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In 'Aruba Networks,' Del. High Court Emphasizes Deal Price as a Measure of Appraisal Value

By Jennifer H. Rearden, Jefferson E. Bell and Mark H. Mixon Jr.

In *Verition Partners Master Fund v. Aruba Networks*, No. 368, 2018 (Del. Apr. 1, 2019), the Delaware Supreme Court considered whether the Delaware Court of Chancery abused its discretion in concluding that, as of the "effective date" of the merger between Aruba Networks Inc. and Hewlett-Packard Co. (HP), the "fair value" of Aruba—as defined by 8 Del. C. Section 262—was its "unaffected market price," i.e., the average "trading price of Aruba's stock during the 30 days before news of the merger leaked, which was three to four months prior to closing." Holding that such a conclusion was an abuse of discretion, the Supreme Court reversed and awarded Verition Partners $19.10 per share, "reflecting the deal price minus the portion of synergies left with Aruba as estimated by … Aruba."

As explained further below, the Supreme Court reversed the Court of Chancery's reliance on "unaffected market price" as the exclusive measure of Aruba's fair value for multiple reasons, including that the Court of Chancery's rejection of a deal-price-less-synergies valuation, which it otherwise viewed as "compelling evidence of fair value," found "no basis in the record … or corporate finance literature," and valuing the company using "unaffected market price" prior to the announcement of the transaction conflicted with Section 262(h) of the DGCL, which requires fair value

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to be determined as of a qualifying transaction's effective date.

In its post-trial opinion, the Court of Chancery considered three different valuation measures: "first, the 'unaffected market price' of Aruba's stock before news of the merger leaked; second, the deal price minus the portion of synergies left with the seller; and third, the two expert witnesses' valuations, which were based primarily on discounted cash flow (DCF) models." After finding that an efficient market for Aruba's stock existed, and that the company's sale process had been reliable, the Court of Chancery rejected the experts' DCF valuations and concluded that both market-based measures provided probative evidence of fair value.

However, the trial court then also rejected the "deal-price-less-synergies figure," believing that it "continued to incorporate an element to value resulting from the merger in the form of reduced agency costs that result from unitary (or controlling) ownership." In other words, the Chancery Court believed that the "agency costs of control" realized by certain buyers upon acquiring a target, typically arising from replacing dispersed ownership overseeing the target's management with more concentrated ownership oversight, represented an additional element of value separate from the synergies and general cost savings that were already deducted from the deal price under a typical deal-price-influenced valuation analysis. Thus, the vice chancellor relied exclusively on the 30-day-average trading price of Aruba's stock before news of the merger leaked because it "provide[d] a direct estimate" of the company's value as a going concern: its deal-price-less-synergies figure minus the reduced agency costs of control.

The Delaware Supreme Court rejected the Court of Chancery's reliance on Aruba's "unaffected market price" for several reasons. First, the Supreme Court clarified that "*Dell* and *DFC* did not imply that the market price of a stock was necessarily the best estimate of the stock's so-called fundamental value at any particular time." Instead, these cases "recognized that when a public company with a deep trading market is sold at a substantial premium to the preannouncement price, after a process in which interested buyers all had a fair and viable opportunity to bid, the deal price is a strong indicator of fair value."

Second, the Supreme Court observed that "the price that HP paid could be seen as reflecting a better assessment of Aruba's going-concern value" than its "unaffected market price." In particular, the company's "unaffected market price was a measurement from three to four months prior to the valuation date, a time period during which it is possible for new, material information relevant to a company's future earnings to emerge." Indeed, Aruba and HP "had material, nonpublic information that, by definition, could not have been baked into the public trading price": prior knowledge that Aruba's quarterly earnings—reported "after the close of the period that the Court of Chancery used to measure the 'unaffected market price'"—would exceed analysts' expectations.

The Supreme Court also reversed the Court of Chancery's rejection of Aruba's deal–price-less-synergies analysis, holding that "the Court of Chancery abused its discretion in using Aruba's 'unaffected market price' because it did so on the inapt theory that it needed to make an additional deduction from the deal price for unspecified 'reduced agency costs.'" This theory was "inapt" because, as a factual matter, "the merger at issue in this case would not replace Aruba's public stockholders with a concentrated group of owners," and thus would not better "align the interests of Aruba's managers and its public stockholders" by consolidating Aruba's "ownership and control." Accordingly, there were unlikely to be any reduced agency costs of control at all. In any event, further reducing such agency costs "ignored the reality that HP's synergies case likely already priced any agency cost reductions it may have expected," and the record otherwise "provided no reason to believe that those estimates omitted any other added value HP thought it would achieve because of the combination."

Finally, the Supreme Court also suggested that "averaging the trading price of Aruba's stock during the 30 days before news of the merger leaked, which was three to four months prior to closing," conflicted with Section 262 of the DGCL, which "requires the Court of Chancery to assess Aruba's fair value as of 'the effective date of the merger.'"

Key Takeaways

In several respects, *Aruba Networks* further develops Delaware's canon on appraisal. First, the Delaware Supreme Court extended its emphasis in *Dell* and *DFC* on objective, market-based indices of fair value to its consideration of the quantum of synergies and cost savings to be deducted from a deal price produced by a robust sale process. Thus, although this approach is not foreclosed from challenge, *Aruba Networks* should provide comfort that the Court of Chancery will defer to the synergies that a buyer or its financial advisers can establish arise from a merger.

Second, *Aruba Networks* clarifies that *Dell* and *DFC* do not compel the Court of Chancery to treat the trading prices of a seller's stock as an exclusive indicator of fair value, especially when "new news" is injected into the market between the announcement of a deal and its closing. Nonetheless, even though deal price (less synergies) usually will be the most reliable indicator of value, the "unaffected market price" of a seller's stock "in an efficient market is an important indicator of its economic value that should be given weight" under appropriate circumstances. Accordingly, buyers and their counsel should continue advocating for the Court of Chancery to use a target's "unaffected market price" as an anchor or "reality check" in statutory appraisal actions.

Jennifer H. Rearden*, a partner resident in Gibson, Dunn & Crutcher's New York office, is a member of the firm's litigation and crisis management practice groups. Rearden represents clients in complex commercial litigation, including major fraud and contract cases, large sales tax matters, hostile M&A, and disputes with states and municipalities, as well as internal investigations.*

Jefferson E. Bell *is a partner in the New York office of the firm and is experienced in a wide variety of complex litigation matters.*

Mark H. Mixon Jr. *is an associate in the firm's New York office.*

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