The Delaware Court of Chancery Selected Business Valuation Case Summaries

SELECTED SUMMARIES OF 2019 DECISIONS

INTRODUCTION

Duff & Phelps' experts testify on commercial and shareholder disputes across the world, as well as in the Delaware Court of Chancery, which is widely recognized as one of the nation's leading business courts in terms of volume of complex business-related cases. As a result, the Delaware Court of Chancery (the "Court") has developed significant case law in this area.

This high volume of business cases results in the Court issuing numerous opinions, many of which address business and security valuation and economic damages. In this Court Case Update, we focus on five opinions from 2019 to highlight how certain valuation and damages analysis topics are viewed by the Court. We chose these five opinions based on the valuation themes they represent and the depth of analysis contained in the Court's opinions. In addition, we focus on one Chancery Court decision that was overturned by the Delaware Supreme Court in 2019.

In our review of the cases herein, we have attempted to summarize the salient points related to valuation and damages only. We recommend that interested readers obtain the full Court opinions to gain a complete understanding of all the issues addressed and each judge's position. We have included a hyperlink to each decision below its case caption.

In this Court Case Update, we summarize the following cases:

DELAWARE COURT OF CHANCERY

Kendall Hoyd and Silver Spur Capital Partners, LP v. Trussway Holdings, LLC,
C.A. No. 2017-0260-SG (Del. Ch. February 28, 2019)
Vice Chancellor Glasscock
Issues: projections, beta, terminal value, guideline companies analysis, company specific risk premium
Click here to view the opinion

Neil Smith and NTS, LLC v. Promontory Financial Group, LLC and Promontory Growth and Innovation, LLC,
C.A. No. 11255-VCG (Del. Ch. April 30, 2019)
Vice Chancellor Glasscock
Issues: Discounted Cash Flow ("DCF"), projections, asset approach
Click here to view the opinion

In re Appraisal of Jarden Corporation,
C.A. No. 12456-VCS (Del. Ch. July 19, 2019, Order on Motion for Reargument September 16, 2019)
Vice Chancellor Slights
Issues: unaffected stock price, deal price, DCF, guideline companies, equity risk premium, size premium
July 19, 2019 opinion: Click here to view the opinion
September 16, 2019 order: Click here to view the opinion

In re Appraisal of Columbia Pipeline Group, Inc.,
C.A. No. 12736-VCL (Del. Ch. August 12, 2019)
Vice Chancellor Laster
Issues: deal price minus synergies, unaffected stock price, DCF
Click here to view the opinion

In re Appraisal of Stillwater Mining Company, Consol.
C.A. No. 2017-0385-JTL (Del. Ch. August 21, 2019)
Vice Chancellor Laster
Issues: deal price, synergies, DCF, unaffected stock price
Click here to view the opinion

DELAWARE SUPREME COURT

Verition Partners Master Fund Ltd. And Verition Multi-Strategy Master Fund Ltd. v. Aruba Networks, Inc.,
C.A. No. 11448-VCL (Del. April 16, 2019)
Chief Justice Strine
Justices Valihura, Vaughn, Seitz, and Traynor
Issues: unaffected stock price, deal price, synergies, agency costs
Click here to view the opinion

All dollar amounts are in USD

CASE SUMMARY

Kendall Hoyd and Silver Spur Capital Partners, LP v. Trussway Holdings, LLC, C.A. No. 2017-0260-SG (Del. Ch. February 28, 2019)

Click here to view the opinion

On February 28, 2019, the Delaware Court of Chancery (the "Court") issued a decision regarding the value of the outstanding shares of Trussway Holdings, Inc. (Trussway) in connection with its conversion into an LLC via merger. The case centered on the value of Trussway Industries, Inc (TII), a wholly-owned subsidiary of Trussway, as the parties agreed on the value of Trussway's other corporate assets and liabilities. Vice Chancellor Glasscock relied on a DCF analysis to determine the value of TII, resulting in a combined value of $236.52 per share for Trussway.

The Petitioner's expert estimated a value of $387.82 per share for Trussway, giving 60% weight to a DCF analysis, 30% weight to a comparable companies analysis, and 10% weight to a precedent transaction analysis. The Respondent's expert relied solely on DCF analyses, weighting two DCF's with adjusted projections to arrive at a value of $225.92 per share.

