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VERITION V. ARUBA NETWORKS: SOME ANSWERS AND SOME QUESTIONS ABOUT MARKET EFFICIENCY IN DELAWARE COURTS

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The Delaware Supreme Court has issued its long-awaited decision in the *Aruba Networks* appraisal action, awarding the dissenting stockholders statutory "fair value" equal to the merger price less the seller's share of synergies in the deal.[1] The Delaware Court of Chancery[2] had read the Delaware Supreme Court decisions in the *Dell*[3] and *DFC*[4] appraisal cases to portend a paradigm shift for stockholder litigation involving publicly-traded companies, leading to an even lower fair value award measured by Aruba's pre-merger "unaffected" stock price.[5] The Supreme Court Decision reversed the Court of Chancery, concluding that its reading of *Dell* and *DFC* "was not supported by any reasonable reading of those decisions."[6] Rather than dilate on *Dell* and *DFC*, the Supreme Court grounded its decision on the appraisal statute and the first principles laid down in old Delaware chestnuts, including *Cavalier Oil*[7] and *Weinberger*.[8]

The result is a 28-page Supreme Court Decision that articulates its disagreements with the Court of Chancery's approach, but leaves many questions raised by the Court of Chancery decisions unanswered. After providing the basic background facts of the transaction as found by the Court of Chancery, this article walks through the history of this litigation and highlights some of the questions that remain for transaction planners, litigators, and the Delaware Courts to explore in future case-by-case development.

Transactional Facts

Tech giant Hewlett Packard approached Aruba Networks in August 2014 about an acquisition. Aruba hired Qatalyst Partners as its financial advisor and the parties began discussions and due diligence. Aruba also quietly tested its market, approaching five potential strategic acquirors. None were interested. Meanwhile, HP began recruiting Aruba's CEO to run the business post-closing, in violation of the parties' confidentiality agreement. Following an earnings announcement and a fall in Aruba's stock price, Aruba terminated its discussions with HP in November 2014.[9]

By January 2015, HP and Aruba had reengaged, but they had a banker problem: HP refused to negotiate with Qatalyst. Aruba solved its problem by engaging Evercore to handle the negotiations with HP, but the problem ran deeper than this deal for Qatalyst, who was desperate to repair its fractured relationship with HP.[10] HP forced Qatalyst into the background, but their relationship history

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and the presence of a large, active buyer gave both sell-side bankers a conflicting incentive to develop or improve their relationships with HP.[11]

In late January, HP made an opening bid at $23.25 per share. With its stock price at a 52-week low, Aruba recognized it was in a position of weakness, but countered at $29.00 per share. In response, HP countered with a "best and final" offer at $24.67. After trying to get to $25.00, Aruba accepted the next day. The deal price represented a 51.6% premium to Aruba's closing price, and a 48.9% premium to its 30-day average.[12]

Litigation History

The parties tried the case in December 2016, and completed their post-trial briefs by the following March. Using a discounted cash flow analysis, the petitioner argued that Aruba's fair value was $32.57 per share.[13] Aruba relied on the merger-price-less-synergies approach and argued that fair value was $19.10 per share.[14]

The Court of Chancery postponed the closing argument to give the parties the opportunity to address the Supreme Court's forthcoming *DFC* decision. After supplemental briefing and post-trial argument, the Supreme Court issued its *Dell* decision. Once again the Court of Chancery invited the parties to submit briefs addressing the new authority, which they did in January 2018.[15]

The Court of Chancery issued its Post-Trial Decision in February 2018. Relying heavily on *Dell* and *DFC*, the Court of Chancery concluded that the best evidence of Aruba's fair value was its "thirty-day average unaffected market price" of $17.13 per share.[16] In so doing, it rejected both sides' DCF valuations, and concluded that the unaffected market price was a more reliable estimate of the value of Aruba as a going concern than a deal-price-less-synergies approach.[17]

