

Fair Value of Banks and Depository Institutions in Dissenting Shareholder Appraisal Actions—Understanding and Addressing Their Unique Operational Traits and Delaware Court Guidance

Justin M. Nielsen and Stephen P. Halligan

A bank or depository institution may be the subject of a dissenting shareholder appraisal rights action or a shareholder oppression action, similar to any other corporation. In estimating the fair value of the bank or other depository institution, the valuation analyst should consider the unique characteristics associated with these types of entities. There are special considerations related to (1) segregating operating and financing activities and (2) estimating the effects of the regulatory environment on the subject industry. These special considerations require the valuation analyst to understand the valuation impact of these and other characteristics that are important to the bank and depository institution industry. This discussion addresses shareholder appraisal rights actions and provides insight into the special considerations appropriate to estimate the fair value of a bank or other depository institution.

INTRODUCTION

By definition, a dissenting shareholder appraisal rights action (“appraisal action”) is a statutory remedy that is available in certain states to noncontrolling corporate stockholders who object to certain actions taken by the corporation, such as mergers.

The appraisal action provides an option to the dissenting shareholders that would require the corporation to repurchase the shareholders’ stock at a price equivalent to the corporation’s value immediately prior to the corporate action.

Generally in an appraisal action, the standard of value is fair value. For these purposes, fair value is typically defined as the pro rata business enter-

prise value that is not discounted either for lack of marketability or for lack of control. In addition, fair value takes into account all relevant factors known or ascertainable as of the valuation date, excluding any synergistic value.

A bank or depository institution can be the subject of a dissenting shareholder appraisal rights action, similar to other corporations. However, the estimation of the fair value of a bank or depository institution includes many subtle, and not so subtle, differences as compared to estimating the fair value of corporations operating in other industries.

Generally, the unique complexities of valuing a bank or depository institution originate from two distinct operating characteristics. These two

characteristics suggest that the valuation analyst understand and diligently apply appropriate valuation procedures in estimating the fair value of a bank or depository institution within an appraisal action.

The Delaware Court of Chancery (the “Court”), which decides matters concerning shareholder equity claims in Delaware, is generally viewed as an important forum for ruling on dispute litigation involving matters related to shareholder dissent (including bank and depository institution appraisal actions).

With its significant influence on valuation-related matters, attorneys and valuation analysts alike frequently look to the Court for guidance regarding the appropriate methodology to value business interests for purposes of appraisal actions.

The goals of this discussion are as follows:

1. To introduce appraisal actions and the Court’s preference for the discounted cash flow (DCF) valuation method
2. To describe some of the unique characteristics associated with estimating the fair value of a bank or depository institution within a shareholder appraisal action
3. To explain the importance of the subject company industry (i.e., the bank or depository institution industry) when applying the DCF valuation method within a shareholder appraisal action

SHAREHOLDER APPRAISAL ACTIONS

As a large number of business entities within the United States are organized in the State of Delaware, the Court has become an influential voice in providing guidance related to appraisal action business valuation issues.

There are several categories of shareholder disputes. Common types of shareholder disputes include the following:

1. Dissenting shareholder appraisal rights (i.e., appraisal actions)
2. Shareholder oppression claims
3. Noncontrolling shareholder “freeze-out” actions
4. Breach of noncompete agreements
5. Purchase/sale agreement disputes
6. Shareholder derivative actions

In a shareholder appraisal action, a noncontrolling shareholder has the right to object or dissent

to certain extraordinary actions taken by the corporation, such as a merger. The “appraisal remedy” requires the corporation to repurchase the shareholder’s stock at a price equivalent to the corporation’s value immediately prior to the corporate action.

This discussion focuses on calculating an opinion of value (i.e., fair value) of a bank or depository institution when applying the income approach, and, specifically, the DCF method within an appraisal action.

THE DCF METHOD

Within the income approach, there are a number of generally accepted valuation methods. Each of these generally accepted valuation methods is fundamentally based on the premise that the value of an investment is a function of the economic income that will be generated by that investment over its expected economic life.

