

Bankruptcy Express Webinar:  
Examining the Valuation of Public  
Companies in Connection with Fraudulent-  
Transfer and Related Litigation and  
Bankruptcy Proceedings

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WILMER CUTLER PICKERING HALE AND DORR LLP



## Presenters



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## Questions Presented

- How should public companies be valued in connection with fraudulent-transfer and related litigation and bankruptcy proceedings?

## Traditional Tests for Valuing Private Companies

The valuation of non-public companies usually involves three tests, two of which are market based.

- *Discounted Cash Flow*: estimate private company's future cash flows and discount to present value
- *Market Multiples*: compare the private company to valuations of public companies in same industry
- *Comparable Transactions*: compare the private company to values achieved in transactions involving similar public companies



# Market Value of the Public Company Itself is Typically the Preferred Technique for Valuing a Public Company

- “When the securities of a company being appraised are publicly traded, there is a straightforward valuation procedure: Sum the market values of all the outstanding securities.” Bradford Cornell, CORPORATE VALUATION: TOOLS FOR EFFECTIVE APPRAISAL AND DECISION MAKING 34 (1993).
- The efficient market hypothesis (EMH) “implies that in situations where the stock and debt [i.e., market] approach can be employed, it will produce the most reliable indicator of value.” CORPORATE VALUATION at 47.
- “[T]he EMH states that the market assessment of value is more accurate, on average, than that of any individual, including an appraiser. For this reason, appraisers should not substitute their own judgment for that of the market.” CORPORATE VALUATION at 47.



## Market Value of the Public Company Itself is Typically the Preferred Technique for Valuing a Public Company (Cont'd)

- “Buyers and sellers who set market prices act without bias. They have no incentive to set values either too high or too low because they are penalized in the marketplace for doing so.” Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. CHI. L. REV. 941, 943 (2002).
- “Whatever ‘inefficiencies’ exist with market prices, the inefficiencies of subjective valuations performed by paid experts in litigation are far greater.” *Market Evidence* at 944.



## Market Value of the Public Company Itself is Typically the Preferred Technique for Valuing a Public Company (Cont'd)

- “The public capital markets in the United States ... reprice thousands of stocks every day, mostly through transactions among financial buyers and sellers who are well informed ... and have no special motivations or compulsions to buy or sell. This constant repricing gives up-to-the-minute evidence of prices that buyers and sellers agree on for securities in all kinds of industries relative to the fundamental variables perceived to drive their values, such as dividends, cash flows, and earnings.” Shannon P. Pratt et al., VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES 264 (5th ed. 2007).



## Courts Prefer Market Price to Value Public Companies

- “Absent some reason to distrust it, the market price is ‘a more reliable measure of the stock’s value than the subjective estimates of one or two expert witnesses.’” *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 633 (3d Cir. 2007) (quoting *In re Prince*, 85 F.3d 314, 320 (7th Cir. 1996)).
- “[T]he public trading market constitutes an impartial gauge of investor confidence and remains the best and most unbiased measure of fair market value and, when available to the Court, is the preferred standard of valuation.” *In re Iridium Operating LLC*, 373 B.R. 283, 293 (Bankr. S.D.N.Y. 2007) (citing *Campbell Soup*).



## Courts Prefer Market Price to Value Public Companies (Cont'd)

- “[A] powerful indication of contemporary, informed opinion as to value comes from private investors who [w]ith their finances and time at stake, and with access to substantial professional expertise, [ ] concluded at the time [ ] that the business was indeed one that could be profitably pursued.” *In re Plassein Int’l Corp.*, Bankr. No. 03-11489(KG), 2008 WL 1990315, at \*8 (Bankr. D. Del. May 5, 2008).
- “When sophisticated parties make reasoned judgments about the value of assets that are supported by then prevailing marketplace values and by the reasonable perceptions about growth, risks, and the market at the time, it is not the place of fraudulent transfer law to reevaluate or question those transactions with the benefit of hindsight.” *Peltz v. Hatten*, 279 B.R. 710, 738 (D. Del. 2002).



