Director Notes

Fairness Opinions in the Sale of a Company

Context Is Key

by John K. Hughes

When the board of directors of a public company is considering the sale of that company, it will commonly retain a financial advisor to assist in that process and help the board evaluate different aspects of the transaction, most notably the financial aspects of any proposals that may be received. As part of that process, the board also will commonly request and receive a fairness opinion from the financial advisor. In short, that opinion evaluates, from a financial point of view, the fairness of the proposed consideration the target company's stockholders are to receive. The opinion gets factored into the board's overall consideration and determination as to the sale. One recent decision from Delaware's Court of Chancery, however, criticized a corporate board for relying on what the court described as a "weak" fairness opinion, particularly when that opinion was considered in light of other design features that the board involved had implemented as part of the sales process. This *Director Notes* discusses those aspects of the case addressing the fairness opinion matters, and it offers guidance to directors regarding such opinions when seeking to meet their fiduciary duties during a sales process.

Under what is referred to as the *Revlon* standard, when the sale of a company is undertaken by a board, the board of directors has a fiduciary duty to use a sales process designed to maximize stockholder value by securing the highest price reasonably available.[1] To assist directors in meeting that standard, most public corporate boards retain one or more financial advisors to assist in the sales process and to provide a fairness opinion in connection with the proposed sale transaction. To reach such an opinion, the financial advisor undertakes a variety of comparative financial analyses, depending on the nature of the transaction. The fairness opinion evaluates, from a financial point of view, the fairness of the proposed consideration the target company's stockholders receive. The opinion is but

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one element that gets factored into the board's overall consideration and determination regarding the sale. As such, a financial advisor's assessment can play a critical role in a merger or acquisition process.

In May 2013, the Delaware Court of Chancery rendered an opinion in *Koehler v. NetSpend Holdings, Inc.* The transaction underlying the case involved NetSpend's agreement to sell itself to Total Systems Services, Inc., for $1.4 billion in cash, a price that, for stockholders, represented a 25 percent one-day premium and a 45 percent one-week premium over the market value of the company's share price.[2] In its decision, the court reviewed, among other matters, the financial analyses the board's financial advisor had performed and that underpinned the advisor's fairness opinion, determining the fairness opinion to be "weak." It criticized the board for not assessing such an opinion in the context of the other design features the board had put in place as part of the sales process it pursued. As such, the decision adds to a list of other cases in which the chancery court has found that the conduct of the board during the sales process likely fell short of the *Revlon* standard.

This *Director Notes* focuses only on those aspects of the court's decision assessing fairness opinion matters. It highlights a number of takeaways that may assist boards and board members involved in evaluating the financial analyses and fairness opinions that financial advisors may provide a board as part of a sales process. While the court's assessment of these matters in *NetSpend* contributed to its overall decision that the plaintiffs had shown a likelihood of success on the merits that the NetSpend board had not met its *Revlon* duties, it is important to note that there were other deal features and deal protections involved in the sales process that, in the aggregate, made the sales process suspect in the court's view and contributed to the court's ruling.[3] Those other deal features and deal protections, and the court's assessment of them, are not reviewed in detail here.

Reliance on investment bankers is "pale substitute" for a market check[4] One design feature of the NetSpend deal was the board's decision, under the circumstances, not to undertake a pre-signing market check.[5] Past transactions during which no pre-signing market check was performed certainly have survived chancery court scrutiny under *Revlon*.[6] However, the court in *NetSpend* emphasized that, in the context where the board chose to run a single-bidder process, the fairness opinion that the board's financial advisor was to supply (and the supporting financial analyses) was critical in providing the board with a reliable body of evidence and knowledge to support a determination that the price the NetSpend stockholders would be receiving was the best the board could reasonably obtain.[7] But when the *NetSpend* court looked more closely at the underlying financial analyses, it found that "the evidence confirmed that the fairness opinion was, in fact, weak…" and "…a 'particularly poor simulacrum' of a pre-signing market check."[8] Considering that the NetSpend board had received the fairness opinion prior to its approval of the merger, the court took the view that the directors presumably would have had the time to try to address the shortcomings in the financial analysis and fix the process, such as by having the financial advisor conduct some form of a pre-signing market check.[9] The court pointed to the following elements to support its view that the opinion was "unreliable" and "ambiguous":[10]

Selected Terminology

A **go-shop provision** in a merger agreement enables the target company, after it has entered into an acquisition or merger agreement with an acquiror, to actively solicit (i.e., "shop") other higher offers and negotiate with other potential acquirors for a specified period (the "go-shop period"), which generally ranges from 30 to 45 days.

