Delaware Appraisal Decisions Chart Separate Courses From *Aruba*

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The Delaware Supreme Court's April 2019 decision in *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc*. reversed the Delaware Court of Chancery's finding that unaffected market price was fair value, holding instead that deal price minus synergies was the more reliable indicator of fair value. *Aruba* underscores the importance of deal price as an indicator of fair value "absent deficiencies in the deal process." The ruling also marks the third time in three years that the Supreme Court has reversed a Court of Chancery decision for underweighting deal price (*Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd* and *DFC Global Corp. v. Muirfield Value Partners, L.P.* are the other two cases).[1]

Three appraisal decisions have since been issued by the Court of Chancery interpreting *Aruba*: (1) *In re Appraisal of Jarden Corporation*, July 19, 2019, in which the court found that the unaffected market price was the most reliable indicator of fair value, and the deal price was not reliable because the "sale process left much to be desired"; and (2) *In re Appraisal of Columbia Pipeline Group, Inc*., August 12, 2019, and (3) *In re Stillwater Mining Company*, August 23, 2019, both in which the court ruled that the respective deal prices were fair value, even though market evidence in both cases indicated that trading prices could be persuasive indicators of value. While the first Court of Chancery appraisal decision following *Aruba* relied on the unaffected market price because of deficiencies in the deal process, the two appraisal decisions since have found that the deal price was the most reliable indicator of fair value. Moreover, none of the Court of Chancery's appraisal decisions since *Aruba* have meaningfully relied on traditional valuation analyses, such as discounted cash flow analyses.

Aruba Underscores Preference for Deal Price Over Market Evidence

The Court of Chancery's opinion in *Aruba* gave exclusive weight to the "unaffected market price," defined as the average market price during the 30-day period predating the merger announcement. The court explained that the unaffected market price ($17.13 per share) was a more reliable indicator of fair value than the deal price minus the buyer's estimated synergies ($19.10 per share).

The Supreme Court reversed, holding instead that the deal price minus the buyer's estimated synergies constituted fair value, and stating that the trial court's interpretation of *Dell* and *DFC* suggested that trading prices should be treated as exclusive indicators of fair value, but that interpretation is "not supported by any reasonable reading of those decisions." The Supreme Court also held that its decisions in *Dell* and *DFC* recognized that when a public company trades in an efficient market, its market price is an important indicator of its economic value. However, when that public company is sold at a substantial premium to the preannouncement market price, after a process in which interested buyers all had a fair and viable opportunity to bid, the deal price likely is strong evidence of fair value. Likewise, when the deal price is further informed by the efforts of arm's-length buyers of the entire company to learn more through due diligence, involving confidential nonpublic information, and with the keener incentives of someone considering taking the non-diversifiable risk of buying the entire entity, the resulting price is even more

[1] See our client alerts concerning *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, "Dell and Fair Value in Statutory Appraisal Actions," (May 29, 2018) and *DFC Global Corp. v. Muirfield Value Partners, L.P.*, "Delaware Courts Continue to Define Appropriate Valuation Methodologies for Statutory Appraisal," (November 21, 2017).

likely to be indicative of fair value. In other words, "HP [the buyer] had more incentive to study Aruba closely than ordinary traders in small blocks of Aruba shares, and also had material, nonpublic information that, by definition, could not have been baked into the public trading price."

Moreover, the Supreme Court held that its decisions in *Dell* and *DFC* did not discount the importance of competition, but rather recognized that a single-bidder sale process that provides an open opportunity for many potential buyers is not necessarily a "failure of competition." As the Supreme Court explained, "[i]t cannot be that an open chance for buyers to bid signals a market failure simply because buyers do not believe the asset on sale is sufficiently valuable for them to engage in a bidding contest against each other." Accordingly, the Supreme Court ordered that final judgment be entered in the amount of $19.10 per share plus any interest, which was the deal price minus Aruba's estimate of synergies.

Jarden Still Relies on Unaffected Market Price Post-*Aruba*

In its first post-*Aruba* appraisal decision, the Court of Chancery issued its post-trial opinion in *Jarden* on July 19, 2019, ruling that the "unaffected market price" was fair value.[2] The court found that the unaffected market price ($48.31 per share) was a more reliable indicator of fair value than the deal price ($59.21 per share) and the respondent's calculation of deal price minus synergies ($46.21 per share). Thus, *Jarden* demonstrates that market price still has a role in the appraisal function, especially when deficiencies are found in the sale process that render the deal price unreliable.

In *Jarden*, the unaffected market price, on the one hand, was a reliable indicator of fair value corroborated by "market evidence," including "unrebutted expert testimony" coupled with an event study of the market's response to Jarden's material announcements, Jarden's public float of 93.9%, its heavy trading volume, its coverage by "numerous professional stock analysts," its "narrow bid-ask spread" and its decision "to finance a sizeable acquisition just prior to the Merger (in the midst of negotiations) with an equity offering valued at $49.00 per share." Moreover, the court found "no credible evidence that material information bearing on Jarden's fair value was withheld from the market as of the Merger" and the unaffected market price was not stale by the time the merger closed.

