Skadden

Supreme Court Reinforces Deal Price Minus Synergies as 'Strong Indicator' of Fair Value

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The Delaware Supreme Court recently issued its highly anticipated decision in the *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.* appraisal action.[1] In a *per curiam* opinion, the Supreme Court reversed the Delaware Court of Chancery's determination that the fair value of Aruba Networks, Inc. (Aruba) was the company's 30-day average unaffected market price prior to announcement of its acquisition by Hewlett-Packard Company (HP) and directed the trial court to enter a final judgment for petitioners for the deal price minus synergies estimated by HP.

The opinion reinforces the Supreme Court's 2017 decisions in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*[2] and *DFC Global Corp. v. Muirfield Value Partners, L.P.*,[3] which, as the Supreme Court in Aruba explained, 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, as a matter of economic reality and theory."[4]

Background

In August 2014, HP approached Aruba, a public company, about a potential combination. Aruba hired professionals and began to shop the company. But no other strategic bidder was interested, and petitioners did not argue that any equity bidder could compete. After several months of negotiations, the Aruba board accepted HP's offer of $24.67 per share. News of the deal leaked two weeks later, causing Aruba's stock price to jump from $18.37 to $22.24. The next day, Aruba released quarterly results that beat analyst expectations. Its stock price rose by 9.7%, to just above the deal price.

Trial Court Decision

Citing the Delaware Supreme Court's decisions in *Dell* and *DFC*, the Court of Chancery determined that the fair value of Aruba was $17.13, the 30-day average unaffected market price, on the theory that "once Delaware law has embraced a traditional formulation of the efficient capital markets hypothesis," the unaffected market price provides a "direct route" to fair value for a company with certain attributes.[5] The trial court found that the deal price minus synergies was a "ceiling" on fair value, but declined to adopt this measure as fair value because it would need to back out theoretical reduced agency costs from the deal price, which, in the trial court's view, was subject to human error.[6]

[1] No. 368, 2018, slip op. (Del. Apr. 16, 2019) (*per curiam*) (*Aruba II*).

[2] 177 A.3d 1 (Del. 2017).

[3] 172 A.3d 346 (Del. 2017).

[4] No. 368, 2018, slip op. at 13.

[5] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, C.A. No. 11448-VCL, slip op. at 6 (Del. Ch. Feb. 15, 2018).

[6] *Id.* at 87; *Aruba II*, No. 368, 2018, slip op. at 7.

Supreme Court Reversal

The Delaware Supreme Court reversed the Court of Chancery's decision, forcefully rejecting its sole reliance on the 30-day unaffected market price and deciding that the "price that HP paid could be seen as reflecting a better assessment of Aruba's going-concern value."[7]

Specifically, the Supreme Court rejected the trial court's view that *Dell* and *DFC* "compelled" reliance on the unaffected market price as the sole indicia of fair value because that view was not supported by "any reasonable reading of those decisions or grounded in any direct citation to them."[8] The court also observed that "the 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."[9] That was the situation in *Aruba*, where HP knew about Aruba's strong quarterly earnings before they were disclosed to the market. Procedurally, the Supreme Court also criticized Aruba for failing to argue market price as fair value until well after trial. Therefore, the court determined, "the extent to which the market price approximated fair value was never subjected to the crucible of pretrial discovery, expert depositions, cross-expert rebuttal, expert testimony at trial, and cross examination at trial."[10]

However, aside from those issues, consistent with *Dell* and *DFC*, the court reaffirmed the "traditional Delaware view" that "the price a stock trades at in an efficient market is an important indicator of its economic value that should be given weight."[11] The Supreme Court explained that "*DFC* and *Dell* 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, as a matter of economic reality and theory."[12] The court also emphasized the "long history of giving important weight to market-tested deal prices" in Delaware law.[13]

The Supreme Court then noted that the trial court itself concluded that the transaction involved "enormous synergies" and that the deal price operated as a ceiling.[14] But the Supreme Court rejected the trial court's "theory that it needed to make an additional deduction from the deal price for unspecified 'reduced agency costs'" as unsupported by the record or corporate finance literature.[15] The Supreme Court explained that "the Court of Chancery's belief that it had to deduct for agency costs ignores the reality that HP's synergies case likely already priced any agency cost reductions it may have expected," and indeed, the "record provides no reason to believe that those estimates omitted any other added value HP thought it could achieve because of the combination."[16]

To avoid "burden[ing] the parties with further proceedings," the Supreme Court simply "order[ed] that a final judgment be entered for the petitioners in the amount of $19.10" — Aruba's estimation of deal price less synergies — "plus any interest to which the petitioners are entitled."[17]

[7] *Aruba II*, No. 368, 2018, slip op. at 19.
[8] *Id.* at 13.
[9] *Id.* at 19.
[10] *Id.* at 21-22.
[11] *Id.* at 18.
[12] *Id.* at 13.
[13] *Id.*
[14] *Id.* at 25.
[15] *Id.* at 9.
[16] *Id.* at 11.
[17] *Id.* at 26.

Takeaways

- *Aruba* reaffirmed the Supreme Court's view that the deal price is a strong indicator of fair value when a public company has a deep trading market and was sold at a substantial premium in a process in which all interested buyers had a fair and viable opportunity to bid.
- Where a merger agreement allows for superior bids, a lack of other buyers does not signal a market failure.
- A court may potentially consider a strategic acquirer's calculation of synergies as the synergies estimate.
- While the unaffected market price of a company's stock in an efficient market may not result in the most reliable indicia of fair value, it remains "an important indicator of ... economic value that should be given weight."
- To ensure that any proposed valuation is considered by the court, litigants must advocate for and present evidence at trial in support of any valuation metric relied upon to prove fair value.