Regarding the comparable company and precedent transaction analyses, the Court concluded that the companies were "too divergent from TII" to provide a reliable indication of value.

While neither party placed any weight on it, the Court also addressed the indications of interest and preliminary offer received as part of a "contemporaneous-but-unconsummated sales process" but concluded that because these indications were preliminary, they were useful only as a "very rough reasonableness check."

Having rejected these alternatives, the Court relied exclusively on the DCF method. In their DCFs, both experts started with management projections, but disagreed as to how the projections should be used. The projections covered a period of nine years, were "used in the course of business, and were also intended for use in the sales process."

In addition to a base case, the projections included additional cash flows from four strategic initiatives. The primary areas of disagreement between the experts related to the appropriate length of the projection period, and whether to include the strategic initiatives.

The Petitioner's expert argued that the projections should be used in their entirety, arguing that there was "no reason to doubt that the forecasts provided…were reasonably prepared on the bases reflecting the best currently available estimates and judgements of the management company." (p.8) The Respondent's expert argued that only the base case projections should be considered (i.e., excluding the strategic initiatives), and that greater weight should be placed on a modified set of projections that only include the first five years.

The Court adopted management's contemporaneous projections as the "best estimate," and noted that "[w]hile a shorter projections period is more common, the nine-year period here is employed in part because TII's business was in the multi-family housing industry, which is cyclical." However, the Court did note a concern regarding "Trussway management's ability (or that of any human prognosticator) to accurately predict corporate performance nine years out, particularly concerning new facets of a business."

Ultimately, the Court equally weighted two DCF values—one derived from the nine-year projections, and one derived from the same forecasts, but applying the terminal year after "a more standard five years." The Court rejected Petitioner's expert's use of a 1% company specific risk premium to account for the uncertainty surrounding the duration and optimistic nature of the projections.

Regarding the strategic initiatives, the Court rejected the Respondent's argument that the strategic initiatives should be

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Kendall Hoyd and Silver Spur Capital Partners, LP v. Trussway Holdings, LLC, C.A. No. 2017-0260-SG (Del. Ch. February 28, 2019)

Click here to view the opinion

considered as "outside the operative reality" of the Company, as the Court in previous matters had incorporated value from potential acquisitions not yet consummated. The Court explained that the strategic initiatives were part of Trussway's operative reality because the company "had the unilateral choice to pursue the initiatives, and projected that they would do so."

For the terminal value, both experts used the Gordon Growth Model with a 2.3% growth rate. Petitioner's expert proposed an equal weighting of the Gordon Growth Model and an exit multiples approach. Vice Chancellor Glasscock deemed the use of the exit multiples approach unwarranted, given his use of management's nine-year projections, including its optimistic growth forecasts.

Finally, on the issue of beta the Court dealt with two topics: (i) whether to use the Blume adjustment and (ii) which method to use to unlever and relever beta. The Court did not adopt the Blume adjustment because it was "unconvinced that adjusted beta would be appropriate for this small, private corporation" and also noted "since I give 50% weight to management's nine-year prediction of cash flows growing at a high rate, any error in applying historic beta is minimized." On the method to unlever/relever beta, the Court adopted the Harris-Pringle model, noting that the difference between the two approaches (Hamada being the other approach) to be de minimus.

CASE SUMMARY

Neil Smith and NTS, LLC v. Promontory Financial Group, LLC and Promontory Growth and Innovation, LLC,
C.A. No. 11255-VCG (Del. Ch. April 30, 2019)

Click here to view the opinion.

On April 30, 2019, the Delaware Court of Chancery (the "Court") issued a decision regarding the valuation of a payout for the Plaintiff Neil Smith ("Smith") upon withdrawing as a member of Promontory Growth and Innovation, LLC ("PGI"). The payout was based on "the de facto LLC agreement" which entitled Smith to a percentage of the value of the LLC at the date of withdrawal, without Smith's continuing services.

