

February 18, 2015

Huff Fund Investment Partnership v. CKx, Inc.

Delaware Supreme Court Affirms Chancery Court's Appraisal Decision that Merger Price Was the Best Indicator of Fair Value and Statutory Interest Could Not be Tolled with a Proffer of Consideration

SUMMARY

On February 12, 2015, the Delaware Supreme Court affirmed in full (without an opinion) the Chancery Court's decision in *Huff Fund Investment Partnership v. CKx, Inc.* (VC Glasscock),¹ an appraisal case in which the Chancery Court held that (i) the merger price was the best indicator of fair value of the common stock of CKx, Inc. ("CKx") and (ii) it did not have the discretion to toll the running of statutory interest (five percent over the Federal Reserve discount rate from the effective date of the merger through the date of payment of the judgment) on the undisputed portion of the value of the stock that CKx unconditionally offered to Huff Fund Investment Partnership ("Huff") at the outset of the appraisal proceedings.

The Delaware Supreme Court's affirmation of the Chancery Court's decision is a mixed bag for those who engage in appraisal arbitrage. On the one hand, the *Huff* decision makes clear that while the Chancery Court may not presume the merger price to be the best indicator of fair value in an appraisal proceeding, it may well find the merger price to be the most reliable indication of value. On the other hand, the Chancery Court's view that it has no discretion to toll the statutory interest rate on a portion of the potential appraisal award offered unconditionally by a target company to a petitioner during the pendency of the proceeding—combined with the historically low incident rate of appraisal proceedings awarding less than the merger price—may still fuel appraisal arbitrage in a low interest rate environment, especially where the purchase of the stock can be effected on a leveraged basis. This is particularly true when the *Huff* decision is considered in conjunction with two other recent Chancery Court decisions in which

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stockholders who bought shares after the record date were still permitted to seek appraisal for their shares without having to show that the shares were not voted in favor of the merger.²

BACKGROUND

In 2013, the board of CKx, which owned and managed iconic entertainment properties that included the rights to *American Idol*, approved a cash merger of CKx at \$5.50 per share, after prolonged attempts to sell itself and an active and thorough auction the Chancery Court found was “free of fiduciary and process irregularities.”³ Huff, a CKx stockholder, opted for appraisal under Section 262(h) of the DGCL. In the appraisal proceeding, Huff’s expert, using “guideline” comparable companies and transactions, as well as a DCF analysis based on CKx management projections prepared for the sales process, concluded that the fair value of a CKx share was \$11.02. By comparison, CKx’s expert, relying on a DCF analysis that discounted the CKx management projections, concluded that the value of CKx was \$4.41 per share.

THE CHANCERY COURT’S DECISION

A. MERGER PRICE RELIABLE INDICATOR OF FAIR VALUE

In holding that the merger price was the most reliable indicator of the fair value of CKx stock, the Chancery Court rejected both parties’ methodologies for valuing the CKx stock as unsound and unreliable. It rejected the Huff expert’s “guideline” comparable company and transaction analyses because it concluded that the guideline companies were not truly comparable to CKx, and those analyses accounted for 40% of Huff’s view of the value of CKx stock. The Chancery Court also found the respective DCF analyses the CKx and Huff experts employed unreliable because of the lack of reliable cash flow projections. The Court noted that a material portion of management’s five-year cash flow projections (which were not prepared in the ordinary course) was based on what the Court believed was an optimistic projection of additional licensing revenue from *American Idol* that amounted to little more than guesswork; however, the Court was unable to endorse the CKx expert’s view that only marginal additional value could be generated by the *American Idol* contract.

In the absence of reliable comparable companies, comparable transactions or DCF analyses, the Chancery Court relied on the merger price as the most reliable indication of CKx’s value, having found that the auction process was thorough, effective and free from any specter of self-interest or disloyalty. In so finding, the Chancery Court rejected Huff’s claim that the Delaware Supreme Court’s rejection in *Golden Telecom*⁴ of the merger price as the presumptive measure of fair value indicated that the merger price is irrelevant in appraisal determinations. Rather, the Chancery Court concluded that the Delaware Supreme Court made clear only that in pursuing the statutory mandate to consider all relevant factors in determining fair value in an appraisal proceeding, the merger price was one of the relevant factors to be considered.

