

INSIGHT: Delaware Supreme Court Drives Nail in Appraisal-Arbitrage Coffin

By Joshua S. Lipshutz and Michael Holecek

May 10, 2019

A Delaware Supreme Court ruling should put an end to the state's Chancery Court second-guessing merger deal prices in future appraisal actions. Gibson Dunn attorneys discuss the case and explain how it will impact appraisal arbitrageurs, those who purchase shares after a merger is announced in hopes the shares will appraise above market value.

On April 16, the Delaware Supreme Court reversed the Court of Chancery's appraisal valuation in *Verition Partners Master Fund Ltd. v. Aruba Networks Inc.* —the third time in less than three years the Delaware high court has rebuked the lower court for second-guessing the market as to a company's "fair value."

As a matter of economics and logic, a company's sale price in an arm's-length transaction is the best measure of its value. The Court of Chancery, however, occasionally ignores the company's sale price, valuing its shares at a *higher* price that no buyer was willing to pay and thereby generating a windfall for dissenting shareholders.

This has created a cottage industry of "appraisal arbitrageurs," who purchase shares after a merger is announced and hope that the Court of Chancery will appraise them for more than their market value. The Delaware Supreme Court's decision in *Verition Partners* should finally put an end to that practice. The court's stern language will make the Court of Chancery think hard before deviating from a company's deal

price, reducing the opportunity for arbitrage.

Opportunity Missed

For a period of time, it appeared that appraisal arbitrage was here to stay.

In 2010, in *Golden Telecom, Inv. v. Glob. GTLP*, the Delaware Supreme Court missed a golden opportunity to solidify the deal price as the best measure of value in appraisal actions. In that case, the appellant argued that Delaware should adopt a presumption in favor of the deal price.

In rejecting that argument, the Delaware Supreme Court focused on the language in 8 Del. C. § 262, which states that dissenting shareholders "shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares" after considering "all relevant factors." According to the Delaware Supreme Court, adopting a presumption in favor of the deal price would improperly shift the responsibility to determine "fair value" from the court to private parties and violate the statute's command to consider "all relevant factors."

Golden Telecom emboldened appraisal arbitrageurs and gave birth to hedge funds whose entire investment strategy was to engage in appraisal litigation. While the Court of Chancery occasionally appraised a company at its deal price, other times it used unreliable and malleable financial models to conclude that the company was worth far more than



Joshua S. Lipshutz
Partner



Michael Holecek
Associate Attorney

anyone in the market was willing to pay for it.

Any Cash Merger, Acquisition Open to Challenge

This allowed arbitrageurs to challenge any cash merger or acquisition—even ones conducted under pristine auction conditions—and hope that the court would appraise their shares above market value. The environment was inimical to the certainty and regularity that corporate transactions require, and a black eye to Delaware’s business-friendly reputation.

The Delaware Supreme Court’s 2017 decision in *DFC Global Corp. v. Muirfield Value Partners L.P.* marked an important shift. In DFC, the Chancery Court found that DFC was sold in an arm’s-length transaction after a robust auction process, yet concluded that DFC’s “fair value” was 40 percent higher than anyone was willing to pay for it.

The Delaware Supreme Court reversed, holding that although there is no official presumption in favor of the deal price, “economic principles suggest that the best evidence of fair value [is] the deal price.” Writing for a unanimous court, Chief Justice Leo E. Strine Jr. emphasized that “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.”

Four months later, in *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, the Delaware Supreme Court again reversed the Chancery’s appraisal valuation. The court held that Vice Chancellor J. Travis Laster erred in giving no weight to Dell’s stock price or the deal price when determining the company’s fair value. In the high court’s view, “the market-based indicators of value—both Dell’s stock price and deal price—have substantial probative value” and “deserved heavy, if not dispositive, weight.”

Warning Issued

The state supreme court warned the Chancery to “be chary about imposing the hazards that always come when a law-trained judge is forced” to rely on alternative valuation models instead of the deal price.

If, after *DFC* and *Dell*, there was any doubt that the Court of Chancery should defer to the deal price in appraisal actions, the Delaware Supreme Court erased that doubt in *Verition Partners*.

In that case, the vice chancellor once again deviated from the deal price, this time in favor of an adjusted 30-day average of the company’s stock price that was *lower* than the deal price. The Delaware Supreme Court reversed, holding that the vice chancellor abused his discretion by not deferring to the deal price (less any synergies obtained by the merger).

Not surprisingly, the decision cited DFC’s and Dell’s command that the deal price represents the best measure of a company’s value. Then, in a remarkable display of consternation, the court described the vice chancellor’s decision as possibly reflecting “a results-oriented move to generate an odd result compelled by his personal frustration at being reversed in *Dell*.”

Further, the Delaware Supreme Court took the rare step of not remanding the case to the vice chancellor to revalue the company in light of the court’s guidance. Rather, the court simply ordered that judgment be entered in the amount of the deal price, less synergies.

After *Verition Partners*, it is difficult to see the Court of Chancery second-guessing the deal price in future appraisal actions, absent significant evidence of a conflicted transaction or other indicia that the deal process was tainted. This development should significantly reduce the opportunity for appraisal arbitrage, and hopefully restore the certainty and predictability that companies transacting business in Delaware expect.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Joshua S. Lipschutz is a partner in the Washington, D.C., and San Francisco offices of Gibson, Dunn & Crutcher.

Michael Holecsek is a Los Angeles-based Gibson Dunn associate. They represented DFC in the case described above.

Reproduced with permission from Copyright 2019 The Bureau of National Affairs, Inc. (800-372-1033) www.bna.com.