A **pre-signing market check** is a process conducted by or on behalf of a target company prior to the target company executing an acquisition or merger agreement with a chosen buyer. The process is undertaken so that the target can determine (or confirm) whether there are other potential parties (whether strategic buyers or financial buyers) that are interested in exploring the possible acquisition of the target company. There can be different degrees of pre-signing market checks in terms of how broad or limited the canvass of potential third-party buyers.

1 **Premium-based analyses** Two of the five financial analyses performed by the financial advisor for the purpose of issuing the fairness opinion were based on NetSpend's stock price (52-week high and low closing price and the analyst share target price range).[11] However, the court observed that:

- NetSpend's stock price had been volatile since its initial public offering (IPO) in 2010, swinging between $3.90 and $16.
- For some time, the board had expressed its view that the public marketplace was substantially undervaluing NetSpend's stock, and that the stock price was not a good indicator of NetSpend's underlying long-term potential value.
- The board had also put in place a stock buyback program to try to address the depressed stock price, further evidencing its concern regarding the stock market as an arbiter of value.
- NetSpend's proxy statement noted that the board's concern regarding the stock price was one of the reasons the board initially brought in the financial advisor.[12]

Given this background, and where the low stock price had led the board to consider strategic options in the first place, the court determined that premium-based analyses performed off of those depressed metrics were "uninformative" and not strong indicators of value for the board to rely on.[13]

2 **Comparable company and comparable transaction analyses** The court also reviewed the selected publicly traded companies analysis and the selected precedent transaction analysis that had been performed and found that the companies presented as "comparable" were, in fact, dissimilar to NetSpend, "which greatly reduced their utility."[14] To underscore the point, the court pointed out that the financial advisor's lead banker had testified that 14 of the 15 companies used in the comparable company analysis were dissimilar.[15] The court further highlighted that, as NetSpend had referenced in its merger proxy, most of the comparable transactions selected for comparison were "quite old, predating the financial crisis, and the target businesses of the comparables were not particularly similar to NetSpend."[16] As a result, the court determined that these analyses also were uninformative and not indicative of value.[17] At that point, the court had found flaws with four of the five financial analyses that had been presented to the board.

3 **Discounted cash-flow (DCF) analysis range and projections** The court then turned to the final financial analysis performed, which was the DCF analysis. The court found the DCF illustrated that the agreed-to $16 per-share cash merger price "was grossly inadequate and the analysis was based on projections that were outside the range of management's customary projections."[18] The court noted that the DCF revealed that the agreed merger price was "20 percent *below* the bottom range of values implied by the DCF" (which range was $19.22 to $25.52).[19] The court determined that the "presence of an anomalous DCF valuation makes the [fairness opinion] a less reliable substitute for a market check."[20] The defendant directors sought to distinguish the DCF by noting it represented an "outlier," and was "just one of six" valuation analyses, and that they were justified in not giving the DCF significant weight.[21]

Delaware courts have long looked to the DCF analysis, however, as a core valuation tool in a variety of circumstances, including appraisal situations, damages calculations, and in change-of-control transactions.[22] The court added to its concerns around the DCF analysis by noting that NetSpend management typically had prepared projections no further out than three years, making the five-year DCF used as part of the fairness opinion process "speculative."[23] This aspect of the opinion also raises considerations for financial advisors when five years of projections for the target company (commonly required to perform DCF analyses) are not available.[24] There were also questions raised in the pleadings around whose cash-flow projections (management's or the financial advisor's) had been used in performing the DCF, which further clouded the dependability of the analysis.

The court highlighted that the NetSpend directors were certainly entitled to rely on fairness opinions since, under Delaware precedent, directors may rely in good faith on the advice of expert opinions.[25] The court determined, however, that, when considering all of the other facts of this case and the actions by the board in pursuing the sales process, the board's reliance on the fairness opinion involved here, with the weaknesses it identified, pushed the totality of the decisions on the sales process "farther towards the limits of the range of reasonableness."[26]

The broader ruling here was similar to the court's approach in earlier Delaware case law, such as in *Del Monte*[27] and *El Paso,*[28] where board actions around the sales process are

criticized by the court as flawed, but the deal is allowed to proceed to a vote and closing because there is no viable alternative and the court doesn't want to stand in the way of stockholders receiving a significant premium to the then-current market price. As in those earlier cases, the court here acknowledged that the directors would not likely face personal liability as a result of the exculpation provisions found under Delaware law.[29] As such, *NetSpend* contributes to the debate over whether Delaware courts have a proper remedy for board or director performance that is judged to be subpar, but is clearly short of a breach of the duty of loyalty (where monetary damages might be available).