Dismayed by the prospect of receiving less than what Aruba had argued, the petitioners moved for reargument. In its opinion denying reargument, the Court of Chancery acknowledged that it "relied heavily on the Delaware Supreme Court's recent decisions in *Dell* and *DFC*," and that in its view, "the *Dell* and *DFC* decisions represented a change in direction for Delaware appraisal law."[18]

The petitioners appealed, and the Supreme Court wholeheartedly disagreed with the Court of Chancery's view. The Supreme Court rejected the perceived novelty of *Dell* and *DFC*,[19] and the Court of Chancery's consequent use of Aruba's unaffected market price as the best evidence of fair value. As the high court explained, *Dell* and *DFC* merely "reaffirm[ed] the traditional Delaware view, which is accepted in corporate finance, that the price a stock trades at in an efficient market is an important indicator of its economic value that should be given weight."[20] But "when that market price is further informed by the efforts of arm's length

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buyers of the entire company to learn more through due diligence, involving confidential non-public information, and with the keener incentives of someone considering taking the non-diversifiable risk of buying the entire entity, the price that results from that process is even more likely to be indicative of so-called fundamental value."[21] In other words, the Supreme Court held that deal price is more reliable evidence of value than stock market price, at least where there is material non-public information and a time lag between the "unaffected date" and the closing date.[22]

As a result, the Supreme Court reversed and remanded the case. It instructed the trial court to "enter a final judgment for the petitioners awarding them $19.10 per share, which reflects the deal price minus the portion of synergies left with the seller as estimated by the respondent in this case, Aruba."[23]

Remaining Questions

On the heels of *Dell* and *DFC*, *Aruba* leaves little possibility of upside for appraisal petitioners in third-party deals involving public targets. As in *Aruba*, the deal price will likely be the starting point, marking a ceiling on fair value. The unaffected stock price likely will command some evidentiary weight, albeit in a supporting role. Synergies are in play, provided there is reliable evidence in the trial record. But even with those guideposts, several questions remain.

What "deficiencies in the deal process" will a petitioner need to prove to escape the gravitational pull of the deal price? Over the last decade, the Court of Chancery has issued a series of appraisal decisions that outline the contours of what makes a deal process likely to generate a reliable price. No two deals are exactly alike. The analysis thus does not fit neatly into a rigid rubric.

The Supreme Court's *Dell* decision refined this analysis. The Court of Chancery even adopted a shorthand for its new formulation: asking whether a deal process is "*Dell* Compliant."[24] A transaction is *Dell* Compliant "where (i) information was sufficiently disseminated to potential bidders, so that (ii) an informed sale could take place, (iii) without undue impediments imposed by the deal structure itself."[25]

In broad strokes, *Aruba* wouldn't seem to change that analysis, but the devil is in the details. For example, deal protections are "impediments" to the economic engine of a deal process, but probably are not "undue impediments" so long as they fall within a standard deviation of market. And a conflicted sell-side banker or CEO could also be an impediment, but *Aruba* suggests that those conflicts alone would not be "undue impediments."

Litigants will push the envelope further still. Would it be an "undue impediment" for a target board to pursue a pure single-bidder strategy, and rely exclusively on the economic evidence generated by a "window shop," or passive market check?[26] With little concern over a tepid outreach to five uninterested trade bidders, *Aruba* suggests the answer may be no.

Is there any hope for an unaffected market price argument in the future? The Supreme Court Decision in *Aruba* identified three reasons for rejecting the unaffected stock price as reliable evidence of fair value.

- **Stale Unaffected Price:** The Supreme Court criticized the economic usefulness of a stock market price from an unaffected date that was four months before the closing of the merger, which is the relevant valuation date for purposes of an appraisal proceeding.[27]
- **Private Information:** The Supreme Court clarified its endorsement of the efficient capital markets hypothesis as the semi-strong form only, implying informational efficiency but not necessarily a market that is fundamental value-efficient. The Supreme Court thus criticized the usefulness of the unaffected price as not reflecting any material non-public information.[28]
- **Litigation Process:** The Supreme Court criticized the Court of Chancery for its use of the unaffected stock price, when neither party argued for it.[29]

The first two criticisms are economic, the third is procedural. All three are curable.

