CORPORATE FINANCE/M&A - USA

Company's unaffected market price is best evidence of fair value for appraisal valuations

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Introduction

In 2015 Hewlett-Packard Company (HP) acquired Aruba Networks, Inc for $24.67 per share. 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 30-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* was the Court of Chancery's first appraisal determination following the Delaware Supreme Court's recent decisions in *Dell*(2) (for further details please see "Delaware Supreme Court reverses Court of Chancery's *Dell* appraisal decision") and *DFC*.(3) These decisions 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.

Facts

The 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 approximately $18 million more for their shares. Vice Chancellor Laster – who was the trial court judge in *Dell* – reviewed the following methods for valuing Aruba's shares:

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

Unaffected market price

Consistent with the Supreme Court's endorsement of the efficient capital markets hypothesis in *Dell* and *DFC*, Laster found that the market for Aruba's common stock was efficient, based on the fact 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 news regarding the company. The decision suggests that future appraisal litigants may wish 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".

Deal price

Despite the absence of meaningful competition (as the petitioners had proved that HP knew that

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there was no meaningful threat of competition for Aruba) and a perhaps less-than-rigorous negotiation by the seller (the court noted that Aruba's financial advisers had "catered to HP" and Aruba's CEO possessed divergent interests), Laster found that the deal price had substantive probative value. The court noted that, 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, it is whether the dissenters received fair value and were not exploited. In this case, the court found that the HP-Aruba transaction was not 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, it concluded that Aruba's stockholders had not been exploited.

However, the court also found that the HP-Aruba transaction generated significant synergies. Because, under the Delaware appraisal statute, those synergies must be deducted from the deal price in the determination of fair value, the court noted that "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 recognised 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

The 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. However, the court gave no weight to the parties' competing DCF analyses, citing separate concerns with each party's valuations. It also observed that DCF models are often used in an appraisal proceeding when the target company was not public or 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, Laster held that Aruba's unaffected market price was the most persuasive evidence of fair value. Although the court viewed both the unaffected market price and the deal-price-less-synergies value as probative of fair value, it found that the deal-price-less-synergies value analysis required the court to apply significant judgement and was therefore subjective. In contrast, the unaffected market price comprises "the collective judgment of the many based on all the publicly available information about a given company and the value of its shares". Laster also stated that the decision had not interpreted *Dell* and *DFC* to mean that unaffected market price is now the standard for fair value. Rather, Laster reasoned that the "forceful discussion" of the efficient capital markets hypothesis in *Dell* and *DFC* meant that, in the circumstances, Aruba's unaffected market price was the best evidence of its fair value.

Comment

The Court of Chancery took a distinct approach in appraising Aruba's shares. *Aruba* potentially represents a significant shift in how appraisal cases are decided and may be useful in understanding how the Delaware courts will apply the guidance of *Dell* and *DFC*. *Aruba* 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 for appraisal.

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Endnotes

(1) *Verition Partners Master Fund Ltd v Aruba Networks, Inc*, 2018 WL 922139 (Del Ch, February 15 2018).

(2) *Dell, Inc v Magnetar Global Event Driven Master Fund Ltd*, 2017 WL 6375829 (Del, December 14 2017).

(3) *DFC Global Corp v Muirfield Value Partners, LP*, 2017 WL 3261190 (Del, August 1 2017). A previous alert on this decision can be found here.

(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.