It remains unclear whether the fairness opinion and the supporting financial analyses provided to the NetSpend board would have been criticized by the court—or, at least, criticized in the same tones—if other aspects of the sales process and other deal features approved by board had been different.[30] Regardless, *NetSpend* offers several takeaways for financial advisors and directors alike.

Takeaways for Financial Advisors

The following are some considerations financial advisors involved in fairness opinion exercises may want to bear in mind:

1. **Chancery court's continued scrutiny of fairness opinions** The court continues to demonstrate that it will closely scrutinize different aspects of the financial analyses commonly performed to support business valuations. In general, Delaware courts have developed a large body of law looking at the proper analytics for valuing businesses. As a result, fairness opinion providers may want to factor the court's views in *NetSpend* into whatever guidelines they may maintain around techniques and assumptions that the Delaware courts have determined to be reasonable or unreasonable, as the case may be, and the context in which those determinations are made.

2. **Plaintiffs' review of the analyses** Financial advisors (deal team members and fairness opinion committees) should already be well aware that plaintiffs' counsel (and their own advisors) will closely inspect each of the financial analyses performed to test how appropriate such analyses may be for the transaction and context involved, how "comparable" selected companies, transactions, and situations may or may not be to a transaction at hand, and how solid the component parts of the DCF might be. Anomalies and shortcomings will be highlighted in pleadings and probed in depositions, where the degree to which boards and board members understand the data will be explored. The court, of course, will factor any actual findings in this regard into its overall deliberations when it stacks up "good" facts and "bad" facts.

3. **Stress-testing analyses** Banker deal teams and fairness opinion committees that typically review opinions and presentation materials before they are delivered to a board should ensure that all such financial analyses in any board presentations are fully vetted, stress-tested, and contextualized for the deal at hand. Potential analytical questions should be addressed upfront in a deliberative process (with in-house and/or outside counsel, as warranted) to avoid the risk of having perceived shortcomings exposed during depositions or chancery court proceedings. The latter may put bankers (and, possibly, their fees) and the board they represent in a gloomy spot and become an unwanted learning experience if it proves difficult to rationally explain the subjective judgments underlying the analyses. This is not to suggest that such stress-testing did not happen in the NetSpend transaction, since the record does not address the point. The court's ruling also raises other questions around what course a financial advisor can consider taking when certain aspects of the financial analyses may not, for whatever reason, be as supportive as might otherwise be the case. In addition, financial advisors and boards alike should view the process of developing and reviewing the relevant financial analyses and the resulting fairness opinion as an evolutionary or organic process, taking into account considerations and developments gathered along the transaction pathway and that should get factored into the final product and the final determination by the board.

4. **Discussion of any weaknesses** If, for any reason, a financial advisor were to believe aspects of any of the financial analyses contained inherent weaknesses or shortcomings, those concerns should be identified and reviewed with the board so that it can factor those items into its deliberations and determinations and decide whether there is any need to recalibrate its strategy scheme accordingly. Any such notations made to a board should be reflected in the record, although that can be a double-edged sword, since that could potentially serve as a roadmap for plaintiff claim development. Whether any shortcomings were discussed with the NetSpend board is unclear based on a reading of the opinion. No statements in the court's opinion suggest that specific discussions were held or questions raised around the relevant matters related to the financial analyses.

Takeaways for Boards of Directors

In addition, the following are some items that boards and board members may want to bear in mind when involved in sale processes and considering fairness opinion-related matters:

1. **A fairness opinion is no panacea** *NetSpend* is but the latest reminder for boards and directors that fairness opinions are just one device in the mergers and acquisitions toolbox to assist directors in establishing that they have sought to satisfy their fiduciary duty to act with due care and in an informed manner in a sale-of-the-company transaction. As *NetSpend* illustrates, however, a fairness opinion is not a panacea. Nor does such an opinion offer an automatic defense to a fiduciary duty claim. Directors and boards (with the assistance of counsel, if necessary) should closely review the supporting analyses behind such opinions and make sure they understand the various inputs. Obtaining a fairness opinion is not simply a check-the-box exercise, and reliance must be reasonable.