There are a number of income approach valuation methods that can be used to estimate value under this premise, most of which are based on:

1. the estimation of an investment’s future economic earnings stream and
2. the application of an appropriate risk-adjusted, present value discount/direct capitalization rate.

The DCF method is a generally accepted method that may be used to value companies on a going-concern basis. The DCF method has appeal because it incorporates the trade-off between risk and expected return, one component to the investment decision and value calculation process.

The DCF method provides an indication of value by (1) estimating the future economic earnings of a business and (2) estimating an appropriate risk-adjusted required rate of return used to discount the estimated future economic earnings back to present value.

There are many factors a valuation analyst may consider in developing the discount rate that reflects the related risk associated with the future company economic earnings (i.e., procedure two in the DCF method). This discussion focuses on the development and application of the projected future economic earnings used in the DCF method (i.e., procedure one in the DCF method).

In defining the estimated future economic earnings of a business, there are a number of common measurements, such as the following:

1. Dividends or partnership distributions

2. Net cash flow to equity or net cash flow to invested capital (i.e., the total market value of company debt and equity)
3. Various accounting measures of income such as net income, net operating income, and several others

The valuation analyst's responsibility is to align the appropriate earnings measure to the subject of the valuation. Generally, if the valuation subject is the value of equity, then the appropriate earnings measure is "cash flow to equity." Similarly, if the valuation subject is the business enterprise, then the appropriate earnings measure is "cash flow to the firm" or "cash flow to invested capital."

Once the valuation analyst determines the appropriate measure of economic earnings to apply in the DCF method, the next procedure is to estimate the estimated earnings over a defined future time period.

One Court-preferred method for estimating the future economic earnings of a business is to obtain from company management financial projections of the company's profitability generated during the normal course of operations and used for general management planning purposes.

Appraisal Actions—the Court and the DCF Method

Prior to 1982, the "Delaware block" was often used by the Court as the preferred method to valuation in an appraisal hearing. The Delaware block method entailed assigning specific weights to certain elements of value, such as total assets, current market price, and company earnings.

The Court ultimately opined that the Delaware block method was archaic and that it excluded other generally accepted valuation approaches and methods that were being used by the financial community and the courts.

In critiquing the Delaware block method, the Court opined in *Weinberger v. UOP, Inc., et al.*:

Accordingly, the standard "Delaware Block" or weighted average method of valuation . . . employed in appraisal and other stock valuation cases, shall no longer exclusively control such proceedings. We believe that a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible. . . ."¹

As further documented in various judicial opinions, the Court has demonstrated that one appropriate method in valuing a dissenting shareholder's stock may be the DCF method. As opined in *CrescentMach I P'ship, L.P. v. Turner* and *Cede & Co. v. JRC Acquisition Corp.*, respectively:

[T]he Court tends to favor the discounted cash flow method ("DCF"). As a practical matter, appraisal cases frequently center around the credibility and weight to be accorded the various projections for the DCF analysis.²

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.³

The Court has addressed some preference for the DCF method in bank and depository institution appraisal actions as well. As opined in *Union Illinois v. Union Financial Group*:

Under Delaware law, it would be appropriate for me to give heavy weight to the value of UFG [Union Financial Group, Ltd.] as implied by a DCF analysis. For example, I could use the generous assumptions I used to test the Merger Price and award the O'Briens \$5.44 per share. Or, I could give that value equal weight to the Merger Price.⁴

It should be noted, however, that according to valuation professional standards, the valuation analyst should consider all available valuation approaches and methods when estimating the value of a dissenting shareholder's stock. Of course, the objective of using more than one valuation approach is to develop mutually supporting evidence as to the conclusion of value.

Nevertheless, while the valuation analyst should consider all available valuation approaches and methods, the DCF method is generally viewed by the Court as an appropriate method in valuing a dissenting shareholder's stock, including a bank or depository institution dissenting shareholder's stock, assuming the company can reasonably project performance beyond the next fiscal year.

The following section addresses some of the issues that the valuation analyst should consider in estimating the fair value of a bank or depository institution within a shareholder appraisal action context.

