GIBSON DUNN

April 5, 2018

AOL AND ARUBA NETWORKS CONTINUE TREND OF DELAWARE COURTS DEFERRING TO DEAL PRICE IN APPRAISAL ACTIONS

To Our Clients and Friends:

Two recent decisions confirm that, in the wake of the Delaware Supreme Court's landmark decisions in *Dell* and *DFC*, Delaware courts are taking an increasingly skeptical view of claims in appraisal actions that the "fair value" of a company's shares exceeds the deal price.[1] However, as demonstrated by each of these recent Delaware Court of Chancery decisions—*In re Appraisal of AOL Inc.* and *Verition Partners Master Fund Limited v. Aruba Networks, Inc.*—several key issues are continuing to evolve in the Delaware courts.[2] In particular, Delaware courts are refining the criteria in appraisal actions for determining whether a transaction was "*Dell*-compliant." If so, then the court will likely look to market-based indicators of fair value, though which such indicator (unaffected share price or deal price) is the best evidence of fair value remains unresolved. If not, the court will likely conduct a valuation based on discounted cash flow (DCF) analysis or an alternative method to determine fair value. The development of these issues will help determine whether M&A appraisal litigation will continue to decline in frequency and will be critical for deal practitioners.[3]

DFC and "*Dell*-Compliant" Transactions

In *DFC*, the Delaware Supreme Court endorsed deal price as the "best evidence of fair value" in an arm's-length merger resulting from a robust sale process. The Court held that, in determining fair value in such transactions, the lower court must "explain" any departure from deal price based on "economic facts," and must justify its selection of alternative valuation methodologies and its weighting of those methodologies, setting forth whether such methodologies are grounded in market-based indicators (such as unaffected share price or deal price) or in other forms of analysis (such as DCF, comparable companies analysis or comparable transactions analysis).

In *Dell*, the Court again focused on the factual contexts in which market-based indicators of fair value should be accorded greater weight. In particular, the Court found that if the target has certain attributes—for example, "many stockholders; no controlling stockholder; highly active trading; and if information is widely available and easily disseminated to the market"—and if the target was sold in an arm's-length transaction, then the "deal price has heavy, if not overriding, probative value."

Aruba Networks and *AOL*: Marking the Boundaries for "*Dell*-Compliant" Transactions

In *Aruba Networks*, the Delaware Court of Chancery concluded that an efficient market existed for the target's stock, in light of the presence of a large number of stockholders, the absence of a controlling stockholder, the deep trading volume for the target's stock and the broad dissemination of information

about the target to the market. In addition, the court found that the target's sale process had been robust, noting that the transaction was an arm's-length merger that did not involve a controller squeeze-out or management buyout, the target's board was disinterested and independent, and the deal protection provisions in the merger agreement were not impermissibly restrictive.

On this basis, the Court determined that the transaction was "*Dell*-compliant" and, as a result, market-based indicators would provide the best evidence of fair value. The Court found that both the deal price and the unaffected stock price provided probative evidence of fair value, but in light of the significant quantum of synergies that the parties expected the transaction to generate, the Court elected to rely upon the unaffected stock price, which reflected "the collective judgment of the many based on all the publicly available information . . . and the value of its shares." The Court observed that using the deal price and subtracting synergies, which may not be counted towards fair value under the appraisal statute,[4] would necessarily involve judgment and introduce a likelihood of error in the Court's computation.

By contrast, *AOL* involved facts much closer to falling under the rubric of a "*Dell*-compliant" transaction, but the Court nonetheless determined that the transaction was not "*Dell*-compliant." At the time of the transaction, the target was well-known to be "likely in play" and had communicated with many potential bidders, no major conflicts of interest were present and the merger agreement did not include a prohibitively large breakup fee. Nonetheless, the Court focused on several facts that pointed to structural defects in the sale process, including that the merger agreement contained a no-shop period with unlimited three-day matching rights for the buyer and that the target failed to conduct a robust auction once the winning bidder emerged. In addition, and importantly, the Court took issue with certain public comments of the target's chief executive officer indicating a high degree of commitment to the deal after it had been announced, which the Court took to signal "to potential market participants that the deal was done, and that they need not bother making an offer." On this basis, the Court declined to ascribe any weight to the deal price and instead conducted a DCF analysis, from which it arrived at a fair value below the deal price. It attributed this gap to the inclusion of synergies in the deal price that are properly excluded from fair value. Parenthetically, the Court did take note of the fact that its computation of fair value was close to the deal price, which offered a "check on fair value analysis," even if it did not factor into the Court's computation.

Key Takeaways

Aruba Networks and *AOL* provide useful guidelines to M&A practitioners seeking to manage appraisal risk, while also leaving several open questions with which the Delaware courts will continue to grapple:

- Whether market-based indicators of fair value will receive deference from the Delaware courts (and, correspondingly, diminish the incentives for would-be appraisal arbitrageurs) depends upon whether the sale process could be considered "*Dell*-compliant." This includes an assessment of both the robustness of the sale process, on which M&A practitioners seeking to manage appraisal risk would be well-advised to focus early, and the efficiency of the trading market for the target's stock, to which litigators in appraisal actions should pay close attention.