2. **Courts review directors' understanding of fairness opinions** Courts regularly examine the circumstances surrounding the obtaining of fairness opinions to determine whether boards are justified in relying upon them in satisfaction of applicable fiduciary duties. As previously noted, the *NetSpend* court did not specifically address in its decision whether, or to what degree, any of the NetSpend directors questioned the financial analyses (including the DCF), highlighted any perceived deficiencies, and/or factored that thinking into their decision making when setting their strategic course, evaluating other proposed deal terms, or assessing the outcome the sales process produced. The oral argument transcript from the case appears to suggest that the board actively discussed the DCF aspects, but the court did not speak to that.[31] Leaving aside what may or may not have happened in *NetSpend,* directors (and counsel representing them) should be probative around such matters, without hesitating to ask pointed and direct questions. Boards and directors should expect any anomaly or aberration to surface in litigation and, with that in mind, they should build as strong a record as possible—illustrating their reasonable deliberations and probity of such matters.[32] As discussed further below, notwithstanding that *NetSpend* was fact-based, plaintiffs' counsel will no doubt attempt to argue in future change-of-control cases that come under challenge that one or another of the financial analyses involved there is sufficiently deficient so as to contribute to a "weak" fairness opinion, and that whatever board may be involved breached its fiduciary duty by failing to recognize it or do something about it.

3. **Context is key** Perhaps most important, *NetSpend* reinforces the theme that directors' deliberations around all deal features, including a fairness opinion, should be highly contextualized. A board and its advisors should evaluate the process design features and other moving parts of the transaction concurrently as they evolve, with a clear eye toward understanding on an ongoing basis how each is working with and/or influencing the other.

4. **Single-bidder situations heighten the focus on a fairness opinion** In single-bidder scenarios, where other design features do not include a pre-signing market check and/or a post-signing go-shop, there is a heightened focus on what information the board is considering and relying on in its effort to fulfill its duties and responsibilities. *NetSpend* highlights that, in such a situation, the board is required to rely more extensively on its own knowledge and that of its financial advisor in determining whether the proposed purchase price is supportable. The weaker the knowledge base or sophistication of the directors as to financial matters, the more sturdy and reliable the fairness opinion must be. If the reliability of one or more of the financial analyses supporting the fairness opinion is questionable or seen as flawed, it will shine a brighter light on the other features in the board's process design in terms of whether they put themselves in a position to achieve the best reasonably available transaction and fulfill their *Revlon* obligations.[33]

5. **When faced with a weak(er) fairness opinion, consider modifying other deal terms** If presented with a fairness opinion that, for any reason, appears to be not particularly strong, the directors should contextualize that and look at their other deal process decisions and consider modifying other deal terms, notwithstanding where the transaction may be in terms of sequencing. The board should consider taking steps to gather other current information around value, including market-based information, as part of its process of determining whether the deal affords the opportunity to attain the highest price reasonably available.[34] If they do not do so, directors may cede to others the ability to control the narrative once they get to chancery court.

The NetSpend board appeared to face a Hobson's choice: (a) accede to the buyer's attempted shutdown move that under no circumstances would it agree to a post-signing go-shop, despite repeated efforts by NetSpend and its advisors to get that term into the deal (and thereby obtain the cover that deal term might afford in the inevitable litigation to follow[35]); or (b) insist on a go-shop and risk cratering the deal and losing the premium payment for stockholders from the chosen buyer. The NetSpend board took the

deal in hand, running the risk it might get pushed around in chancery court. Looking back, that trade appears to be the far better one than what the result may have been if the board had scuttled the deal because it couldn't get a market-based "simulacrum" in the form of a go-shop (the utility of which the board may have clearly analogized to the lack of benefit to be derived from running a pre-signing process in the first place). If the board had let the deal go, it surely would have ended up with stockholder litigation for having let a premium deal get away and for having tanked the stock price as a result. In effect, it looks like the NetSpend board may have essentially made the same determination that the court did: while the sales process and the fairness opinion perhaps turned out to be a little less than clinical, it was not enough to keep the deal from moving forward.

On one level, *NetSpend* can be viewed as simply another in a line of cases analyzing a board's sale process and design features as measured against its *Revlon* obligations. Here, it was against the backdrop where there may not have been an active, competitive bidding pool, nor had there been a pre-signing market check or a post-signing go-shop. On another level, however, the case also serves to illustrate a broader lesson for boards and directors: At certain times in certain deals, developments may arise that amount to strategic inflection points. These pivot points are more than the garden-variety changes or hiccups that normally occur in the deal-making process. In *NetSpend*, such an inflection point was the receipt of a fairness opinion the court viewed as "weak." That development had the effect of re-contextualizing other deal-process design features involving the pre-signing market canvas and the post-signing go-shop (leaving aside what one may think of the utility of go-shops as a proxy for a pre-signing market check). In other deals, other developments may trigger the need for such re-contextualizing. *NetSpend* teaches that, when such developments occur, directors and boards need to be able to identify them and react in real time so as to carefully assess, debate, and understand their dimensions, and determine whether any re-thinking and/or recalibration of any other deal design features or tactics is needed to allow the directors to better fulfill their fiduciary duties.