So what if an appraisal respondent cures them? Assume that an appraisal respondent argues early and often that its unaffected price is the best evidence of value. Assume also that through expert testimony or otherwise, the respondent

creates a trial record that (1) supports the informational efficiency of the market, (2) eliminates the possibility that any value-relevant information remained private on the unaffected date, and (3) provides a sound basis to carry forward the unaffected price to the valuation date. Then what?

It depends. If the Supreme Court had remanded *Aruba* and the respondent had cured these criticisms in a re-trial, the Supreme Court Decision suggests that the deal price less synergies would still carry the day. In a *Dell* and *Aruba* compliant deal process, the acquiror's "much sharper incentive to engage in price discovery than an ordinary trader" would win out.[30] That is a refinement on *Dell* and *DFC*, which both emphasized the crowdsourcing function of markets.[31] It also eases the tension between the Delaware Courts' endorsement of the efficient capital markets hypothesis in appraisal cases and the freedom they have preserved for directors in *Unocal* cases "to function on a theory that they understood better than the public market for the firm's shares what the value of their firm was."[32]

But what about a case involving a weaker deal process? If the Court of Chancery faced a choice between a fairly presented and well supported unaffected stock price and a sky-high DCF valuation, what would be the result? In this way, paradoxically, weaker deal process evidence might increase the likelihood of an unaffected stock price result.

Conclusions

For all the twists and turns in the trial court and the anticipation for the Supreme Court Decision, doctrinally, *Aruba* ends not with a bang but with a whimper. It doesn't change the law. It should help guide the trial court's application of *Dell* and *DFC* in the future. It cements the most likely outcome of an appraisal case involving a third-party deal for a public company as the deal price minus synergies; any deviation from that will require a powerful set of facts.

ENDNOTES:

[1]*Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2019 WL 1614026 (Del. Apr. 16, 2019) (the "Supreme Court Decision").

[2]This refers to the "Post-Trial Decision," 2018 WL 922139 (Del. Ch. Feb. 15, 2018), and the "Reargument Decision," 2018 WL 2315943 (Del. Ch. May 21, 2018).

[3]*Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*, 177 A.3d 1, 20–21 (Del. 2017).

[4]*DFC Global Corporation v. Muirfield Value Partners, L.P.*, 172 A.3d 346, 367–68 (Del. 2017).

[5]*Post-Trial Decision*, at *1 ("The Delaware Supreme Court's decisions in *Dell* and *DFC* endorse using the market price of a widely traded firm as evidence of fair value.") (footnotes omitted); *Reargument Decision*, at *1 ("In a post-trial memorandum opinion dated February 15, 2018, I determined that the fair value of Aruba for purposes of appraisal was $17.13 per share. In reaching this conclusion, I relied heavily on the Delaware Supreme Court's recent decisions in *Dell* and *DFC*. As I read them, those decisions endorsed using the market price of a widely traded firm as an indicator of fair value if the market for the shares of the firm exhibited attributes associated with the premises underlying the efficient capital markets hypothesis.").

[6]*Supreme Court Decision*, at *5.

[7]*Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989).

[8]*Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

[9]*Post-Trial Decision*, at *7-12.

[10]*Post-Trial Decision*, at *13-16.

[11]*Post-Trial Decision*, at *19-20.

[12]*Post-Trial Decision*, at *16-19.

[13]*Supreme Court Decision*, at *2.

[14]*Supreme Court Decision*, at *2.

[15]*Post-Trial Decision*, at *23.

[16]*Post-Trial Decision*, at *55.

[17]*Post-Trial Decision*, at *54.

[18]*Reargument Decision*, at *1, 8.

[19]*Supreme Court Decision*, at *5.

[20]*Supreme Court Decision*, at *6.

[21]*Supreme Court Decision*, at *6.

[22]*Supreme Court Decision*, at *7.

[23]*Supreme Court Decision*, at *1.

[24]*In re AOL Inc.*, 2018 WL 1037450, at *1-2 (Del. Ch. Feb. 23, 2018); *see also In re Appraisal of Solera Holdings, Inc.*, 2018 WL 3625644, at *16 (Del. Ch. July 30, 2018).

