



Delaware M&A Appraisal After *DFC, Dell and Aruba*

Posted by Gregory V. Gooding, William D. Regner, and Shannon Rose Selden, Debevoise & Plimpton LLP, on Monday, May 6, 2019

Editor’s note: Gregory V. Gooding, William D. Regner, and Shannon Rose Selden are partners at Debevoise & Plimpton LLP. This post is based on their Debevoise memorandum, and is part of the [Delaware law series](#); links to other posts in the series are available [here](#). Related research from the Program on Corporate Governance includes [Using the Deal Price for Determining “Fair Value” in Appraisal Proceedings](#) (discussed on the Forum [here](#)) and [Appraisal After Dell](#), both by Guhan Subramanian.

With its April 16, 2019 opinion in *Verition Partners Master Fund Ltd. v Aruba Networks, Inc.*,¹ and following its late 2017 decisions in *DFC Global*² and *Dell*,³ the Delaware Supreme Court has completed a trio of decisions that are likely to reshape the law and practice of public company merger appraisal in Delaware. In each case, the Delaware Supreme Court overturned an appraisal award of the Court of Chancery for failing to give sufficient weight to the parties’ negotiated merger price. While the Supreme Court made clear that deal price is not the exclusive—or even presumptive—measure of fair value for appraisal purposes, and that the appraisal statute obligates the Court of Chancery to “take into account all relevant factors,”⁴ the overall thrust of these cases is to make deal price the starting (and in many cases the ending) point for appraisal analysis in transactions between unaffiliated parties where the target company has a robust trading market and the deal results from an unconflicted and reasonable sale process.

The deals giving rise to the appraisal actions underlying this trio of Supreme Court decisions—and the appraisal analyses undertaken by the Court of Chancery—were each decidedly different:

- DFC Global was acquired by a private equity firm following a two-year sale process, initiated by the company, which included a broad range of potential private equity and strategic buyers. The Court of Chancery appraised the fair value of the company at \$10.30 per share—nearly 10% more than the \$9.50 deal price agreed to by the parties and approved by DFC Global’s stockholders—in a decision that gave equal one-third weighting to the deal price, a customary comparable company analysis and a discounted cash flow (DFC) analysis.
- Dell also involved a private equity acquisition, albeit one that also included the Company’s eponymous founder, CEO and 16% stockholder. Despite having a highly active trading market and broad analyst coverage, a post-signing go-shop and unusually

¹ C.A. No. 11-448-VCL (Del. 2019).

² *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017).

³ *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017).

⁴ Del. Gen. Corp. L. §262(h).

target-favorable deal protections, the Court of Chancery gave no weight to the \$13.75 per share deal price and instead relied exclusively on a DFC analysis to value the company at \$17.62 per share, nearly 30% higher than the deal price.

- The acquisition of Aruba by Hewlett-Packard was a strategic merger expected to give rise to significant synergies that, like all elements of value arising from the merger, are required to be ignored for purposes of appraisal.⁵ Taking into account both the Supreme Court's endorsement in the *Dell* decision of market price as an indicator of the fair value of a widely traded company and the inherent difficulty of measuring synergies, the Court of Chancery appraised Aruba based exclusively on the company's 30-day pre-announcement trading price of \$17.13 per share, more than 30% less than the \$24.67 per share deal price.

In each instance, the Delaware Supreme Court reversed on the ground that the lower court of gave the parties' deal price insufficient weight. In *DFC Global*, the Court held that "economic principles" indicate that the best evidence of fair value was a deal price resulting from an "open process, informed by robust information, and easy access to deeper, non-public information, in which many parties with an incentive to make a profit had a chance to bid." In *Dell*, the Court held that where there is "compelling" evidence of "market efficiency, fair play, low barriers to entry, outreach to all logical buyers" and a well-designed sales process, the lower court abused its discretion by failing to give the deal price "heavy weight." In last week's *Aruba* decision, the Court directed the lower court to enter a final judgment at a price (\$19.10 per share) that reflected the deal price less the respondent's estimate of deal synergies.