NetSpend Aftermath

After *NetSpend*, the M&A litigation world didn't stand still for long. There was concern by bankers and boards alike that the chancery court had perhaps given plaintiffs' counsel a new claim theory to graft onto challenges to subsequently announced public merger transactions. The concern was that plaintiffs' counsel would begin alleging breach of fiduciary duty claims against boards based on their reliance on "weak" fairness opinions any time key financial analyses undertaken by a financial advisor produced a fairness range above or near the deal price.

The plaintiffs' bar didn't disappoint. In January 2013, BioClinica, Inc., announced that it had entered into a merger agreement with a financial sponsor after the company had run a sales process. As with nearly all announced merger transactions, litigation ensued, challenging the transaction based on grounds BioClinica's board had run an unfair sales process and agreed to an unfair price. The litigation commenced pre-*NetSpend* and was heard by the same vice chancellor in Delaware's Court of Chancery who rendered *NetSpend*. In an earlier phase of the litigation, the chancery court denied plaintiffs' motion to expedite, essentially foreclosing attempts to enjoin the transaction before it was completed. Subsequently, plaintiffs continued the litigation and amended their complaint to seek post-closing damages based on essentially the same claims they had pressed in seeking to enjoin the transaction in the first place. In their amended complaint, plaintiffs argued, among other things, that *NetSpend*, which had since been decided, supported their liability theory, asserting the BioClinica board had breached its fiduciary duties by relying on a fairness opinion from its financial advisor as part of the sales process that the board knew was "weak."[36]

In October 2013, the chancery court issued its opinion in the BioClinica litigation, denying all claims by plaintiffs.[37] A full review of *BioClinica* is beyond the scope of this article. What is relevant here, however, and what may be of some small comfort to boards and bankers in terms of how broadly *NetSpend* may be read as precedent, is that the chancery court went out of its way to specifically reject plaintiffs' attempt to exploit *NetSpend* based on a mere allegation of fairness opinion "weakness," and it found the two cases were easily distinguishable.

The court noted that *NetSpend* involved a single-bidder process, no pre-signing market check, no go-shop, standstills that included "don't ask, don't waive" provisions, and potential breaches of a duty of care on the part of the directors. In that context, the court observed the fairness opinion there took on greater significance. In contrast, the court noted that, in *BioClinica*, there had been a full pre-signing market canvas, no "don't ask, don't waive" standstills, and poorly pled alleged breaches of the duty of loyalty on the part of directors (since duty of care claims had already been addressed in the earlier stage of the litigation).[38]

In drawing these distinctions, the chancery court emphasized that its criticism of the board's process in *NetSpend* around the "weak" fairness opinion was contextual and fact-specific, since the board there knew a sale had been accomplished through a single-bidder process, neither the stockholders nor the court had any market-based indications the offer price was adequate, and the fairness opinion was the only mechanism through which the board could determine that no superior offer would have emerged.[39] The court said this fact was "critical."[40] No doubt others in subsequent change-of-control litigation will attempt to fashion claim theories based on assertions that a board involved there relied on a weak fairness opinion in breaching its fiduciary duties. It remains to be seen how successful those attempts will be. For now, *BioClinica* stands for the proposition and further reinforces the view that boards and directors must be context-sensitive.

Endnotes

1 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del. 1986).

2 *Koehler v. NetSpend Holdings, Inc.,* No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013) [hereinafter *NetSpend*].

3 See *NetSpend*, 2013 WL 2181518, p. 1, p. 19. There were also other deal protection provisions included in the merger agreement (e.g., no-shop, match rights, 3.9 percent break-up fee, voting agreements for 40 percent of the stock) that the plaintiff had challenged as unreasonable and "too strong" in the context of NetSpend never having solicited other offers via a pre-signing market check or post-signing go-shop, and instead pursuing a single-bidder sales process. The court determined these other deal protections, on their own, were fairly routine and would not have deterred another bidder. The court did note, however, that when viewed in the context of the other process design features referenced above that it did criticize, and combined with such features, they contributed to the court's overall determination that the board's sales process was unreasonable as a means to meet the *Revlon* standard. See *NetSpend* pp. 12, 17-18, 19-21.

4 *NetSpend*, p. 17, citing *Barkan v. Amsted Indus., Inc.,* 567 A.2d 1279, 1286 (Del. 1989) at 1287 (holding that reliance on a fairness opinion is a "pale substitute" for a market check).