ESTIMATING THE FAIR VALUE OF A BANK OR DEPOSITORY INSTITUTION IN AN APPRAISAL ACTION—THE DCF METHOD

While all industries possess differing operational characteristics and value-driver nuances, the financial services industry, and specifically the bank and depository institution industry, has distinct operating characteristics the valuation analyst should consider when estimating fair value within an appraisal action.

Generally acting as intermediaries between those who save money and those who borrow money, the principal activities for banks and depository institutions include the collection of deposits and the subsequent disbursement of loans.

Banks typically generate more than half of their annual revenue through the “earned spread,” which is more commonly identified as net interest income. The earned spread is the difference between (1) the interest rate the bank or depository institution can charge on loans made and (2) the interest rate the bank or depository institution can pay on the customer deposits.

Interest income is classified as an operating activity for banks and depository institutions, rather than a nonoperating source of revenue. This accounting treatment is different when compared to other industries.

Additionally, banks or depository institutions use what may be viewed as debt (i.e., customer deposits) as a funding source to facilitate their day-to-day operations, which obligates them to categorize interest expense as an operating expense rather than a nonoperating expense.

Other products and services offered by banks and depository institutions can vary widely as a result of each corporation’s established core competency. As a result of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999, these products and services have expanded into related financial fields such as the following:

1. Investment management
2. Mutual funds
3. Insurance
4. Municipal finance
5. Corporate investment banking

As such, the nature of these additional services provided by banks and depository institutions warrants a high level of industry regulation. And industry oversight has only increased with the advent of



new regulations (e.g., the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010).

These regulations include increasingly strict enforcement and disclosure requirements, as well as detailed accounting rules that do not typically apply to other industries.

Therefore, the aforementioned characteristics (i.e., atypical operating accounting methods and rules and stringent financial regulations) create certain methodological challenges when applying the DCF model to estimate the fair value of a bank or depository institution.

Two fundamental operating characteristics associated with the bank and depository institution industry are addressed below:

1. The issue of separating operating and financing expenses and their respective implications on (a) measuring cash flow and (b) defining what constitutes debt and the cost of debt
2. The effects of the regulatory environment/subject company industry on (a) assessing the reasonableness of bank and depository institution management-prepared projections and (b) estimating the appropriate long-term growth rate used in the terminal value (TV) calculation (if applicable)

Cash Flow to Equity Models in Bank and Depository Institution Valuations

As presented above, the DCF model provides an indication of value by discounting an estimated measure of future economic earnings at an appropriate risk-adjusted rate of return. Generally, cash flow to the firm (CFF) and cash flow to equity (CFE)

are two common earnings measurements used in the DCF model.

The DCF model variation using CFF—the cash flow available to all the firm’s suppliers of capital, after operating expenses (including taxes) and expenditures needed to sustain the firm’s productive capacity are met—attempts to value firms by discounting expected cash flow prior to debt payments at the company’s weighted average cost of capital (WACC).

As presented in the formula below, the general formula for CFF begins with net income and is adjusted to arrive at the cash flow available to all the firm’s suppliers of capital (i.e., common and preferred stockholders and bondholders):

$$\begin{aligned} & \text{Net income} \\ & + \text{Noncash charges} \\ & + \text{Interest expense} * (1 - \text{tax rate}) \\ & - \text{Investments in fixed capital} \\ & - \text{Investments in working capital} \\ & = \text{Cash flow to the firm} \end{aligned}$$

Noncash charges and after-tax interest expense are added back to net income, while adjustments are made to subtract investments in fixed capital (i.e., capital expenditures) and investments in working capital from net income. Interest expense, which was subtracted from pretax income to obtain net income, is a cash flow available to one of the firm’s capital providers (i.e., debt holders), and is, therefore, added back in the CFF calculation.

However, determining which interest expense to add back to net income can pose a significant issue in estimating the fair value of a bank or depository institution, as the valuation analyst would need to separate operating interest expense from financing interest expense—an area where there is no clearly defined line between the two.