PGI, founded by Smith and Eugene Ludwig, provided management consulting services with the goal of improving the profitability and overall performance of financial service and other companies. PGI worked on contingency and charged a fee based on a percentage of the client's profit improvement. The Court explained that PGI's business was sparse, because its services "only appealed to companies of a certain size, and only a few of those companies would be open to a profit improvement project at any given time." Further, application of PGI's profit improvement services was a one-time engagement and did not generate repeat customers.

The Court explained that arriving at a value for PGI in this case was complicated by several factors. First, Smith was a key individual in the business, and the loss of his services therefore had a material impact on the value of PGI. Next, PGI had an "unusual business model" where repeat business was not a factor, and clients varied in size and were available sporadically. This resulted in highly variable performance in the short life of the firm and made revenue projections difficult to develop.

Three separate approaches were put forward by the parties to estimate the value of PGI: an asset approach, a DCF approach, and a valuation based on a contemporaneous proposed transaction.

Defendants put forward a value of zero based on an asset approach, in which its expert assigned value to PGI's assets and liabilities. Defendants claimed that the value of PGI was zero because the fair value of its liabilities exceeded the fair value of its assets. However, the Court determined that an asset approach was inappropriate to value PGI because as a professional services firm, it had few tangible assets. The Court noted that an asset approach tends to undervalue viable service businesses such as PGI and would not properly capture PGI's sales prospects.

The Plaintiffs presented a DCF analysis based on long-term projections for PGI. However, the Court argued that the DCF analysis was unreliable. First, the Court noted the "boom or bust economics" of the business, which had performed services for three companies in four years under Smith, with those three deals generating revenue of (i) less than $1 million, (ii) around $5 million, and (iii) over $130 million. Further, the projections were "effectively stale," and the forecasts from March 2012 had simply been rolled forward to August 2013 without adjustment.

Finally, Plaintiffs suggested a valuation method to assess PGI that relied on a proposed transaction around the time of Smith's withdrawal as a member of the LLC. While the deal was not consummated, the Court determined that the implied enterprise valuation of $16.25 million that was contained in the proposal reflected the agreement of both parties, because the Plaintiffs made the initial proposal and the Defendants agreed to the terms of the deal. This proposed agreement was established near-contemporaneous with Smith's withdrawal.

The $16.25 million valuation reflected the value of PGI with Smith's continuing involvement. However, Smith was only entitled to 50% of the value PGI, without his continuing services. The Plaintiff's expert argued that Smith was responsible for 50% of the value of PGI, and the Court agreed, based in part on the fact that PGI had been formed with Smith and Ludwig as equal partners. The Court noted that while Smith was largely responsible for performing the underlying work at PGI, there was a team of five managing directors that remained who could pitch clients and perform PGI's process in Smith's absence. Therefore, the Court determined that PGI's value without Smith was $8.125 million, or half of $16.25 million. According to the de facto LLC agreement, Smith was owed 50% of that amount, or $4.06 million.

Finally, the Court reduced this amount by $3.13 million, reflecting (i) Smith's portion (i.e., 50%) of the outstanding debt owed by PGI and (ii) Smith's overdrawn capital account.

CASE SUMMARY

In re Appraisal of Jarden Corporation, C.A. No. 12456-VCS (Del. Ch. July 19, 2019, Order on Motion for Reargument September 16, 2019)

Click here to view the opinion.
Click here to view the Order on Motion for Reargument.

On July 19, 2019, the Delaware Court of Chancery (the "Court") issued an appraisal decision regarding the fair value of Jarden Corporation in connection with its April 15, 2016 merger with Newell Rubbermaid, Inc. In its decision, the Court determined the fair value of Jarden based on the Company's unaffected market price of $48.31 per share. The Court found that the unaffected market price was corroborated by other indications of value, including: (i) other market evidence, such as a pre-merger stock offering at $49.00 per share, (ii) the Court's independent DCF analysis, which resulted in a value of $48.13 per share, and to a lesser extent (iii) Respondent's merger-price-less-synergies analysis, resulting in a value of $46.21 per share.

