee to assess the transaction and engaged a financial adviser, the court determined that the special committee members were closely connected to the Snyders, giving the Snyders considerable behind-the-scenes influence.

Bouchard also noted that the use of comparable transactions by the Famers shareholders' expert to arrive at a value of $137.97 per share was inflated because it failed to account for synergies that were potentially incorporated in the merger prices in those transactions. After undertaking a fair value assessment itself, using a discounted net income analysis, the court arrived at a valuation of $91.90 per share as the fair value of Farmers' stock, which was 11% higher than the merger price.

Dunmire is a reminder that the Delaware Chancery Court is likely to give substantial weight to the deal price in determining the fair value of a company if the deal price is the product of a robust arm's-length sales process.(2) A sales process that is less than robust or in which the negotiations are not arm's-length will impair price discovery and produce a deal price that the court is unlikely to consider to be a reliable indicator of fair value. In addition, sellers should carefully evaluate the independence of the members of any special committee that is formed to consider a sale transaction to ensure that they are truly independent. Both sides in an appraisal proceeding have the burden of proving their respective valuation positions by a preponderance of evidence, and parties to appraisal proceedings should therefore take notice that the court will readily challenge experts' valuations when performing its own independent valuation of the fair value of a company.

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Endnotes

(1) *Dunmire v Farmers & Merch Bancorp of Western Pennsylvania, Inc*, CA 10589-CB (Del Ch Nov 10 2016).

(2) See also *Merion Capital LP v Lender Processing Services, Inc*, CA 9320-VCL (Del Ch Dec 16 2016).