Furthermore, debt balances and debt payments for banks and depository institutions are not easily defined. For example, banks and depository institutions receive deposits from customers and pay interest on a portion of these accounts, yet this action is not classified as an actual “debt” issued by the company.

The inability to reasonably define debt and the associated debt interest payments for a bank or depository institution can have a significant impact on the company’s WACC, thereby potentially skewing the firm fair value estimation.

An illustrative example would be to assume that all interest-bearing deposits for a bank or depository

institution were classified as company debt. This assumption would result in a company cost of debt that would be unrealistically low, likely leading to an unrealistically low estimated company WACC.

The reduced WACC would thereby inflate the firm fair value in the application of the DCF method. For these reasons, using CFF as an economic earnings measurement in estimating the fair value of a bank or depository institution is impractical.

As an alternative to CFF, the valuation analyst may decide to value the equity of a bank or depository institution. The equity of a bank or depository institution can be valued directly by using CFE as the earnings measurement and discounting the CFE at the company’s cost of equity.

CFE is defined as the cash flow available to the firm’s common stockholders once operating expenses (including taxes), expenditures needed to sustain the firm’s productive capacity, and payments to (and receipts from) debt holders are accounted for, as presented below:

$$\begin{aligned} & \text{Net income} \\ & + \text{Noncash charges} \\ & - \text{Investments in fixed capital} \\ & - \text{Investments in working capital} \\ & - \text{Net new borrowing} \\ & = \text{Cash flow to equity} \end{aligned}$$

As presented above, the formula for CFE begins with net income and is adjusted to arrive at the cash flow available to the firm’s common stockholders. Similar to the calculation of CFF, noncash charges are added back to net income, while adjustments are made to subtract investments in fixed capital, investments in working capital, and net new debt from net income.

Unlike CFF, however, CFE does not require an adjustment for interest expense, as it is only attempting to calculate the cash flow available to the firm’s equity shareholders.

As presented in *Valuing Financial Service Firms*, by Aswath Damodaran, professor of finance at the New York University Leonard N. Stern School of Business:

The basic principles of valuation apply just as much for financial service firms as they do for other firms. There are, however, a few aspects relating to financial service firms that can affect how they are valued. The first is that debt, for a financial service firm, is difficult to define and measure, making it difficult to estimate firm value or costs of

capital. Consequently, it is far easier to value the equity directly in a financial service firm, by discounting cash flows to equity at the cost of equity.⁵

While there exists additional complexities related to the estimation of the appropriate investment in working capital included in the bank or depository institution estimated CFE, these complexities are beyond the scope of this discussion.

It is clear, however, that the valuation analyst should consider using CFE when applying the DCF method to estimate the fair value of a bank or depository institution.

The Dividend Discount Model

With some of the difficulty in accurately estimating the free cash flow of banks and depository institutions, the valuation analyst may consider the application of the dividend discount method (DDM) as an alternative to the standard DCF method.

The DDM uses the firm's dividends as a proxy for free cash flow, and discounts the dividends at the appropriate cost of equity.

The basic DDM discounts forecasted firm dividends to present value, resulting in an estimated intrinsic value contribution to the firm's shareholders. In this DDM, future dividends are assumed to be the earnings measurement to equity holders of the firm (estimated into perpetuity), and are discounted at the appropriate cost of equity.

This basic DDM formula is presented below:

$$\sum_{t=1}^{t=\infty} \frac{Div_t}{(1 + K_e)^t}$$

More commonly, this basic model is split into two periods (as presented below):

1. A finite period covering future estimated dividends at a high rate of growth (g_S)
2. An infinite terminal value calculation based on a steady rate of growth (g_L) which should approximate nominal gross domestic product growth (i.e., terminal growth)

This general two-stage DDM formula is presented below:

$$\sum_{t=1}^n \frac{D_0 (1 + g_S)^t}{(1 + K_e)^t} + \frac{D_0 \times (1 + g_S)^n \times (1 + g_L)}{(1 + K_e)^n \times (K_e - g_L)}$$

Banks and depository institutions may be considered an appropriate candidate for the application of the DDM due to:

1. their well established and mature industry, which allows for a higher degree of confidence in estimating long-term growth rates;
2. the high correlation between past earnings growth and expected future earnings growth when compared to other companies and industries; and
3. their long, consistent history of paying dividends.