[25]*AOL*, 2018 WL 1037450, at *8.

[26]*Cf. C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' and Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1053 (Del. 2014) ("When a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its stockholders a fully informed, uncoerced opportunity to vote to accept the deal, we cannot conclude that the board likely violated its *Revlon* duties.").

[27]*Supreme Court Decision*, at *7.

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[28] *Supreme Court Decision*, at *8.

[29] *Supreme Court Decision*, at *7.

[30] *Supreme Court Decision*, at *8.

[31] *Dell*, 177 A.3d at 25 ("In these circumstances, a mass of investors quickly digests all publicly available information about a company, and in trading the company's stock, recalibrates its price to reflect the market's adjusted, consensus valuation of the company."); *DFC*, 172 A.3d at 370 ("[C]orporate finance theory reflects a belief that if an asset—such as the value of a company as reflected in the trading value of its stock—can be subject to close examination and bidding by many humans with an incentive to estimate its future cash flows value, the resulting collective judgment as to value is likely to be highly informative and that, all estimators having equal access to information, the likelihood of outguessing the market over time and building a portfolio of stocks beating it is slight.").

[32] *Paramount Commc'ns Inc. v. Time Inc.*, 1989 WL 79880, at *19 (Del. Ch. July 14, 1989) ("But just as the Constitution does not enshrine Mr. Herbert Spencer's social statics, neither does the common law of directors' duties elevate the theory of a single, efficient capital market to the dignity of a sacred text. Directors may operate on the theory that the stock market valuation is 'wrong' in some sense, without breaching faith with shareholders. No one, after all, has access to more information concerning the corporation's present and future condition."); *see also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1376 (Del. 1995) ("[T]he directors of a Delaware corporation have the prerogative to determine that the market undervalues its stock and to protect its stockholders from offers that do not reflect the long-term value of the corporation under its present management plan."); *cf. Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 301 (Del. 1996) ("[T]he market price of shares may not be representative of true value.").

WHEN ONE DOOR CLOSES: COURT REQUIRES DIVESTITURE IN LONG-CONSUMMATED MERGER

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Congratulations! Your deal navigated through antitrust review, you closed the transaction, and you are making your way through the three-year integration plan. The target's corporate office was closed, you have transitioned the back-office functions to your personnel and systems, and you have consolidated product lines. Concerns about antitrust risk are long past. "Not so fast," says one federal court.

The U.S. District Court for the Eastern District of Virginia ordered JELD-WEN, Inc. to divest a plant from its October 2012 acquisition Craftmaster International ("CMI"). This is the first case in the Hart-Scott-Rodino Act era (since 1976) in which a court ordered a divestiture in a private merger challenge following a government decision to investigate but not challenge the transaction in court. Although JELD-WEN has appealed the decision, this case may embolden customers or competitors who want to sink a transaction, and escalate risk for merging parties.

One Door Closed

Doorskins are decorative coverings of interior molded doors. For more than a decade, JELD-WEN, CMI, and Masonite were the only doorskin suppliers to independent manufacturers of molded doors. Each company was vertically-integrated and also competed with downstream molded door manufacturers.

After announcing its CMI acquisition in July 2012, JELD-WEN notified the U.S. Department of Justice Antitrust Division ("DOJ"), which opened a preliminary investigation into the competitive effect of the transaction. Prior to the deal, JELD-WEN executed long-term supply agreements with independent door manufacturers as a strategy to "assuage the [antitrust] concerns of the DOJ" and the independent door manufacturers. During its investigation, DOJ interviewed Steves & Sons, Inc. ("Steves"), JELD-WEN's customer (in doorskins) and competitor (in finished doors). Steves did not oppose the acquisition because of price protections in its JELD-WEN supply agreement. DOJ closed its investigation in September and the parties closed the acquisition a month later.

Another One Opens

The supply agreement, which covered 80% of Steves' doorskin requirements, prohibited JELD-WEN from increasing doorskin prices unless JELD-WEN documented