5 *NetSpend*, pp. 3–9. In brief, the decision was made as part of the board's overall strategic approach given, among other factors, prior failed sales processes that the board believed had consumed significant time and effort, and the board's attempt to maintain a posture that the company was "not for sale" when dealing with the ultimate purchaser in an effort to try to get that party to pay up if it wanted to complete an acquisition. For a discussion of factors to be considered generally when deciding whether to pursue an auction process or negotiate privately, see Guhan Subramanian, *Negotiauctions: New Dealmaking Strategies for a Competitive Marketplace* (New York: W.W. Norton & Company, Inc., 2010) pp. 37-56.

6 See, e.g., *In re Smurfit-Smurfit-Strone Container Corp. S'holder Litig.,* 2011 WL 2028076 (Del. Ch. May 20, 2011, revised May 24, 2011).

7 See *NetSpend*, 2013 WL 2181518, pp. 12-14.

8 *NetSpend*, p.16 (citing *In re Vitalink Commcn's Corp. S'holders Litig.,* No 12085, 1991 WL 238816, at *1328–32 (Del. Ch. Nov. 8, 1991) (reviewing a DCF and two comparables-based analyses to determine if a fairness opinion was "reliable").

9 *NetSpend*, pp. 13, 16. Of course, there are timing considerations involved here. At the time the board decided to forego a pre-signing market check (during the period September-October 2012), the fairness opinion and the final associated financial analyses supporting the opinion had not yet been provided to the board (which only occurred February 5, 2013), although, presumably, the analyses had been getting shared with the board along the way. See NetSpend Holdings Inc. Form DEFM14A, filed April 23, 2013, pp. 37–44, hereinafter, "NetSpend Proxy." It also could be more than a little awkward, with unknown economic consequences on any deal in hand, if once a board has received a fairness opinion that it determined might contain some shortcomings, to roll the deal back from the launch pad and into the workshop so as to restart a market survey exercise. Admittedly, such consequences would be different, depending on where along the deal's time line such a determination was made.

10 See *NetSpend*, 2013 WL 2181518, pp. 13, 16.

11 The court referenced five financial analyses, although defendants referenced six financial analyses. The disparity appears to exist because defendants were counting a selected public company analysis the financial advisor conducted ("Selected Public Companies (based on [Earnings Per Share] EPS)" and "Selected Public Companies (based on [Earnings Before Interest, Taxes, Depreciation, and Amortization] EBITDA)") as two separate analyses, whereas the court looked at these analyses as one analysis (with two components).

12 See "NetSpend Proxy," p. 34.

13 *NetSpend*, 2013 WL 2181518, p. 16. See also Gilbert E. Matthews, "Valuation Methods in Fairness Opinions: An Empirical Study of Cash Transactions," *Business Valuation Review*, 31, no. 2-3, Summer/Fall 2012, pp. 55–74 [hereinafter "Valuation Methods"] (analyzing empirically the valuation methods used in 352 fairness opinions in U.S. cash transactions during two 12-month periods (September 2007-August 2008; September 2010-August 2011), and noting, among other things, that "the validity of using average premiums [paid] has been questioned by numerous writers for more than two decades," although admittedly this comment appears aimed more at premium paid analyses used when comparing a transaction at hand to comparable marketplace transactions, as opposed to standalone stock price performance). "Valuation Methods," p. 61 (internal citations omitted).

14 See *NetSpend*, 2013 WL 2181518, p. 16 (citing *In re Radiology Assocs., Inc.,* 611 A.2d 485, 490 (Del. Ch.1991) ("The utility of the comparable company approach depends on the similarity between the company the court is valuing and the companies used for comparison. At some point, the differences become so large that the use of the comparable company method becomes meaningless for valuation purposes.").

15 See *NetSpend*, 2013 WL 2181518, pp. 16-17.

16 Ibid.

17 Ibid.

18 Ibid.

19 Ibid. (emphasis in original)

20 Ibid.

21 See "NetSpend Defendants' Answering Brief In Opposition to Plaintiff's Motion For Preliminary Injunction," p. 37 [hereinafter "NetSpend Defendants' Answering Brief"].Also see note 11 and accompanying text.

22 See, e.g., *Crescent/Mach I Partnership, L.P. v. Turner,* 2007 WL 2801387, p. 10 (Del. Ch. May 2, 2007) ("Although it is appropriate to consider all accepted methodologies, the Court tends to favor the discounted cash flow method."); *Cede & Co. v. JRC Acquisition Corp.,* No. 18648-NC, 2004 WL 286963, p. 2 (Del. Ch. Feb. 10, 2004) ("In recent years, the DCF valuation methodology has featured prominently in this court because it 'is the approach that merits the greatest confidence' within the financial community.") (quoting *Ryan v. Tad's Enterprises, Inc.,* 709 A.2d 682, 702 (Del. Ch. 1996)). See also Matthews, "Valuation Methods," p. 58 (finding, among other things, that the most common valuation methods used by investment banks and valuation firms in the fairness opinions for the transactions reviewed were the income approach (DCF) and the market approach (comparable company and comparable transactions), and that such methodologies were found to have been used in the transactions included in the data set 91 percent and 96 percent, respectively.