The Court found that Jarden's analysis of the Unaffected Market Price was "corroborated by credible evidence," citing several factors that indicated Jarden stock traded in an efficient market. These indicators of efficiency included that Jarden traded on the New York Stock Exchange, was a member of the S&P 400 index, had a 94% public float, had high trading volume and large market capitalization, had a bid-ask spread of 0.02%, was widely covered by market analysts, and had a stock price that responded to the announcement of value-relevant information "as one would expect in a semi-strong efficient market." For these reasons, the Court determined that the unaffected market price was the most reliable indicator of the fair value of Jarden.

The Petitioners challenged the reliability of Jarden's Unaffected Market Price in three ways: First, they claimed that the market lacked material information concerning Jarden (i.e., information asymmetry) that skewed the trading price. Second, Petitioners argued that the Unaffected Market Price must be adjusted to account for a so-called "conglomerate discount" and a minority discount. Finally, Petitioners asserted that the Unaffected Market Price was stale by the time the merger closed. The Court did not find persuasive evidence to support the Petitioner's arguments, concluding that the market was well informed, rejecting any application of "conglomerate" or minority discounts, and finding no evidence suggesting that the value of Jarden increased between the date set for the unaffected market price and the closing of the merger.

In support of the Unaffected Market Price, the Court also considered other market evidence, a DCF analysis, and the merger price. The Court found contemporaneous internal valuations of Jarden's stock to be reliable evidence of fair value, as they provided an assessment of value "uncluttered by transactional or forensic incentives." The Court highlighted Jarden's decision to finance an acquisition just prior to the merger with an equity offering at $49.00 per share. The Court found that "[w]hile far from dispositive, Jarden's internal efforts to value itself as a going concern for business, not litigation, purposes provides a useful input," and serves as relevant market evidence of Jarden's fair value. After Jarden's stock price fell in early November 2015, Jarden approved a stock buy-back up to $50 million in shares at prices capped at this internal valuation of $49.00 per share, providing further evidence of the Company's view on value.

In considering the deal price as an indication of value, the Court took issue with certain procedural aspects of the transaction, including Jarden's decision to engage in a single-bidder strategy with no pre-signing or post-signing market check, and that Jarden's lead negotiator acted with little oversight by Jarden's board of directors. Another factor limiting the Court's reliance on the merger price was that estimating the value of the synergies and assessing how that value was shared by the parties to the merger was "especially difficult in this case." For these reasons, the Court placed little weight on the deal price less synergies approach, and only considered it as a "reality check" on the final fair value determination.

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In re Appraisal of Jarden Corporation, C.A. No. 12456-VCS (Del. Ch. July 19, 2019, Order on Motion for Reargument September 16, 2019)

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Both Petitioner and Respondent experts performed a DCF analysis to support their fair value conclusions, with results that were "solar systems apart." A large portion of the disagreements related to assumptions for the terminal period, reflecting the performance of Jarden beyond the explicit five-year projection period of the projections. Differences included the long-term growth assumption, estimation of the terminal investment rate, and the discount rate. For the discount rate, differences between the experts included the calculation of beta, the selection of the equity risk premium, and the application of a size premium. The experts both estimated beta using Jarden's historical trading prices and adjusted the beta estimate for cash and financial assets. Petitioners' expert also proposed using comparable company betas, but the Court rejected this approach. For the ERP, both experts relied on the data published in the Duff & Phelps Valuation Handbook. Petitioners' expert applied the supply-side ERP, while Respondent's expert used the midpoint of the supply-side and historical ERP estimates. The Court in this case found the supply-side ERP to be strongly supported by valuation literature, and the mid-point approach to be unexplained and lacking "methodological foundation." Finally, the Court concluded that it was appropriate to apply a size premium, stating that Respondent's expert "provided no credible explanation" for the position that a size premium was not necessary. Ultimately, the Court utilized components of both expert's DCF analyses, resulting in a valuation of $48.13 per share.

The DCF conclusion was adjusted to $48.23 in an Order following a Motion for Reargument, to correct errors made by the Court in structuring the DCF model and calculating the value. For example, depreciation was not added back in the calculation of free cash flow, the cost of debt incorrectly adjusted for tax twice, and the Court's model did not deduct the agreed-upon pension and post-retirement liabilities. Despite the corrections to the DCF, the Court's final fair value determination—based on the unaffected market price—was unchanged.