## But Some Argue that Stock Price May Not Always Be Reliable

- Market price may be unreliable if “information and insight not communicated to the market may not be reflected in stock prices,” or “the stock is thinly traded.” *ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 343 (S.D. Tex. 2008).
- The weight courts give to market price “depends on the reliability of that stock price as a reflection of the value of the company at the relevant time. Thus, market efficiency is an important consideration in determining what weight to give the market value of the stock.” *ASARCO*, 396 B.R. at 343.



## But Some Argue that Stock Price May Not Always Be Reliable (Cont'd)

- In one case, the court rejected market value because the defendant, “but not the average investor, knew that Winstar’s true financial picture was much bleaker than the Debtors’ publicized financials would indicate.” *In re Winstar Commc’ns, Inc.*, 348 B.R. 234, 276 (Bankr. D. Del. 2005).
- The market in some cases may be “simply too unstable to be an adequate indicator of valuation.” *Winstar*, 348 B.R. at 276.



## Debt Markets as Alternate Valuation Technique

- Bond prices may be affected by factors unrelated to default, such as interest rate fluctuations.
- Large interest rate fluctuations may impact bond prices, despite no change in a company's solvency or risk of default
- Technical difficulties in shorting bonds may make bond prices more optimistic than investor expectations

Michael Simkovic & Benjamin S. Kaminetzky, Leveraged Buyout Bankruptcies, the Problem of Hindsight Bias, and the Credit Default Swap Solution (2010), available at [http://works.bepress.com/michael\\_simkovic/5/](http://works.bepress.com/michael_simkovic/5/).



## Credit Default Swap Markets as Alternate Valuation Technique

- “Credit default swaps are designed specifically to permit bets on the likelihood of default of a particular company and therefore arguably provide an even clearer market based indicator of the likelihood of default than bond spreads.”  
*Leveraged Buyout Bankruptcies*, at 31.
- CDS market performance suggests insider trading occurs, lessening information gap between management and market participants
- Courts can reduce risk of manipulation by considering multiple markets (CDS, bond, equity)

Michael Simkovic & Benjamin S. Kaminetzky, *Leveraged Buyout Bankruptcies, the Problem of Hindsight Bias, and the Credit Default Swap Solution* (2010), available at [http://works.bepress.com/michael\\_simkovic/5/](http://works.bepress.com/michael_simkovic/5/).

# Appendix

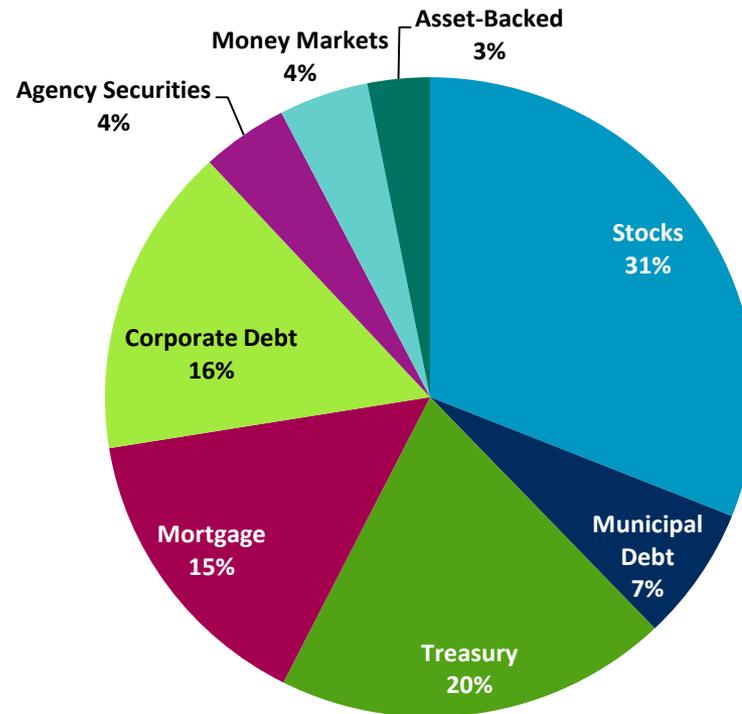


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# The U.S. Capital Markets are the Deepest and Most Liquid in the World

The United States represents over 25% of the global capital markets.

