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Delaware Supreme Court Reaffirms Importance of Deal Price in Appraisal Litigation

In *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*,[1] the Delaware Supreme Court again endorsed deal-price-minus-synergies as a foundational method for valuing companies in statutory appraisal proceedings.[2] The Supreme Court also rejected the Court of Chancery's total reliance on the target company's 30-day average unaffected stock price, without any incorporation of a deal-price-minus-synergies valuation. The Court of Chancery had determined that the fair value of the acquired company, Aruba Networks, Inc. ("Aruba"), was $17.13 per share (*i.e.*, the 30-day average unaffected stock price), well below the $24.67 deal price.[3] The Supreme Court unanimously reversed the trial court, holding that Aruba's fair value was instead equal to the deal price after subtracting synergies, or $19.10 per share.

The proceedings stemmed from the 2015 acquisition of Aruba by Hewlett-Packard Company ("HP") for nearly $3 billion. Two funds managed by Verition Fund Management, an appraisal arbitrage hedge fund, sought statutory appraisal rights in respect of shares worth more than $56 million (valued at the deal price). At trial, the petitioners argued—using a discounted cash flow analysis—that their shares were worth $32.57 apiece, a premium of 32% above the deal price. Aruba countered that the company should be valued using the deal price less the value of the synergies created by the merger that were incorporated into the deal price. According to Aruba, that methodology—backing out per-share value attributable to synergies of $5.57—led to a valuation of $19.10 per share. However, in supplemental post-trial briefing, following the Supreme Court's decisions in *Dell* and *DFC,* Aruba jettisoned its prior approach and argued that the company should instead be valued based on the thirty-day average unaffected trading price of its shares, or $17.13 per share.[4] The Court of Chancery agreed that this lower figure was the best evidence of the company's fair value and entered judgment accordingly.[5]

Petitioners appealed, and the Delaware Supreme Court reversed. In a unanimous decision, the Supreme Court principally took issue with the Court of Chancery's perception that a deal-price-minus-synergies valuation fails to account for an additional "element of value derived from the merger itself: the value that the acquirer creates by reducing agency costs."[6] The trial court had reasoned that the deal price reflected Aruba's ability to capture a portion of the value not only of the post-merger synergies that HP expected to realize, but also of the savings HP expected to achieve by consolidating the ownership and management of Aruba.[7] Accordingly, the trial court believed that it needed to account for both synergies *and* expected agency cost reductions to arrive at Aruba's fair value. The Supreme Court disagreed, holding that

[1] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2019 WL 1614026 (Del. Apr. 16, 2019) (*per curiam*).
[2] *See, e.g.*, *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017); *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017).
[3] *Verition Partners Master Fund, Ltd. v. Aruba Networks, Inc.*, 2018 WL 922139 (Del. Ch. Feb. 15, 2018).
[4] *See Aruba*, 2019 WL 1614026, at *2. Aruba's revised litigation position emerged in post-trial briefing requested by the trial court in response to the Delaware Supreme Court's decisions in *Dell* and *DFC*, which encouraged the trial court to give significant weight in appraisal proceedings to reliable market-based evidence of a company's fair value. *See Dell*, 177 A.3d at 24 ("[T]he price produced by an efficient market is generally a more reliable assessment of fair value than the view of a single market analyst . . . ."); *see also DFC*, 172 A.3d at 370-71 ("[T]he purpose of an appraisal . . . is to make sure that [petitioners] receive fair compensation for their shares in the sense that it reflects what they deserve to receive based on what would fairly be given to them in an arm's-length transaction.").
[5] *See Aruba*, 2018 WL 922139, at *55.
[6] *Id*. at *3.
[7] *See id*. at *54.

this methodology was unsupported by the record and, specifically, that there was no basis for concluding that any savings from reduced agency costs were not already accounted for in the calculated synergies.[8]

The Delaware Supreme Court also disagreed with what it viewed as the trial court's urge to treat the unaffected market price of a company's stock as automatically the best evidence of a company's fair value. Clarifying its holdings in *Dell* and *DFC*, the Supreme Court explained that, although the unaffected market price of a company's stock in an efficient market "is an important indicator of its economic value that should be given weight," stock price does not "invariably reflect[] the company's fair value in an appraisal."[9]

The Delaware Supreme Court identified a number of reasons why that was so in the case of Aruba. For example, the appraisal statute requires that acquired companies be valued as of the date of the closing of the transaction,[10] but the time period used by the Court of Chancery to derive Aruba's unaffected stock price was—as it must be in all transactions featuring a lag between public knowledge of the deal and closing—earlier than the transaction's closing date, in this case several months earlier. Thus, the Supreme Court reasoned, the unaffected stock price from that earlier period did not reflect Aruba's developments subsequent to news of the deal breaking, including a favorable earnings report that resulted in a bump in the company's stock price.[11] Additionally, the deal price reflected the fact that HP, as the acquirer, had access to material non-public information about Aruba's prospects, which gave it an informational advantage over the market.[12] The Supreme Court observed that Aruba's argument that its unaffected stock price was the best measure of fair value was "never subjected to the crucible of pretrial discovery, expert depositions, cross-expert rebuttal, expert testimony at trial, and cross examination at trial."[13] The Supreme Court also made clear that deal-price-less-synergies is an appropriate measure of fair value even where a sales process produces only a single bidder.[14] For these reasons, the Supreme Court concluded that the transaction price for Aruba (minus synergies) was a better measure of fair value than its unaffected stock price.[15]

Despite the fact that the Delaware Supreme Court's valuation of Aruba exceeded that of the trial court's, its decision nonetheless confirms the centrality of market-based evidence of fair value—especially based on the deal price (backing out synergies, as required by the appraisal statute)—in appraisal proceedings. *Aruba*, like *Dell* and *DFC*, confirms that, when an efficient market or an arm's-length deal generates evidence of a company's fair value, that evidence must be given significant weight. The decision also underscores the continued risk faced by appraisal petitioners of receiving appraisal awards below, and in some instances well below, the deal price.

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[8] *See Aruba*, 2019 WL 1614026, at *4-5.
[9] *Id*. at *6.
[10] *See* 8 *Del. C.* § 262(h).
[11] *See Aruba*, 2019 WL 1614026, at *7.
[12] *See id*.
[13] *Id*.
[14] *Id*. at *6.
[15] *See id*. at *8-9.