ROPES & GRAY

ALERT

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Delaware Court of Chancery Concludes that Company's Unaffected Market Price Is the Best Evidence of Fair Value for Appraisal Valuation Purposes

Hewlett-Packard Company acquired Aruba Networks, Inc. for $24.67 per share in 2015. In *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*,[1] an appraisal proceeding filed in connection with the transaction, the Delaware Court of Chancery concluded that the "best evidence" of Aruba's fair value was its thirty-day average unaffected (pre-announcement) market price of $17.13 per share—more than 30% *lower* than the deal price. The post-trial decision in *Aruba* is the Court of Chancery's first appraisal determination following the Delaware Supreme Court's recent decisions in *Dell*[2] and *DFC,*[3] which underscored the Supreme Court's willingness to give significant weight to the deal price as the best measure of fair value where it results from a third-party, arm's-length transaction.

In this appraisal action, petitioners Verition Partners Master Fund and Verition Multi-Strategy Master Fund owned shares of Aruba's common stock worth over $54 million at the deal price and sought about $18 million more for their shares. Vice Chancellor Laster—who was the trial court judge in *Dell*—reviewed three methods for valuing Aruba's shares:

- the company's unaffected market price,
- the deal price, and
- the parties' competing discount cash flow (DCF) analyses.

Unaffected market price. Vice Chancellor Laster found that, consistent with the Supreme Court's endorsement of the efficient capital markets hypothesis in *Dell* and *DFC*, the market for Aruba's common stock had basic attributes to indicate an efficient market for the stock. Those attributes included that:

- Aruba had many stockholders,
- Aruba had no controlling stockholder,
- Aruba's stock was highly actively traded, and
- information about Aruba was widely available and easily disseminated to the market.

In addition, as in *Dell*, the Court observed that there was evidence that Aruba's stock price reacted quickly to the release of news about the company. The decision suggests that future appraisal litigants may seek to retain experts on market efficiency, as is common in federal securities class actions, and that future appraisal decisions may consider "subtler aspects of the efficient capital markets hypothesis."

[1] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2018 WL 922139 (Del. Ch. Feb. 15, 2018).
[2] *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 2017 WL 6375829 (Del. Dec. 14, 2017). Our previous Alert on this decision can be found here.
[3] *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 2017 WL 3261190 (Del. Aug. 1, 2017). Our previous Alert on this decision can be found here.

Deal price. Despite the absence of meaningful competition (the petitioners proved that HP knew it did not face a meaningful threat of competition for Aruba) and a perhaps less than rigorous negotiation by the seller (the Court noted that Aruba's financial advisers "catered to HP" and Aruba's CEO possessed divergent interests), Vice Chancellor Laster found that the deal price had substantive probative value. The Court noted that, in a scenario where the underlying market price is reliable, competition and negotiation become secondary. Quoting extensively from the Supreme Court's opinions in *Dell* and *DFC*, the Court explained that the issue in an appraisal proceeding is not whether a negotiator has extracted the highest possible bid; rather, the key inquiry is whether the dissenters received fair value and were not exploited. In this case, the Court found nothing about the HP-Aruba transaction to be exploitive, noting that:

- the transaction was a third-party, arm's-length merger;
- the transaction did not involve a controller squeeze-out, a management buyout, or an equity rollover by members of management or a large stockholder;
- Aruba's board was disinterested and independent; and
- the deal protection provisions in the merger agreement were not impermissibly restrictive.

When the Court compared the deal price of $24.67 per share to the unaffected market price of $17.13 per share, the Court concluded that it was not possible to find that Aruba's stockholders were exploited.

However, the Court also found that the HP-Aruba transaction generated significant synergies. Because, under the Delaware appraisal statute, those synergies would have to be deducted from the deal price in the determination of fair value, the Court noted: "there is good reason to think that the deal price exceeded fair value and, if anything, should establish a ceiling for fair value." The Court recognized the inherent difficulties in quantifying synergies, but nevertheless proceeded to calculate a deal-price-less-synergies value of approximately $18.20 per share.

DCF analyses. Petitioners' expert opined that Aruba's fair value at closing was $32.57 per share, while Aruba's expert opined that it was $19.75 per share. The Court determined not to give *any* weight to the parties' competing DCF analyses, citing separate concerns with each party's expert valuations. The Court also observed that DCF models are often used in an appraisal proceeding when the target company was not public or was not sold subject to an open market check, neither of which applied to Aruba. Moreover, when market evidence is available, the Supreme Court in *Dell* cautioned that "the Court of Chancery should be chary about imposing the hazards that always come when a law-trained judge is forced to make a point estimate of fair value based on widely divergent partisan expert testimony."

After considering the three valuation methodologies, Vice Chancellor Laster held that Aruba's unaffected market price was the most persuasive evidence of fair value. Although it viewed both the unaffected market price and the deal-price-less-synergies value as probative of fair value, the Court favored the use of the unaffected market price because the deal-price-less-synergies value analysis required the Court to apply significant judgment and because it suffered from significant uncertainty. In contrast, the unaffected market price is the product of "the collective judgment of the many based on all the publicly available information about a given company and the value of its shares." Vice Chancellor Laster also stated that the decision was not interpreting the Supreme Court's recent decisions in *Dell* and *DFC* to hold that unaffected market price is now the standard for fair value. Rather, the Vice Chancellor reasoned that the "forceful discussion" of the efficient capital markets hypothesis in *Dell* and *DFC* compelled him to conclude that, under the circumstances presented, Aruba's unaffected market price was not only entitled to substantial weight but was the "best evidence" of its fair value.

The Court of Chancery took a distinct approach in appraising Aruba's shares. The *Aruba* decision potentially represents a significant shift in how appraisal cases are decided and provides a useful data point for understanding how Delaware courts may apply the guidance articulated in *Dell* and *DFC*. The *Aruba* decision will motivate respondents facing dissenter appraisal actions to seek below deal price "fair value" determinations.[4] The risk to dissenting stockholders of receiving less than the deal price in an appraisal action (particularly in arm's-length, third-party acquisitions of public targets and where the transaction involved substantial synergies) may reduce their appetite to pursue appraisal.

[4] The likelihood that a respondent may succeed in getting a below deal price "fair value" determination in appraisal actions may also focus deal proponents' attention on contractual merger mechanics in order to assure that they do not expand, by contract, the limited right of dissenters to abandon appraisal rights under Section 262(e) of the Delaware General Corporation Law.