Finally, the Court rejected the use of a comparable company analysis in this case, concluding that "Jarden had no comparable peers." The Court criticized Petitioners' expert (who relied on the comparable company approach for his fair value conclusion) for relying on the peer set developed by Barclays in connection with the transaction, without doing "any qualitative assessment of any inherent differences between the Jarden business and the business of its peers companies." The Court found that deferring to management's peer set without any independent analysis was "not useful and, frankly, not credible."

CASE SUMMARY

In re Appraisal of Columbia Pipeline Group, Inc., C.A. No. 12736-VCL (Del. Ch. August 12, 2019)

Click here to view the opinion.

On August 12, 2019, the Delaware Court of Chancery (the "Court") issued a decision regarding the fair value of the common stock of Columbia Pipeline Group, Inc. ("Columbia") in connection with the July 1, 2016 merger with TransCanada Corporation. Vice Chancellor Laster determined that the fair value of Columbia was $25.50 per share, equal to the cash consideration paid in the transaction.

In reaching its decision, the Delaware Court of Chancery leaned on the three recent decisions reached by the Delaware Supreme Court, DFC, Dell and Aruba, in which the deal price in an arm's length transaction was endorsed as evidence of fair value.

In this case, the parties proposed three separate valuation methods to value Columbia. TransCanada relied upon a combination of (i) the deal price minus synergies and (ii) Columbia's unaffected trading price, while the Petitioners relied solely on a DCF analysis.

Referencing prior decisions by the Delaware Supreme Court, the Delaware Court of Chancery primarily relied on six factors to conclude that the deal price was an appropriate measure of fair value.

- The merger was an arm's-length transaction with a third party.
- The board did not labor under any conflicts of interest.
- TransCanada conducted due diligence and received confidential insight about Columbia's value.
- Columbia contacted other potential buyers in the pre-signing phase, and none of the potential buyers pursued a merger.
- Columbia negotiated several price increases with TransCanada.
- No bidders emerged in the post-signing phase.

Both Petitioners and Respondent argued for adjustments to the deal price. Respondent TransCanada contended that the deal price should be adjusted downward to eliminate elements of value arising from the Merger. While the Court identified evidence of synergies, it indicated that the "real question [was] the extent to which the deal price included synergies." Ultimately, the Court concluded that while TransCanada likely could have justified a smaller synergy deduction, it claimed a larger and unpersuasive one. Therefore, the Court declined to make any downward adjustment for synergies.

Petitioners argued that if the deal price were to receive any weight, it should be adjusted upward to reflect improvements in value experienced between the signing and closing. However, the Court found that Petitioners failed to prove that Columbia's value increased and failed to prove how any change in value could be translated into an adjustment to the deal price.

TransCanada contended that the unaffected trading price of Columbia was a strong indicator of fair value, while Petitioners contended that it should not be given any weight. Because the Court found the deal price to be the most reliable approach, it considered analysis of the unaffected trading price to be comparatively unimportant. The Court found that the reliability of the unaffected trading price as an indication of fair value did not impact its ability to rely on the deal price.

Petitioners relied solely on a DCF to estimate fair value, while Respondent did not prepare its own DCF. Respondent instead only critiqued Petitioners' DCF.

The Delaware Court of Chancery referenced Delaware Supreme Court decisions in Dell and DFC that cautioned against using the DCF methodology when market-based indicators are available. The Court of Chancery noted the contrast between Petitioners' DCF valuation and contemporaneous market evidence, as Petitioners' valuation of $32.47 per share was 27% higher than the deal price of $25.50 per share and 64% higher than the unaffected trading price of $19.75 per share. The Court also indicated that Petitioners' DCF valuation conflicted with the market behavior of potential strategic acquirers who had shown interest in Columbia but did not step forward to top TransCanada's price. Finally, the Court questioned the utility of a DCF in a case where the terminal value represented 97% of the result, finding that "this back-loading highlights the very real risks" presented by using that methodology.

CASE SUMMARY

In re Appraisal of Stillwater Mining Company, Consol. C.A. No. 2017-0385-JTL (Del. Ch. August 21, 2019)

Click here to view the opinion.