23 *NetSpend*, 2013 WL 2181518, p. 17. Defendants, meanwhile, had noted that NetSpend produces only one-year projections in the ordinary course, but, for purposes of considering a possible transaction, the company had prepared three-year projections, whereas the DCF analysis performed relied on (and heavily emphasized) five-year projections. See "NetSpend Defendants' Answering Brief," p. 38. Plaintiff had also raised a disclosure claim around differences between how management and the board's financial advisor calculated free cash flow, seeking to compel disclosure of a chart illustrating such differences that was included in presentation materials that the financial advisor prepared for the board. The court determined, however, that while the chart had not been disclosed, there was a narrative description in the NetSpend proxy and this was not a material deficiency. *NetSpend*, 2013 WL 2181518, p. 10. Plaintiff also had asserted that the financial advisor had presented two DCF analyses to the board, the second of which indicated significantly lower implied values as compared to the first, and that only the second DCF analysis had been disclosed in the NetSpend proxy. The court noted the plaintiff failed to raise this argument in its opening brief (which would generally result in the argument being waived). Regardless, the court found the argument to be meritless since defendants had noted the discrepancies between the two DCF analyses appeared to be caused "by a computer glitch or spreadsheet error that may have artificially inflated the first DCF." Ibid. Defendants also acknowledged that, notwithstanding the "outlier" label they sought to attach to the financial advisor's DCF analysis, they sought to use the higher indicative values contained in that analysis opportunistically in negotiations with Total Systems to try to get Total System to increase its bid. See "NetSpend Defendants' Answering Brief," p. 39.

24 See generally, Matthews, "Valuation Methods," p. 58, noting that the results of the survey referenced therein indicated that DCF analyses were utilized in all 307 situations where management had disclosed that it had made projections for three or more years, and that there were 45 opinions where the companies involved had not made projections or had only made them for one or two years. In 13 of those situations, DCF calculations were performed utilizing projections extrapolated by the valuator. In the remaining 32 opinions that lacked adequate projections (or any projections at all), DCF was not applied. For 12 of those, the disclosure explicitly stated that DCF was not used because adequate projections were not available. The other 20 opinions did not contain an explicit explanation as to why a DCF was not included. Ibid.

25 *NetSpend*, 2013 WL 2181518, p. 16 (citing 8 Del. C. § 141(e)).

26 *NetSpend*, 2013 WL 2181518, p. 16, note 211 (citing *Ryan v. Lyondell Chem. Co.,* No 3176-VCN, 2008 WL 2923427, p. 23 (Del. Ch. July 29, 2008) ("When control of the corporation is at stake...directors of a Delaware corporation are expected to take context-appropriate steps to assure themselves and, thus, their stockholders, that the price to be paid is the 'best price reasonably available.'").

27 See *In re Del Monte Foods Co. S'holders Litig.,* 25 A.3d 813 (Del. Ch. 2011). Although, in *Del Monte,* the deal was enjoined for a period so as to allow for a second go-shop to be conducted by an investment bank viewed as non-conflicted.

28 See *In re El Paso Corp. S'holder Litig,* 41 A.3d 432 (Del. Ch. 2012).

29 See DGCL § 102(b)(7) (allowing Delaware corporations to shield board members from liability for breaches of duty of care, but not breaches of duty of loyalty).

30 Notwithstanding the court's criticism of the board's reliance on the fairness opinion, the court stated it found it noteworthy that, while the plaintiff pointed out the flaws in fairness opinion analysis, it did not offer any competing evidence around value that was different from that presented by the financial advisor. See *NetSpend*, 2013 WL 2181518, pp. 22-23.

