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Delaware Chancery Court Considers Panera Deal Price in Appraisal Suit

Court of Chancery Determines Deal Price Exceeds Fair Value, But Panera Is Not Entitled to a Refund Under the Appraisal Statute

SUMMARY

The Delaware Court of Chancery ruled in *In re Appraisal of Panera Bread Company*,[1] following a six-day trial, in a 130-page decision issued on January 31, 2020, that the petitioners received more than fair value for each share of Panera Bread Company ("Panera") in connection with its 2017 acquisition by JAB Holdings B.V. ("JAB"), with the Court relying on the deal price, minus synergies value, as the metric of fair value for the case. Because Panera had paid the appraisal petitioners the full merger price as permitted by Delaware law, it sought a refund of the amount of the deducted synergies. Addressing an issue of first impression, the Court concluded that Panera did not have a basis for a refund under Delaware's appraisal statute. The *Panera* decision reaffirms well-established indicia used by Delaware courts to evaluate whether a sale process is reliable and probative of fair value, while providing useful guidance to merger parties when considering the important question of whether or in what amount to pay appraisal petitioners in order to reduce exposure to prejudgment interest.

BACKGROUND

Panera involved the acquisition of Panera, a bakery-café concept, by JAB for $315.00 per share in cash, which was announced in April 2017 and closed in July 2017. Panera was founded by Ronald M. Shaich, who served in various roles, including as Chief Executive Officer, Co-Chief Executive Officer and on the Board of Directors, throughout his tenure at the company. Under Shaich's leadership as CEO, Panera began implementing various initiatives focused on enhancing the company's guest experience in 2014 and tracked these initiatives through a five-year strategic plan, which it heavily publicized to generate market recognition. In 2016, the company was approached by Starbucks, and after the parties evaluated a

potential joint venture and potential strategic transaction, Starbucks eventually informed Panera that it would not move forward with a transaction.

By February 2017, Panera reached the "inflection point" of its period of innovation and began to reap the benefits of its initiatives,[2] at which time Panera began discussions with JAB. In March 2017, JAB made an initial offer to Panera of $286.00 per share in cash. Through negotiations, JAB raised its offer to $296.50 per share in cash, and then finally to $315.00 per share in cash, although JAB had previously indicated that it would not offer more than $299.00 per share.[3]

During negotiations, Panera and Morgan Stanley, its financial advisor, identified potential interlopers (including Starbucks), with Morgan Stanley ruling out financial sponsors, and these discussions with Morgan Stanley aligned with "Shaich's and the board's deep knowledge of the industry."[4] Shaich had previously discussed a potential transaction with many of the potential interested parties, or had industry knowledge of their ongoing projects or company-wide issues, and Panera had already previously engaged with Starbucks. Further, no potential bidders emerged during Panera's negotiations with JAB despite a leak, and no topping bidder emerged following announcement of the merger.

In July 2017, dissenting stockholders notified Panera of their desire to exercise appraisal rights in respect of 1,863,578 shares of Panera's common stock. The petitioners in the case, holding 785,108 of those shares, contended a fair value of $361.00 per share.

THE COURT OF CHANCERY DECISION

In its decision, the Court reaffirmed the characteristics of a sale process that Delaware courts review in appraisal proceedings and weigh against any weaknesses in the sale process in order to determine whether the deal price reflects fair value. While there is no presumption that the deal price reflects fair value, the Delaware Supreme Court has long endorsed the efficient market hypothesis, and "the persuasiveness of the deal price depends on the reliability of the sale process that generated it."[5] Indicia of reliability of a sale process that have previously been approved by the Delaware Supreme Court include, among others, arm's-length negotiation, board deliberation without conflicts of interest, buyer due diligence and receipt of confidential information about the target's value and extraction of multiple price increases, with the absence of post-signing bidders an indicator particularly emphasized by the Delaware Supreme Court.[6]