These characteristics of banks and depository institutions are particularly important in the application of the DDM, primarily because the DDM implicitly assumes that the dividends being paid are not only reasonable, but sustainable over the long term (i.e., into perpetuity).

One caveat to the application of the DDM in estimating the fair value of a bank or depository institution is the industry regulatory capital requirements and their subsequent effect on a company's payout ratio. The impact of the current regulatory capital requirements is important because they can limit the assumptions within the DDM.

Banks and depository institutions should have adequate capital on hand in order to meet anticipated customer deposit withdrawals—a capital cushion that is large enough, as a percentage of assets, to meet anticipated losses on loans and issued securities.

The regulatory capital adequacy ratios for which banks must comply influence an already significant trade-off in the industry—deciding between paying dividends and investing in future growth. As is widely known, companies that pay out their earnings as dividends forgo reinvestment in their company, and may become less competitive in the future as a result.

Increasingly stringent regulatory capital requirements restrict the amount of capital available to both the firm and the stakeholders, which decreases the company's expected future growth and/or competitiveness within the market.

The Bank and Depository Institution Industry/Regulatory Environment

The subject company industry can play a significant role in estimating appropriate assumptions that will be utilized in a DCF method or DDM fair value calculation.

In estimating the fair value of a bank or depository institution in a shareholder appraisal action,



the industry, and specifically the regulatory requirements, should be considered by the valuation analyst when applying the DCF method or the DDM.

In applying the DCF method, the valuation analyst may assume that the estimated future earnings will eventually stabilize. These long-term stabilized future earnings can then be capitalized as an annuity in perpetuity and discounted back to the valuation date.

Generally, the value of the long-term stabilized earnings is labeled as the residual value, reversion value, or terminal value (TV).

There are many issues that a valuation analyst may consider in estimating the future earnings of a business and in estimating an appropriate present value discount rate for a business. However, it is important that the valuation analysis address the subject company industry when applying the DCF method.

Specifically, the subject company industry is important in (1) assessing the reasonableness of company management-prepared projections and (2) estimating the appropriate long-term growth rate used in the TV calculation.

The Court has a history of addressing subject company industry-related issues within a shareholder appraisal action context, specifically the importance of analyzing the subject industry in regard to:

1. company management-prepared financial projections and
2. the estimation of the long-term growth rate applied in a TV calculation.

The following two sections highlight several recent Court opinions that address subject com-

pany industry-related issues within the context of an appraisal action.

While the Court decisions are not related to the bank or depository institution industry, they may provide meaningful guidance for the valuation analyst in regards to the proper consideration of the subject company industry when applying the DCF method in a shareholder appraisal action.

Industry Consideration—Management Projections

Based on historical and recent opinions, the Court expects the valuation analyst to perform appropriate due diligence with regard to the subject company industry, including as it relates to the reasonableness of management-prepared projections when applying the DCF method.

The valuation analyst may review management projections and confirm that the assumptions on which the projections are based are reasonable and appropriate given the historical, current, and future outlook of the subject company industry.

As explained by the Court *In re John Q. Hammons Hotels Inc. Shareholder Litigation*:

In this case, it is undisputed that JQH operated in a very competitive industry [emphasis added]—the hotel business. JQH had no competitive advantages, such as brand names or proprietary technology. Worse still, a large portion of its portfolio is located in secondary and tertiary markets, which have lower barriers to entry than primary markets. Hotels in secondary and tertiary markets face significant competition because of the lower barriers to entry. . . . And JQH's hotels were even subject to competition from their own franchisors in many of the markets where JQH operated. Dr. Kursh's expert report failed to take into account some of these factors affecting JQH, and his report is significantly impaired as a result.⁶

The above decision highlights the fact that by neglecting to appropriately consider the subject company industry, the valuation analyst may be at risk of having the Court dismiss the opinion of value entirely.