The Delaware Supreme Court in each of these opinions emphasized the probative value of the agreed deal price and deemphasized the value of alternative valuation methodologies such as discounted cash flow models. For example, in *Dell* the Court noted that while a DFC may be "the best tool for valuing companies when there is no credible market information and no market check," in a transaction involving an efficient trading market and a "robust sale process involving willing buyers with thorough information and the time to make a bid" it is hazardous for a judge to ignore such market evidence in favor of its own evaluation of "widely divergent partisan expert testimony."⁶ In *Aruba*, the Court noted the circularity inherent in such substitutes for a market-based deal price, as those tools themselves "often depend on market data and the efficiency of the markets from which that data is derived."⁷

When is deal price less probative? Certainly in the case of an acquisition by a controlling stockholder, but also if there is insufficient evidence of an efficient pre-deal trading market in the target's stock, which inevitably serves to anchor the price in a sales process. In *Dell*, the Supreme Court emphasized the Company's "vast and diffuse base of public stockholders, its extensive analyst coverage, and the absence of a controlling stockholder," all of which the court characterized as "hallmarks of an efficient market."

A flawed sales process or evidence of pre-deal market manipulation will likely also lead the court to discount deal price. For example, management might "purposefully temper[] investors' expectations for the Company so that it could eventually take over the Company at a fire-sale price."⁸ A weak market check prior to signing a transaction coupled with highly restrictive deal

⁵ Del. Gen. Corp. L. §262(h).

⁶ *Dell*, pp. 61-65.

⁷ *Aruba*, p 15.

⁸ *Dell*, p. 42.

protections may undermine confidence in the agreed deal price, as may an unwillingness of key management to work with alternative buyers.⁹

Even where deal value is ignored or discounted, appraisal petitioners still face the risk that appraised value will be less than they would have gotten in the merger, at least in the case of a strategic transaction giving rise to synergies. For example, in the 2018 appraisal of AOL following its \$50 per share acquisition by Verizon, the Court of Chancery determined that the combination of relative strong deal protections (including a 3.5% break-up fee and unlimited three-day matching rights) and “unusually preclusive” statements by AOL’s CEO as to his intention to close the deal with Verizon undermined the reliability of the deal price in determining fair value. As a result, the Court of Chancery appraised AOL exclusively on the basis of a DFC analysis, which resulted in a below-deal-price award of \$48.70.¹⁰

Not surprisingly, the number of appraisal actions filed in Delaware has declined significantly following the *Dell* and *DFC Global* decisions. In 2018, a total of 26 appraisal petitions were filed in Delaware, a 56% decline from the 60 such petitions filed in 2017 and barely one-third of the 76 appraisal actions filed in 2016.¹¹ The results of recent appraisal actions that have reached an ultimate award are even more striking. A survey of Delaware appraisals involving public company mergers shows that over the 14-year period ending in December 2016, 68% of appraisal awards were above the deal price, with 10.5% of awards being below the deal price and 21.5% being at the deal price. In contrast, of the seven public company appraisal awards in 2017 and 2018, five were below the deal price, one was at the deal price, and one was a modest 2.8% above the deal price.¹²

Going forward, it seems likely that appraisal actions in strategic mergers—in which synergies must be factored out of the fair value determination—will be increasingly rare. While private equity-led going private transactions, given the absence of synergies, may remain inviting targets for appraisal litigation, the Delaware Supreme Court’s *Aruba* decision left open the door to an argument that the elimination of public company agency costs is itself a synergistic benefit that should be subtracted from deal price in determining fair value.¹³ As a result, we expect future appraisal cases to be largely limited to acquisitions of private and small-cap companies, controlling stockholder transactions and deals with significant process flaws.

⁹ See *Dell* pp 52-59. The Delaware Supreme Court specifically noted that none of these factors was present in the *Dell* transaction.

¹⁰ *In re Appraisal of AOL Inc.*, C.A. No. 11204-VCG (Del. Ch. Feb. 23, 2018)

¹¹ Cornerstone Research, *Appraisal Litigation in Delaware: Trends in Petitions and Opinions 2006—2018*, p.4.

¹² L. Hamermesh and M. Wachter, *Finding the Right Balance In Appraisal Litigation: Deal Price, Deal Process, and Synergies* (2018), PennLaw: Legal Scholarship Repository. Note that the pre-2016 above-deal price awards include the subsequently reduced *DFC Global* and *Dell* awards. The data in the above text also includes two appraisal awards in 2018 that post-dated the Hamermesh and Wachter article.

¹³ “Synergies do not just involve the benefits when, for example, two symbiotic product lines can be sold together. They also classically involve cost reductions . . . Private equity firms often expect to improve performance and squeeze costs too, including by reducing ‘agency costs.’” *Aruba*, pp 10-11.