The deal price, on the other hand, was not a reliable indicator of fair value, with or without synergies backed out. The court explained that the deal price was unreliable because the "sale process left much to be desired." In particular, Jarden's lead negotiator acted with "little to no oversight by the Board" and suggested "a price range the Board would accept to sell the Company before negotiations began in earnest." The sale process lacked a "pre-signing or post-signing market check." The parties agreed that attempting to back out synergies "was especially difficult in this case." Nevertheless, the court considered, as a reality check, the deal price less synergies value ($46.21 per share) as proffered by the respondent.

As to the traditional valuation methodologies, the court found unreliable the petitioners' "comparable company/market multiples analysis," which resulted in a value of $71.35 per share. The court noted that petitioners' analysis would imply that "the market mispriced Jarden by over $5 billion." Similarly, the court disagreed with both the petitioners' and respondent's discounted cash flow analyses. Instead, the court performed its own discounted cash flow analysis that resulted in a valuation of $48.13 per share, which was adjusted to $48.23 per share in the court's September 16, 2019, order on petitioners' motion for reargument. The court found that its own discounted cash flow analysis merely corroborated its determination that the unaffected market price of $48.31 per share was fair value.

[2] In *Jarden*, the "unaffected market price" was the closing price on the day prior to the merger announcement, as opposed to the 30-day average used in *Aruba*.

Columbia, Stillwater Defer to Deal Price

In the Court of Chancery's August 2019 appraisal decisions in both *Columbia* and *Stillwater*, the court deferred to the deal price after determining that the sale process in each case involved "objective indicia of deal-price fairness." Likewise, in both decisions, the court rejected adjustments to the deal price for lack of concrete, quantifiable amounts and accorded no weight to market prices or discounted cash flow analyses because in the presence of a reliable deal price, other less reliable indicators would inject error into the fair value determination. Thus, both *Columbia* and *Stillwater* underscore the continuing trend to defer to deal prices that result from sale processes with objective indicia of fairness.

Columbia

In *Columbia*, the Court of Chancery ruled that the deal price of $25.50 per share was fair value. After extensively reviewing the Supreme Court's three recent decisions in *DFC*, *Dell* and *Aruba*, the court explained that each of these decisions endorsed using deal price in an arm's-length transaction as evidence of fair value. However, the court noted that each decision weighed in on aspects of the sale process that made the deal price a reliable indicator of fair value.

The court's analysis in *Columbia* began by identifying six "objective indicia of deal-price fairness": (1) the merger in *Columbia* was an arm's-length transaction with a third party, (2) the board had no conflicts of interest, (3) the buyer conducted due diligence that included confidential insights into Columbia's value, (4) the pre-signing market check included outreach to potential buyers providing them a free chance to pursue a merger, (5) the seller extracted multiple price increases from the buyer and (6) the post-signing market check permitted superior bids, and none emerged. In sum, the court found that the sale process bore enough objective indicia of deal-price fairness to render the deal price a persuasive and reliable indicator of fair value.

The *Columbia* opinion proceeded to address, in turn, the petitioners' several challenges to the sale process, including that:

- management possessed conflicts of interest that resulted in "a fire sale of Columbia to obtain personal benefits";
- "Columbia favored TransCanada over opportunities with other buyers";
- standstill arrangements with potential suitors distinguished Columbia from past precedent;
- management created an information vacuum insulating Columbia's board during the sale process;
- the stockholders' vote was uninformed; and
- the deal protection devices undermined the validity of the deal price.

However, the court did not find any of these challenges to be persuasive evidence of an unreliable sale process because the petitioners failed to show that the deal price "left a portion of Columbia's fundamental value on the table," and "any other serious bidders were not precluded from coming forward, yet none did."

The court in *Columbia* also rejected the respondent's request for a downward adjustment to the deal price to account for synergies and eliminate elements of value arising from the merger. The court explained that the respondent had not carried their burden to prove that any downward adjustment was warranted, and the court noted the irony that the respondent's expert used a discounted cash flow analysis to show synergies valued at $4.64 per share, while also rejecting the use of a discounted cash flow analysis to show fair value.

The court in *Columbia* concluded with a summary analysis of the market price and the parties' respective discounted cash flow analyses. The court held that it need not determine the reliability of the market price because it found that the deal price was a reliable and persuasive indicator of fair value. Nevertheless, the court indicates that it has considered the market price and determined that the deal price is a more reliable indicator, noting that "[r]elying on trading price would only inject error into the fair value determination." The court similarly dispatched the parties' discounted cash flow analyses, explaining that there is no need to "call the balls and strikes of the valuation inputs" because "a DCF valuation is [not] likely to provide a reliable indication of fair value" when a company is "publicly traded, widely held, and sold in a process that began with pre-signing outreach and finished with an open, albeit passive, post-signing market check."