## U.S. Capital Markets: ~\$66 Trillion

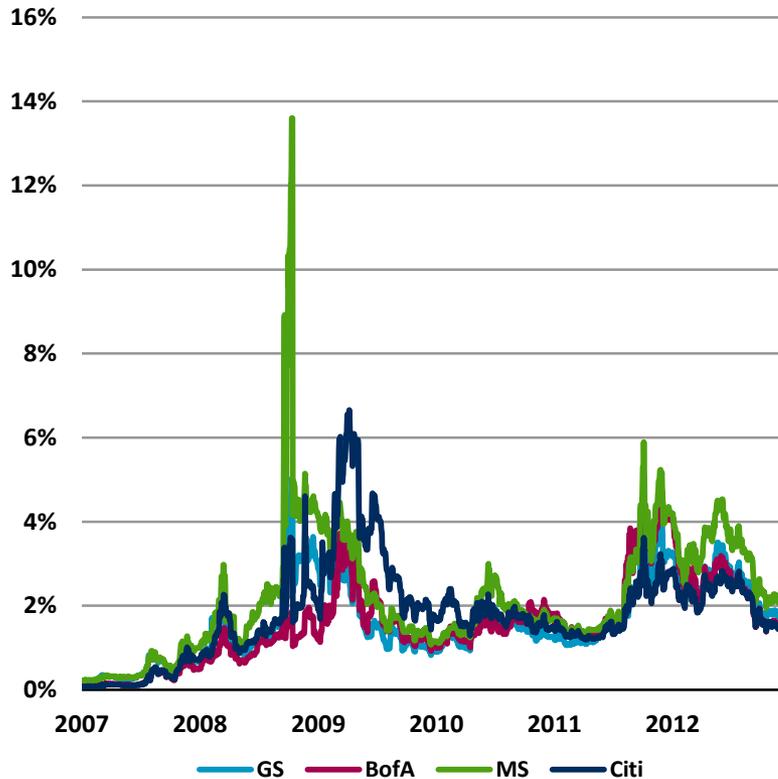


Source: SIFMA, Bloomberg.

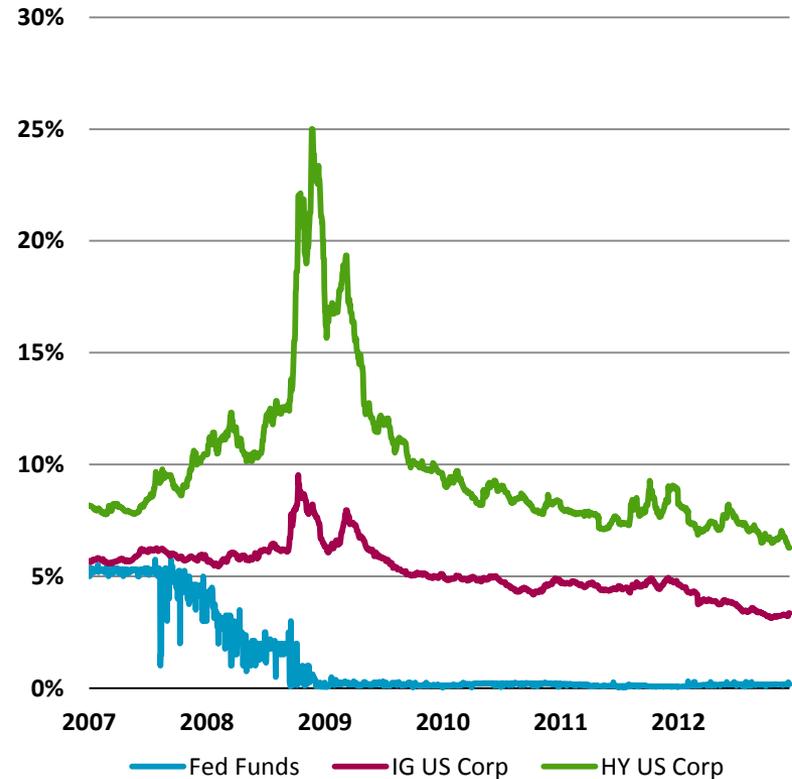
Note: Market data as of December 2012. Does not include credit default swaps, which had a total notional amount outstanding of approximately \$30 trillion at December 2011.