The Court found that Panera's sale process was sufficiently reliable to make deal price persuasive evidence of fair value, noting, among evidence of other indicia, the following: the two increases in JAB's offer price even though JAB had previously insisted it would not offer more than $299.00 per share; the extensive public information about the company available to JAB given the company's transparency and other confidential information provided to JAB; and no appearance of other potential bidders, particularly in light of a leak. The Court found that Panera's routine deal protections, together with the "unremarkable

conclusion that no bidders emerged in the face of nonpreclusive deal protections" through a 104-day period between signing and closing, would seem to survive enhanced scrutiny.[7]

- ***Pre-Signing Market Check:*** The Court noted that when "directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market"[8] or using traditional value-maximizing tools, such as an auction, provided that the board "must possess an impeccable knowledge of the company's business."[9] Outreach to logical buyers is a key indicator of reliability,[10] and the Court concluded that the Panera Board led outreach to all logical buyers (*i.e.*, Starbucks and JAB), highlighting the Panera Board's "impeccable knowledge of the market in the pre-signing phase."[11]
- ***Termination Fee:*** The Court noted that Panera's 3.0% termination fee "falls on the low end of the range" presented by other deals (referencing deals with 2.27%, 3.5% and 3.9% termination fees).[12]
- ***"No-Shop":*** The Court described Panera's "no-shop" with a fiduciary out and matching rights as differing little from that of other deals with protections held by Delaware courts to satisfy enhanced scrutiny.[13] The Court also noted that the absence of a "go-shop" did not affect the reliability of Panera's outreach.[14]
- ***Passive Post-Signing Market Check:*** The Court noted that the duration of Panera's passive post-signing market check "falls in the middle" of other examples (pointing to deals with 50 days, 126 days and 153 days between signing and closing) and provided sufficient time for a topping bid to appear.[15]

The Court also addressed the petitioners' contention that weaknesses in Panera's pre-signing process undermined the deal price's reliability. The petitioners pointed to the Panera Board's alleged failure to oversee the negotiations led by Shaich, but the Court concluded that the board "exercised active oversight,"[16] with Shaich operating on the Panera Board's instructions, with the assistance of outside counsel.[17] Another primary allegation by the petitioners was that Shaich's personal conflicts undermined the process and that he had left value on the table given his desire to retire and his dislike of running a public company. In response, the Court extensively discussed Shaich's "deep" commitment to realizing value for Panera[18] and his tenure with Panera, including the fact that he had "repeatedly prioritized the Company's success over his preferred professional trajectory,"[19] which indicated that his personal interests did not undermine the sale process. The petitioners also raised a secondary contention that Shaich was apathetic on price because he wanted to liquidate and diversify his assets upon closing a transaction, which the Court disregarded given the absence of evidence.[20] The Court recognized Shaich as the deal's lead negotiator who was intent on obtaining the highest price possible and whose deep understanding of the market contributed to the robustness of the sale process, noting that "[t]he market and the restaurant industry both recognize Shaich as a visionary."[21]

Having established that the deal price was a persuasive metric of fair value in the case, the Court deducted a reasonable estimate of merger-specific synergistic gains from the deal price, which amounted to $11.56 of cost and tax synergies per share.[22] Based on this valuation method, the Court found that the fair value of Panera's common stock at the time of the merger was $303.44 and, as a result, that petitioners obtained more than fair value.[23]

Panera sought a refund of the amount of the deducted synergies, but the Court concluded that it could not order a refund since it is not explicitly provided for by Section 262 of the DGCL.[24] Pursuant to Section 262(h) of the DGCL, a surviving corporation seeking to decrease the amount of interest that could accrue in an appraisal suit may prepay petitioners an amount in cash,[25] and upon such prepayment, interest accrues only on the sum of (1) any difference between such amount and the fair value of the shares determined by the court and (2) any interest accrued to date unless paid at that time.[26] The Court concluded that any prepayment in excess of the judicially determined fair value of the shares is not a remedy available under the statute, and the prepayment agreement here did not provide any contractual right to claw-back overpayments, as some others have done.[27] The Court described prepayment under the DGCL as "a business decision, made with knowledge of the company's sale process that is superior to the stockholder's, and with counsel's prediction of how long the litigation may take and how much interest may accrue."[28]

IMPLICATIONS

A few notable takeaways from the Delaware Court of Chancery's decision in *Panera* include the following:

- In its assessment, the Court emphasized the Panera Board's deep knowledge in the pre-signing phase of the company—including its valuation metrics, performance and projections—and of the market. This reaffirms the need for boards of directors to develop a strong record of their attention to the company's performance and market over time, rather than solely in the context of considering a particular transaction.
- Boards of directors engaged in a sales process should continue to develop a record of a robust deal process, which may be equally important in any appraisal proceeding or in any fiduciary litigation.
- Prepayment of the deal price is a business decision to be made by companies after weighing various factors regarding the appraisal action, and upon electing prepayment, companies may want to consider stipulating claw-back rights so that they may recover any amount of the prepayment that may be judicially determined to exceed the fair value of the appraisal shares.
- In its discussion of deal protections, the Court noted that it "has recently posited that deal price is persuasive evidence of fair value, even with a limited pre-signing outreach, if the merger agreement's deal protections are sufficiently open to permit a post-signing passive market check in line with what decisions have held is sufficient to satisfy enhanced scrutiny."[29] The referenced recent decision currently is on appeal to the Delaware Supreme Court, which may provide further guidance on process sufficiency in appraisal proceedings moving forward.

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ENDNOTES

[1] *In re Appraisal of Panera Bread Company*, C.A. No. 2017-0593-MTZ (Del. Ch. Jan. 31, 2020).

[2] *Id.* at 22.

[3] *Id.* at 33.

[4] *Id.* at 37.

[5] *Id.* at 52 (quoting *In re Appraisal of Stillwater Min. Co.,* 2019 WL 3943851, at *21 (Del. Ch. Aug. 21, 2019) (citing *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 21 (Del. 2017); *DFC Glob. Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346, 366-67 (Del. 2017))).

[6] *Id.* at 53-54.

[7] *Id.* at 61 (n.385).

[8] *Id.* at 68 (quoting *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1287 (Del. 1989)).

[9] *Id.* (quoting *In re OPENLANE, Inc. S'holders Litig.*, 2011 WL 4599662, at *5 (Del. Ch. Sept. 30, 2011)).

[10] *Id.* at 63 (citing *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 35 (Del. 2017)).

[11] *Id.* at 69.

[12] *Id.* at 61-62 (n.385 (citing *C & J Energy Servs., Inc. v. City of Miami Gen. Emps.*, 107 A.3d 1049, 1063 (Del. 2014); *In re Dollar Thrifty Shareholder Litigation*, 14 A.3d 573, 592-93, 614-16 (Del. Ch. 2010); and *In re PLX Tech. Inc. S'holders Litig.*, 2018 WL 5018535, at *2, *26-27, *44, *55 (Del. Ch. Oct. 16, 2018))).

[13] *Id.*

[14] *Id.* at 69.

[15] *Id.* at 61-62 (n.385 (citing *C & J Energy*, 107 A.3d 1049, 1063; *Dollar Thrifty*, 14 A.3d 573, 592-93, 614-16; and *PLX*, 2018 WL 5018535, at *2, *26-27, *44, *55)).

[16] *Id.* at 71.

[17] *Id.* at 27-28, 73. Panera and its Board were represented by Sullivan & Cromwell LLP.

[18] *Id.* at 88.

[19] *Id.* at 87.

[20] *Id.* at 85 (n.504).

[21] *Id.* at 5.

[22] *Id.* at 102-103.

[23] *Id.* at 125.

[24] *Id.* at 129.

[25] *Id.* at 126 (citing 8 *Del. C.* § 262(h)).

[26] 8 *Del. C.* § 262(h).

[27] *Panera*, C.A. No. 2017-0593-MTZ, at 127 (citing *Artic Invs. LLC v. Medivation, Inc.*, C.A. No. 2017-0009-JRS, D.I. 20 at 5 (Del. Ch. Mar. 6, 2016)).

[28] *Id.* at 130 (n.704).

ENDNOTES (CONTINUED)

29 *Id.* at 61 (n.385 (citing *In re Appraisal of Stillwater Min. Co.*, 2019 WL 3943851, at *24-30 (Del. Ch. Aug. 21, 2019))).

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