Stillwater

In *Stillwater*, the Court of Chancery determined that the deal price of $18.00 was fair value. The petitioners argued that fair value was $25.91 based on their expert's discounted cash flow model. The respondent contended that fair value was $17.63, based on a combination of the deal price, adjusted trading price and their expert's discounted cash flow model. The court concluded that the deal price was "the most persuasive indicator of fair value," and "[r]elying on any of the other valuation metrics would introduce error."

The court's opinion in *Stillwater* bears many similarities to the opinion in *Columbia*. Like in *Columbia*, the *Stillwater* opinion begins by identifying "objective indicia" that "suggest that the deal price was a fair price": (1) the merger was "an arm's length transaction with a third party," (2) "the Board did not labor under any conflicts of interest," (3) the buyer "received confidential information about Stillwater's value" in due diligence, (4) the company "extracted multiple price increases " and (5) "no bidders emerged during the post-signing phase." The court concluded that, while fewer than the indicia in *DFC*, *Dell* or *Aruba*, "the objective indicia that were present provide a cogent foundation for relying on the deal price as a persuasive indicator of fair value."

Also like in *Columbia*, the court in *Stillwater* proceeded to address the petitioners' several challenges to the reliability of the sale process, including that:

- Stillwater engaged in "a single bidder strategy in which it only interacted with [the buyer] before signing the Merger Agreement" and performed "no pre-signing outreach";
- the CEO pursued the buyer's indication of interest without board authorization;
- the CEO had personal interests in the transaction based on his desire to leave Stillwater;
- the board failed to exercise meaningful oversight;
- the financial advisor did not have time to run a meaningful presigning market check;
- the buyer pressured Stillwater to sign a merger agreement while the price of Stillwater's primary product, palladium, was rising;
- the deal protection devices prevented stockholders from capturing the value of an increasing market price; and
- the stockholders' vote was uninformed.

In response to the petitioners' challenges to the presigning phase, the court explained that even "if Stillwater had pursued a single-bidder strategy," the deal price would still provide persuasive evidence of fair value because there was "a meaningful post-singing market check." Relying on the Delaware Supreme Court's opinion in *C & J Energy Services, Inc. v. City of Miami General Employees and Sanitation Employees Retirement Trust* and other precedent involving "enhanced scrutiny" in breach of fiduciary duty cases, the court held that the sale process satisfied "enhanced scrutiny jurisprudence" and "the deal price will provide persuasive evidence of fair value in an appraisal proceeding involving a publicly traded firm if the sale process would satisfy enhanced scrutiny in a breach of fiduciary duty case." Likewise, in response to the challenges concerning the rising price of palladium, the court reasoned that the merger agreement "was not attempting to give the stockholder the benefit of a transaction that included the potential upside or downside that would result from changes in the price of palladium after signing"; rather, the merger agreement "was trying to provide stockholders with the ability to opt for the comparative certainty of deal consideration." Furthermore, the court declined to adjust the deal price for any changes in value between signing and closing because the petitioners failed to carry their burden by "identifying a persuasive reason for the change and proving the amount." In sum, the court determined that the sale process was reliable "given the arm's-length nature of the Merger, the premium over market, and the substance of what took place during the sale process."

The court also rejected the respondent's argument that a downward adjustment was appropriate because the respondent failed to prove "a quantifiable amount that the court should deduct from the deal price." Likewise, after considering the parties' respective positions concerning the adjusted market price, including their arguments about the factors of market efficiency and their respective experts' event studies, the court accorded no weight to the market price because there was "sufficient reason for concern," and the deal price provided an available alternative "market-tested indicator." The court also did not accord any weight to the parties' respective discounted cash flow analyses because these analyses were undercut by the legitimate debates among their respective experts concerning the inputs, and the deal price provided an alternative "market-based metric."

Implications

Directors and officers of corporations considering a transaction that may give rise to appraisal rights should evaluate the following implications of recent decisions:

- *Aruba* and the Court of Chancery's subsequent appraisal decisions make clear that, while there is no judicial presumption in favor of deal price, Delaware courts continue to rely on the deal price to determine fair value so long as the sale process has objective indicia of deal-price fairness.
    - When the sale process leaves much to be desired, however, *Jarden* demonstrates that unaffected market price may still provide a reliable indicator of fair value even after *Aruba*, and a finding that the deal price is unreliable does not necessarily mean that the fair value will be greater than the deal price.
    - When the sale process contains objective indicia of deal-price fairness, *Columbia* and *Stillwater* show that a respondent must prove synergies to reduce fair value below the deal price, and Delaware courts are weary to accord any weight to traditional valuation analyses if there is a legitimate debate among competing experts concerning the inputs.
- The consistent flow of Delaware opinions finding fair value at or below deal price likely has a deterrent effect on stockholders considering seeking appraisal in public company transactions.