# However, Even in the Deepest Capital Markets a Crisis of Confidence Can Seize Liquidity...

## 5 Year CDS Spreads

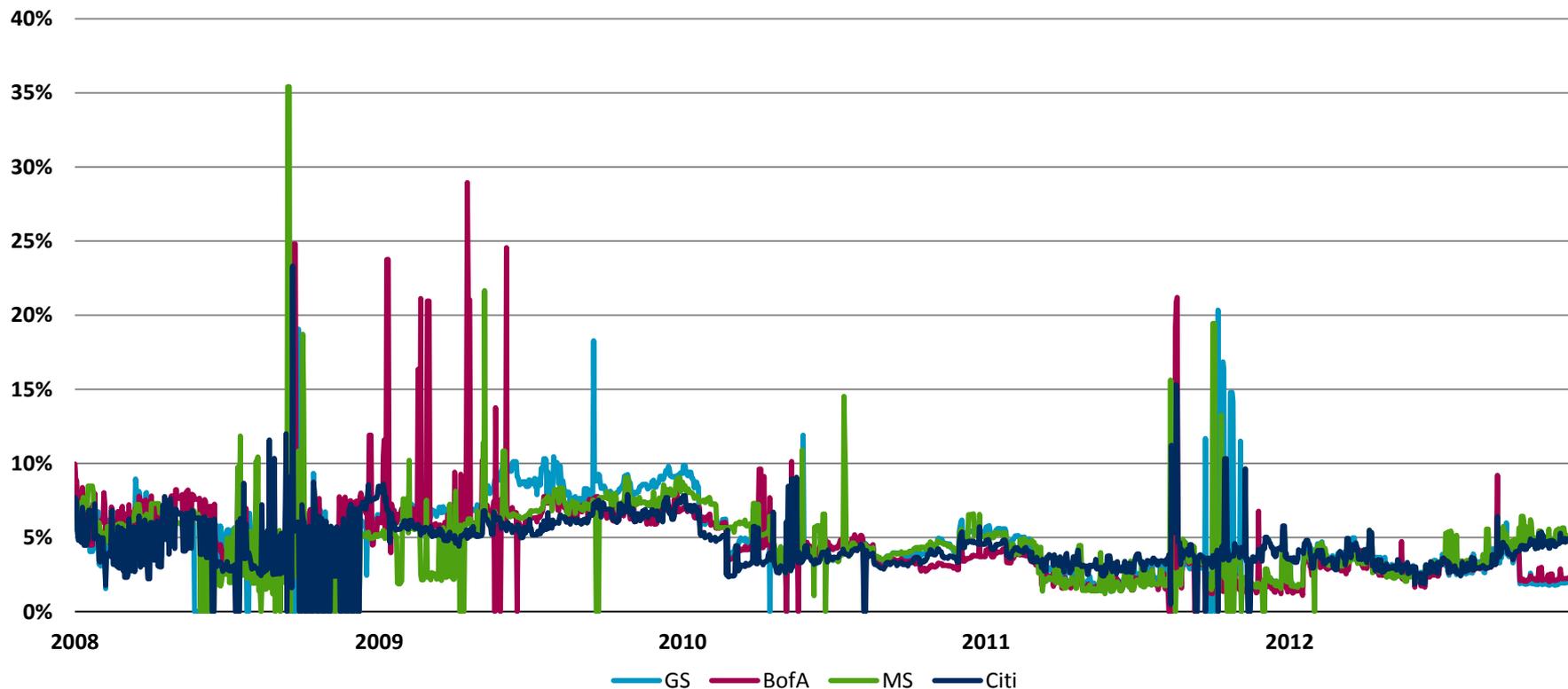


## Credit Spreads



...and Cause Securities to Transact Inefficiently With Little Ability for Accurate Price Discovery.

Percentage Bid-Ask Spreads on 5 Year CDS





# Contact Information



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