On August 21, 2019, the Delaware Court of Chancery (the "Court") issued a decision in the Stillwater Mining Company (Stillwater) appraisal matter, finding that the $18.00 per share price paid by Sibanye Gold Limited (Sibanye) for Stillwater was the best measure of fair value for the company's shares. The Court concluded that neither the adjusted trading price, as calculated by Sibanye, nor the DCF valuations "provided a persuasive indicator of fair value," and that a reliance on either would "introduce error." As such, Vice Chancellor Laster found the deal price was the best measure of fair value for Stillwater's shares. The Court found that Sibanye failed to meet its burden in establishing any amount for synergies that should be deducted from the deal price, and therefore no such adjustment was made. While Stillwater was the Respondent, the Court refers to Sibanye in its decision, noting: "The respondent in an appraisal proceeding is technically the surviving corporation, but the real party in interest is the acquirer. The petitioners' true opponent in this proceeding was Sibanye."

The Petitioners' expert relied solely on a DCF to arrive at a value of $25.91 per share, while Sibanye's expert contended the value was $17.63 per share, based on the deal price, the unaffected trading price with a timing adjustment, and a DCF. The Court concluded that Sibanye "proved that the sale process was sufficiently reliable to make the deal price a persuasive indicator of fair value." While Sibanye's expert did not account for synergies, the Court rejected Sibanye's argument in its opening brief for the deduction of synergies from the deal price, noting that Sibanye "failed to prove that an adjustment was warranted."

The Court referenced the Delaware Supreme Court's decisions in Dell, DFC and Aruba when discussing the sale process, noting: "The decisions in DFC, Dell, and Aruba are highly informative because they analyze fact patterns in which the Delaware Supreme Court viewed the sales processes as sufficiently reliable to use the deal price as either (i) the exclusive basis for its own fair value determination (Aruba), (ii) as a valuation indicator that 'deserved heavy, if not dispositive weight' (Dell), or (iii) as a valuation indicator that provided 'the best evidence of fair value' (DFC)." The Court cautioned that these decisions do not establish legal requirements for a sale process and noted that evaluation of a sale process is fact-specific and depends on the evidence presented in a given case. While the Petitioners cited to DFC in asserting that deal price deserves weight only if certain criteria are met, the Court noted that DFC "did not identify minimum characteristics that a sale process must have before a trial court can give it weight."

The Court identified certain "objective indicia" of the reliability of the Stillwater sale process, to be used as a starting point for the analysis, based on appraisal decisions in Dell, DFC and Aruba, including that:

- The merger was an arm's-length transaction with a third party.
- The Board was not conflicted, given that six of the seven board members were disinterested, outside directors with the statutory authority to say "no" to a merger.
- Sibanye conducted due diligence and received confidential information about Stillwater's value.
- Stillwater negotiated with Sibanye and extracted multiple price increases.
- No bidders emerged during the post-signing phase, which the Court considered to be "most important."

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In re Appraisal of Stillwater Mining Company, Consol.
C.A. No. 2017-0385-JTL (Del. Ch. August 21, 2019)

Click here to view the opinion.

The Court emphasized that the presence of these factors does not establish a presumption in favor of the deal price, yet their presence "provide a cogent foundation for relying on the deal price as a persuasive indicator of fair value."

The bulk of the Petitioners' objections to the deal price concerned the pre-signing phase, including the general argument that a reliable sales process requires some degree of pre-signing outreach. Vice Chancellor Laster acknowledged that the sales process was "not perfect," but that "the facts of this case, when viewed as a whole, compare favorably or are on par with the facts in C & J Energy, PLX, DFC, DELL, and Aruba … It was an arm's-length transaction. It was approved by an unconflicted Board and by Stillwater's stockholders. And it resulted from adversarial price negotiations between Stillwater and Sibanye. Most significantly, no bidders emerged during the post-signing phase, despite a Merger agreement that contained a suite of deal protections that would pass muster under enhanced scrutiny."