- For those transactions found to be "*Dell*-compliant," the best evidence of fair value will be a market-based indicator of the target's stock. Whether such evidence will be the deal price, the unaffected stock price or a different measure remains an open question dependent upon the facts of the particular case. However, for those transactions in which synergies are anticipated by the parties to be a material driver of value, *Aruba Networks* suggests that the unaffected share price may be viewed as a measure of fair value that is less susceptible to errors or biases in judgment.

- For those transactions found not to be "*Dell*-compliant," DCF analyses or other similar calculated valuation methodologies are more likely to be employed by courts to determine fair value. As AOL and other recent opinions indicate, however, there is no guarantee for stockholders that the result will yield a fair value in excess of the deal price—particularly given the statutory mandate to exclude expected synergies from the computation.

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[1] *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). See our earlier discussion of *Dell* and *DFC* here.

[2] *In re Appraisal of AOL Inc.*, C.A. No. 11204-VCG, 2018 WL 1037450 (Del. Ch. Feb. 23, 2018); *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, C.A. No. 11448-VCL, 2018 WL 922139 (Del. Ch. Feb. 15, 2018).

[3] It is worth noting that, after *DFC* and *Dell*, the Delaware Supreme Court summarily affirmed the decision of the Court of Chancery in *Merlin Partners, LP v. SWS Grp., Inc.*, No. 295, 2017, 2018 WL 1037477 (Table) (Del. Feb. 23, 2018), *aff'g, In re Appraisal of SWS Grp., Inc.*, C.A. No. 10554-VCG, 2017 WL 2334852 (Del. Ch. May 30, 2017). The Court of Chancery decided *SWS Group* prior to the Delaware Supreme Court's decisions in *DFC* and *Dell*. Nonetheless, it is clear that the court would have found the transaction at issue in *SWS Group* not to be "*Dell*-compliant," as the transaction involved the sale of the target to a buyer that was also a lender to the target and so could exercise veto rights over any transaction. Indeed, no party to the *SWS Group* litigation argued that the deal price provided probative evidence of fair value. See our earlier discussion of the *SWS Group* decision by the Delaware Court of Chancery here.

[4] *See* 8 Del. C. § 262(h) ("[T]he Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation . . . ."); *see also Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 507 (Del. Ch.) ("The entity must be valued as a going concern based on its business plan at the time of the merger, and any synergies or other value expected from the merger giving rise to the appraisal proceeding itself must be disregarded." (internal citations omitted)), *aff'd*, 11 A.3d 214 (Del. 2010).

The following Gibson Dunn lawyers assisted in preparing this client update: Barbara Becker, Jeffrey Chapman, Stephen Glover, Eduardo Gallardo, Jonathan Layne, Joshua Lipshutz, Brian Lutz, Adam Offenhartz, Aric Wu, Meryl Young, Daniel Alterbaum, Colin Davis, and Mark Mixon.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these issues. For further information, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any of the following leaders and members of the firm's Mergers and Acquisitions practice group:

Mergers and Acquisitions Group / Corporate Transactions:
Barbara L. Becker - Co-Chair, New York (+1 212-351-4062, bbecker@gibsondunn.com)
Jeffrey A. Chapman - Co-Chair, Dallas (+1 214-698-3120, jchapman@gibsondunn.com)
Stephen I. Glover - Co-Chair, Washington, D.C. (+1 202-955-8593, siglover@gibsondunn.com)
Dennis J. Friedman - New York (+1 212-351-3900, dfriedman@gibsondunn.com)
Jonathan K. Layne - Los Angeles (+1 310-552-8641, jlayne@gibsondunn.com)
Eduardo Gallardo - New York (+1 212-351-3847, egallardo@gibsondunn.com)
Jonathan Corsico - Washington, D.C. (+1 202-887-3652), jcorsico@gibsondunn.com

Mergers and Acquisitions Group / Litigation:
Meryl L. Young - Orange County (+1 949-451-4229, myoung@gibsondunn.com)
Brian M. Lutz - San Francisco (+1 415-393-8379, blutz@gibsondunn.com)
Aric H. Wu - New York (+1 212-351-3820, awu@gibsondunn.com)
Paul J. Collins - Palo Alto (+1 650-849-5309, pcollins@gibsondunn.com)
Michael M. Farhang - Los Angeles (+1 213-229-7005, mfarhang@gibsondunn.com)
Joshua S. Lipshutz - Washington, D.C. (+1 202-955-8217, jlipshutz@gibsondunn.com)
Adam H. Offenhartz - New York (+1 212-351-3808, aoffenhartz@gibsondunn.com)