In explaining the decision to disallow the application of the DCF method in *Doft & Co., et al., v. Travelocity.com, Inc., et al.*, the Court relied on, in part, the state of the subject company industry as testified to by Anwar Zakkour, a Solomon Smith Barney managing director:

Q. Did Salomon Smith Barney prepare a discounted cash flow analysis of Travelocity in connection with this transaction?

A. Absolutely not.

Q. Why was no discounted cash flow analysis prepared in connection with this transaction?

A. Because this was an **industry** [emphasis added] that was in flux. And the management team itself, which should have been the team that was most able to put together a set of projections, would have told you it was virtually impossible to predict the performance of this company into any sort of reasonable future term. And they in fact had very little confidence with even their 2002 forecast numbers because of that.

September 11th didn't help the pace of migration from off-line to online. It didn't help. The airlines being very focused on cutting their distribution costs didn't help. These were all things that were happening real time. Travelocity going from being the number one player to being very unfavorably compared to Expedia and certainly losing its number one position to them in a very short time didn't help. These are all things that support that. And other than maybe God himself, I suspect nobody could really predict what this business is going to do in the next five years.⁷

The Court further explains in *Doft & Co., et al., v. Travelocity.com, Inc., et al.*:

For these reasons, the court reluctantly concludes that it cannot properly rely on either party's DCF valuation. The goal of the DCF method of valuation is to value the future cash flows. Here, the record clearly shows that, in the absence of reasonably reliable contemporaneous projections, the degree of speculation and uncertainty characterizing the future prospects of Travelocity and the **industry in which it operates** [emphasis added] make a DCF analysis of marginal utility as a valuation technique in this case.⁸

Industry Consideration—Estimated Long-Term Growth Rate in TV Calculation

The Court has also opined on subject company industry consideration when estimating the appropriate long-term growth rate to use in a TV calcula-

tion in the DCF method performed in a shareholder appraisal action context.

For example, the Court explains in *Towerview, LLC, et al., v. Cox Radio, Inc.*:

As noted, the rate of inflation generally is the “floor for a terminal value.” “Generally, once an **industry** [emphasis added] has matured, a company will grow at a steady rate that is roughly equal to the rate of nominal GDP growth.” Some experts maintain that “the terminal growth rate should never be higher than the expected long-term nominal growth rate of the general economy, which includes both inflation and real growth. Moreover, both experts in this case acknowledged that the expected long-term inflation rate in 2009 was 2%–2.5%. There also was some evidence that the expected rate of real GDP growth was between 2.5% and 2.7%, but this evidence was not particularly reliable. I find that the radio **industry** [emphasis added] is a mature industry and that CXR was a solidly profitable company. Thus, a long-term growth rate at least equal to expected inflation is appropriate here.⁹

In order to appropriately estimate the long-term growth rate to be used in the TV calculation, the Court's decision implies that the valuation analyst may address (1) the profitability of the subject company and (2) the maturity stage of the industry (i.e., the current and projected profitability of the subject company industry).

As further opined by the Court in *Merion Capital, L.P., et al., v. 3M Cogent, Inc.*:

Relying on historical GDP and inflation data, economic analysts projections, and the growth prospects of the biometrics industry [emphasis added], Bailey selected a perpetuity growth rate of 4.5%. The Gordian Experts, on the other hand, used a range of growth rates between 2% and 5%, and implicitly selected the midpoint of 3.5%. The Gordian Experts, however, provided no analysis or explanation in support of the number they chose for the terminal growth rate. Because Bailey was the only expert who sought to justify his conclusions, and his conclusion is within the range of rates identified by Respondent's expert and appears to be reasonable based on the evidence, I adopt Bailey's estimate of a 4.5% perpetuity growth rate.¹⁰

As opined by the Court in the above shareholder appraisal action decisions, when applying the DCF method, the state of the subject company industry may be considered when (1) assessing the reasonableness of company management-prepared projections and (2) estimating the appropriate long-term growth rate to be used in a TV calculation.

