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COZEN O'CONNOR

Delaware Supreme Court Reemphasizes Importance of Deal Price in Appraisal Litigation

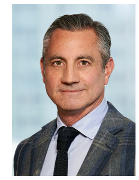
On April 16, 2019, the Delaware Supreme Court reversed a significant appraisal decision from the Court of Chancery in *Verition Partners v. Aruba Networks, Inc.*,[1] holding that the Chancery Court abused its discretion in using Aruba Networks, Inc.'s 30-day average unaffected market price — $17.13 per share — as determinative of the company's fair value. Instead, after appropriately excluding synergies "or other value the buyer expects from changes it plans to make to the company's 'going concern' business plan,"[2] the Supreme Court accepted Aruba's calculation of its fair value at $19.10 per share, 22.6 percent below the $24.67 per share deal price. While the Supreme Court did not dismiss the relevance of unaffected market price when there is an efficient market, it ruled that the Court of Chancery's reason for using that approach was unjustified based on the record before it.

The Supreme Court also clarified its holdings in *DFC Global Corporation v. Muirfield Value Partners L.P.*[3] and *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.*,[4] and affirmed its longstanding recognition of merger consideration as strong evidence of fair value in statutory appraisal actions involving transactions resulting from a fair and competitive sale process.

Background

In 2017, the Delaware Supreme Court reversed two Court of Chancery appraisal decisions, holding that the lower courts did not properly consider deal price in calculating the fair value of the acquired company's shares. In *DFC Global*, the Supreme Court held that the lower court erred by assigning equal weight to the deal price, an expert's discounted cash flow analysis, and a comparable companies analysis. According to the Supreme Court, "the sale value resulting from a robust market check will often be the most reliable evidence of fair value, and … second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous."[5] Likewise, in *Dell*, the Supreme Court held that "the trial court erred in not assigning any mathematical weight to the deal price" because "the deal price deserved heavy, if not dispositive, weight."[6] Importantly, however, in its opinions in *DFC Global* and *Dell*, the Supreme Court explicitly refused to create a presumption that deal price is always the best evidence of fair value. As the Supreme Court further explained in *DFC Global* (and reiterated in *Dell*), "economic principles suggest that the best evidence of fair value was the deal price," but only so long as that price "resulted from an open process, informed by robust public information, and easy access to deeper, non-public information, in which many parties with an incentive to make a profit had a chance to bid."[7]

Following *DFC Global* and *Dell*, Vice Chancellor Laster issued his decision in *Aruba Networks*.[8] In their pre- and post-trial briefs, plaintiffs contended that Aruba's fair value was $32.57 per share, while Aruba contended that its fair value was "deal price less synergies," or $19.10 per share. After finding that the deal price provided "reliable evidence of fair value," Vice Chancellor Laster calculated his own "deal-price-less-synergies" estimate of $18.10 per share.[9] However, noting that a "deal-price-less-synergies" calculation that he performed on his own "could have errors at multiple levels," and that the calculation of fair market value would also need to exclude "reduced agency costs" (costs associated with competing interests of shareholders and management), Vice Chancellor Laster determined that fair value was $17.13 per share — approximately 30.6 percent below the merger consideration — by averaging the unaffected market price of Aruba's shares in



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the 30 days before the merger was publicly disclosed.[10] After the Court of Chancery rejected plaintiffs' motion for re-argument, plaintiffs appealed.

On appeal, the Supreme Court found that the Court of Chancery's decision "to rely exclusively" on Aruba's stock price instead of the merger price less synergies was "rooted in an erroneous factual finding that lacked record support." Accordingly, the Supreme Court reversed and remanded the case to the Court of Chancery to enter a final judgment for the plaintiffs awarding them $19.10 per share, reflecting Aruba's initial calculation of "deal price less synergies."

Key Takeaways

- After adopting a preference for deal price in *DFC* and *Dell*, assuming a reasonable process, the *Aruba* decision reaffirms a preference for the deal price less synergies in a strategic merger and recognizes that those synergies can be a substantial component of the price paid.
- The Supreme Court did not address the Court of Chancery's conclusion that various process defects were insufficiently material to demonstrate that they had an impact on price. Although the Supreme Court emphasized the importance of a sufficient process when determining whether to give effect to the deal price, it remains to be seen to what extent process defects might undermine reliance on the deal price.
- While the decision in *Aruba* may provide some comfort to merger arbitrageurs seeking to limit the potential downside of an appraisal claim presented by a fair market value determination at the unaffected market price, the Supreme Court's decisions relying on deal price less synergies as evidence of fair value, in *Dell*, *DFC*, and *Aruba*, may continue to provide a strong deterrent to commencing such litigation in the absence of compelling reasons to believe that the deal price is not reliable evidence of fair value.

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[1] No. 368,2018, 2019 WL 1614026 (Del. Apr. 16, 2019).

[2] *Id.* at *7.

[3] 172 A.3d 346 (Del. 2017).

[4] 177 A.3d 1 (Del. 2017).

[5] 172 A.3d 346, 366 (Del. 2017).

[6] 177 A.3d 1, 23 (Del. 2017).

[7] 172 A.3d at 349; Dell, 177 A.3d at 21.

[8] 2018 WL 922139 (Del Ch. Feb 15, 2018).

[9] *Id.* at *2, 44.

[10] *Id.* at *54.