31 In the record from the oral argument on the preliminary injunction, defense counsel appears to suggest that discussions occurred around the DCF analysis, although the scope and contours of any such discussions is not clearly discernible from the comments in terms of who was saying what to whom and when or the degree to which the financial advisor was included in those deliberations. See *NetSpend,* "Preliminary Injunction Transcript," May 10, 2013, p. 68. In addition, the financial advisor's presentation materials that were provided to the board, as well as the minutes of various board sessions during which aspects of the transaction were discussed, are listed as exhibits in the pleadings in the case, but presumably were filed under seal, as they are not publicly available as part of the docket, so it is unclear whether those materials might include facts germane to the discussion around the DCF. See also "NetSpend Defendants' Answering Brief," p. 20 (which also appears to address the issue to a certain degree, noting that the board "discussed the fact that the price was below the DCF range, but concluded that the premium transaction was nonetheless in the best interests of stockholders, because, among other things, the DCF analysis was based on five-year projections that the company did not prepare in the ordinary course of business and did not account for the substantial regulatory risks (such as the Durbin Amendment) and competitive risks (including well financed existing and potential competitors) faced by the company.").

32 One difficult aspect for counsel, where the board or individual directors have not otherwise locked onto the issue, is to ensure that the issue is raised and discussed adequately with the board and the financial advisor, an effort that may be challenging given that certain directors may have more probity and patience around exploring such issues than others, who may want to simply move on rather than get bogged down in the details.

33 *NetSpend* contrasts with another chancery court decision handed down a month earlier that also involved a single-bidder negotiation strategy where there was no pre-signing market check and no go-shop. See *In re Plains Exploration & Prod. Co. S'holder Litig.,* No. 8090-VCN, 2013 WL 1909124, (Del. Ch. May 9, 2013) There, various aspects of different financial analyses underpinning the fairness opinion provided to the board of directors by the board's financial advisor had been challenged as had occurred in *NetSpend*. In *Plains*, however, the court did not find fault with the board decision to pursue a single-bidder strategy, found the board was experienced and sophisticated in financial matters, did not find a breach of the board's *Revlon* duties, and denied challenges that plaintiffs' counsel had made with respect to aspects of the financial advisor's financial analyses. Ibid. In short, the fairness opinion (and accompanying financial analyses) was viewed as a much stronger linchpin to support the board's decision to forgo a pre-signing market check and a post-signing go-shop.

34 *NetSpend* also raises interesting questions around what course a board can or should pursue in a single-bidder scenario where the bidder flatly refuses to agree to a go-shop provision, despite repeated attempts to negotiate such a term. See "NetSpend Defendants' Answering Brief," p. 15 ("We are simply unprepared to move forward…with a merger agreement with that provision. Accordingly, TSYS' offer is contingent upon your withdrawing your request that the merger agreement include a 'go-shop' provision."). It is somewhat incongruous that Total Systems flatly refused to include a go-shop at the same time it was arguing that there were no other bidders interested, although it did suggest that the company run a go-shop before the deal was signed up. If it truly believed there were no other potential bidders for NetSpend, how much execution risk would a go-shop have presented?

35 Inevitable, given recent statistics around the likelihood of litigation in mergers and acquisitions transactions. See Robert M. Daines and Olga Koumrain, "Shareholder Litigation Involving Mergers and Acquisitions," Cornerstone Research, February 2013 (illustrating that, for 2012, plaintiff law firms filed lawsuits on behalf of shareholders in 96 percent of M&A deals valued over $500 million and 93 percent of such transactions valued over $100 million, with deals valued over $100 million attracting an average of 4.8 lawsuits per deal and deals valued over $500 million attracting an average of 5.4 lawsuits).

36 Plaintiffs' allegation that the fairness opinion was "weak" was based on an assertion that the board purposely inflated the company's future capital expenditure estimates of the company in an attempt to depress the implied values for BioClinica in the fairness opinion because it was "difficult for [the financial advisor] to render an opinion of fairness" without the adjustment. See *In Re BioClinica, Inc. S'Holder Litigation,* C.A. No. 8272-VCG (October 16, 2013) (hereinafter *BioClinica*), p. 8.

37 Ibid.

38 Ibid., p. 19.

39 Ibid.

40 Ibid. The court in *BioClinica* also included a footnote specifically trying to cut off attempts by plaintiffs' counsel to extrapolate fact-specific rulings into broader claim theories. ("In drafting [NetSpend], I was conscious of the possibility that taking note that the fairness opinion was 'weak' might induce some opportunistic plaintiffs to champion "weak fairness opinions" as the breach-of-fiduciary-duty claim du jour. I (apparently unsuccessfully) attempted to convey in [NetSpend] that the weakness of the fairness opinion was contextual. That is, in the absence of a market check, I was left to view the board's decision-making and sales process in the context of the DCF's indication that the company could have been worth more. Directors of Delaware corporations have a right to rely on experts under 8 Del. C. § 141(e). That the fairness opinion in [NetSpend] provided context for my analysis of the board's decision-making process does not create a new basis to challenge every sales process."). *BioClinica*, p. 19, note 65.

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