Further, neglecting to appropriately consider the subject industry may lead to the Court dismissing the valuation analyst opinion in its entirety.

In regards to the bank and depository institution industry, it may be helpful to understand the regulatory requirements in place as of the valuation date. Specifically, a bank or depository institution return on equity capital will be estimated based on:

1. the company's business choices and
2. regulatory restrictions in place as of the valuation date.

Therefore it may be helpful to understand the pertinent regulations when applying the DCF in a bank or depository appraisal action. This is because any changes in the regulatory environment can result in large shifts in the estimated fair value of the company.

SUMMARY AND CONCLUSION

In a shareholder appraisal action, a noncontrolling shareholder possesses the right to object to certain extraordinary actions taken by the corporation, such as a merger. The appraisal remedy requires the corporation to repurchase the shareholder's stock at a price equivalent to the corporation's value immediately prior to the corporate action.

A bank or depository institution can be the subject of a dissenting shareholder appraisal rights action, just like any other corporation. However, in the estimation of the fair value of a bank or depository institution, the valuation analyst should address some of their individual operational traits as compared to many other corporations.

The Delaware Court of Chancery is generally regarded as an important forum for ruling on dispute litigation involving matters related to shareholder dissent. Of the several categories of shareholder disputes, this discussion focused on dissenting shareholder appraisal rights actions specifically related to banks and depository institutions.

As proffered by the Court, the DCF method is one method of estimating the fair value of a corporation within an appraisal action context. However, in applying the DCF to a bank or depository institution fair value analysis, the valuation analyst may consider

the unique operating characteristics associated with the industry in estimating the appropriate earnings measurement (i.e., CFE rather than CFF).

Further, when applying the DCF method in a dissenting shareholder appraisal action, the valuation analyst may consider the subject company industry, and specifically the regulatory environment in which the bank or depository institution operates.

Based on guidance from the Chancery Court, when applying the DCF method, the subject company industry may be considered when (1) assessing the reasonableness of company management-prepared projections and (2) estimating the appropriate long-term growth rate to be utilized in a terminal value calculation.

Neglecting to address the subject company industry may lead to dismissal of the valuation analyst opinion in its entirety.

Notes:

1. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. Ch. 1983)
2. Crescent/Mach I Partnership, L.P. v. Turner, No. Civ.A. 17455-VCN, Civ.A. 17711-VCN, 2007 WL 1342263 at *9 (Del. Ch. May 2, 2007).
3. Cede & Co. v. JRC Acquisition Corp., No. Civ.A. 18648-NC, 2004 WL 286963, at *2 (Del. Ch. Feb. 10, 2004).
4. Union Illinois v. Union Financial Group, 847 A.2d 340 (Del. Ch. 2004)
5. Aswath Damodaran, "Valuing Financial Service Firms," whitepaper (April 2009), <http://www.stern.nyu.edu/~adamodar/pdfiles/papers/finfirm09.pdf> (accessed 9/4/15).
6. In re John Q. Hammons Hotels Inc. Shareholder Litigation, No. 758-CC, 2011 WL 227634 (Del. Ch. Jan. 14, 2011).
7. Doft & Co. v. Travelocity.com, Inc., No. Civ.A. 19734, 2004 WL 1152338 (Del. Ch. May 21, 2004).
8. *Id.*
9. Towerview, LLC v. Cox Radio, Inc., C.A. No. 4809-VCP, 2013 WL 3316186 (Del. Ch. June 28, 2013).
10. Merion Capital, L.P., v. 3M Cogent, Inc., No. 6247-VCP, 2013 WL 3793896 (Del. Ch. July 8, 2013).



Justin Nielsen is a manager in our Portland, Oregon, practice office. Justin can be reached at (503) 243-7515 or at jmnielsen@willamette.com.

Stephen Halligan is an associate in our Portland, Oregon, practice office. Stephen can be reached at (503) 243-7529 or at sphalligan@willamette.com.