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B. NO EVIDENCE THAT SYNERGIES WERE INCLUDED IN MERGER PRICE

Noting that DGCL Section 262(h) requires the Chancery Court to determine fair value exclusive of “any element of value arising from the accomplishment or expectation of the merger,” the Chancery Court declined to adjust the merger price “fair value” downward to reflect synergies the buyer sought to realize post-merger because there was no evidence that the cost savings could only have been achieved through a merger and no evidence that the buyer had arrived at its merger price based on the cost savings. In addition, the Chancery Court declined to adjust the fair value upward to account for (i) the value of certain assets that CKx was to purchase post-merger, (ii) “unexploited revenue opportunities” the buyer had identified in due diligence, (iii) support agreements the buyer had obtained from large CKx shareholders or (iv) a higher bid from another bidder that the CKx board rejected because of financing issues. While suggesting that events and discoveries following the execution but prior to the closing of the merger agreement could have an impact on the fair value of a company for appraisal purposes, the Chancery Court noted that potential buyers in the auction process were aware of the business opportunities and that presumably they were reflected in the merger price. In addition, the Chancery Court found it difficult to measure the value of the additional consideration represented by the support agreements. Finally, the Chancery Court found no evidentiary basis to support Huff’s contention that the losing bidder could have paid a higher price if the CKx board had provided it additional time.

C. NO TOLLING OF STATUTORY INTEREST

The Delaware Supreme Court’s affirmation of the Chancery Court’s *Huff* decision also underlined the lack of discretion the Chancery Court has to toll the interest required to be paid under DGCL Section 262(h) (five percent over the Federal Reserve discount rate from the effective date of the merger through the date of payment of the judgment) before the proceeding has been completed. The Chancery Court denied CKx’s request to toll the further accrual of interest on the \$3.63 per share that CKx had offered unconditionally to Huff in anticipation of a final appraisal determination, explaining that the DGCL did not permit the Chancery Court to enter a partial judgment to enable such a payment and thereby toll the accrual of interest on the amount offered. The Chancery Court noted that the only discretion available to it is to determine at the end of the appraisal proceedings whether the awarding of interest would be unjust upon a finding of good cause.

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ENDNOTES

- ¹ [Huff Fund Investment Partnership v. CKx, Inc.](#), No. 348,2014 (Del. Feb. 12, 2015); [Huff Fund Investment Partnership v. CKx, Inc.](#), C.A. No. 6844-VCG (Del. Ch. May 19, 2014); [Huff Fund Investment Partnership v. CKx, Inc.](#), C.A. No. 6844-VCG (Del. Ch. Feb. 12, 2014); [Huff Fund Investment Partnership v. CKx, Inc.](#), C.A. No. 6844-VCG (Del. Ch. Nov. 1, 2013) (hereinafter, “Slip Op. I”).
- ² *Merion Capital LP v. BMC Software, Inc.*, C.A. No. 8900-VCG (Del. Ch. Jan. 5, 2015); *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG (Del. Ch. Jan. 5, 2015). In *Ancestry*, the Chancery Court held that the appraisal petitioner, who was the beneficial owner of shares held in fungible bulk by the record owner, Cede & Co., had standing to seek appraisal because Cede held at least as many shares not voted in favor of the merger as the number for which appraisal demand was made. In *Merion*, the Chancery Court held that the appraisal petitioner, who bought shares after the record date, had standing to seek appraisal because the petitioner itself had never voted any of the shares in favor of the merger. In each case, the Chancery Court rejected any “share-tracing” requirement for petitioners to prove that the specific shares they sought to have appraised were not voted in favor of the merger by prior owners.
- ³ Slip Op. I at 3.
- ⁴ *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010).

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