The Court concluded that there was no reason to adjust the deal price for synergies, given that: (i) Sibanye told its stockholders that the deal price did not reflect synergies; (ii) Stillwater's President and CEO at the time of the merger testified at trial that he did not believe there were any synergies; and (iii) Sibanye's valuation expert opined that the evidence he reviewed did not indicate that the deal resulted in quantifiable synergies. The Court noted that while Petitioners argued for an adjustment to the unaffected trading price based on the time between signing and closing, Petitioners made no such argument for an adjustment to the deal price. As such, the Court concluded that Petitioners failed to prove that the deal price should be adjusted upward.

While the Court discussed the arguments made by both parties with respect to Stillwater's trading price, the Court ultimately concluded that "[b]ased on the parties' showings, the trading price is a less persuasive and less reliable valuation indicator in this case than the deal price." However, the Court also noted "[t]his decision does not find that the trading price was so unreliable that it could not be used as a valuation indicator."

The Court also did not rely on a DCF, noting that the experts "disagreed over many inputs, with small changes producing large swings in value." The Court noted that the "legitimate debates over these inputs and the large swings in value they created undercut the reliability of the DCF model as a valuation indicator."

Vice Chancellor Laster noted that there was legitimate debate over DCF inputs, stating that "[i]f this were a case where a reliable market-based metric was not available, then the court might have to parse through the valuation inputs and hazard semi-informed guesses about which expert's view was closer to the truth. In this case, there is a persuasive market-based metric: the deal price that resulted from a reliable sale process."

CASE SUMMARY

Verition Partners Master Fund Ltd. And Verition Multi-Strategy Master Fund Ltd. v. Aruba Networks, Inc.,
C.A. No. 11448-VCL (Del. April 16, 2019)

Click here to view the opinion.

On April 16, 2019, the Delaware Supreme Court reversed the ruling by the Court of Chancery in the Aruba appraisal matter. The Supreme Court accepted Aruba's calculation of fair value at $19.10 per share, 22.6% below the $24.67 per share deal price but above the Court of Chancery's $17.13 market price valuation.

The Supreme Court began its opinion by stating that the Court of Chancery "abused its discretion, based on this record, in arriving at Aruba's thirty-day average unaffected market price as the fair value of the appellants' shares." The Supreme Court also noted that the "trial judge's decision to use the trading price as his sole basis for determining fair value was his alone, and in no way dictated by a rational reading of Dell."

In the initial February 15, 2018 opinion, the Court of Chancery concluded that the fair value of Aruba's common stock on the closing date of its acquisition by Hewlett-Packard was $17.13 per share, more than 30% less than the merger price of $24.67 per share. In the initial opinion, the Court of Chancery considered three different valuation measures: (i) the unaffected market price of Aruba's stock before news of the merger leaked; (ii) deal price minus the portion of synergies left with the seller; and (iii) the two expert witnesses' valuations, which were based primarily on discounted cash flow ("DCF") models.

In weighting the valuation methodologies, the Vice Chancellor relied exclusively on the unaffected trading price, rather than the deal price minus synergies, because the "deal-price-less-synergies figure continues to incorporate an element of value resulting from the merger" in the form of "reduced agency costs that result from unitary (or controlling) ownership." To avoid "double count[ing]" when backing out these theoretical "reduced agency costs" from the deal price, the Vice Chancellor elected to rely exclusively on the stock price. The initial opinion was issued after the Delaware Supreme Court's decisions in DFC and Dell, two Court of Chancery appraisal decisions that were both reversed by the Delaware Supreme Court. The Vice Chancellor had allowed the parties to submit supplemental briefings after the Delaware Supreme Court's rulings. Neither party in the initial matter had argued for the adoption of the stock price as an indication of Fair Value, until, after the Dell reversal, the Vice Chancellor requested supplemental briefing on "the market attributes of Aruba's stock."

In reversing the Court of Chancery decision, the Supreme Court stated that it "appears… that the Court of Chancery would have given weight to the deal price minus synergies absent its view that it also had to deduct unspecified agency costs to adhere to Cavalier Oil's going-concern standard." The Supreme Court found no evidence to support the determination that the reduced agency costs were not included as part of the synergies that were deducted from the deal price.

The Supreme Court also rejected the idea that agency costs might be reduced when a company's ownership is consolidated, stating that unlike a private equity deal, the merger at issue in this case would not replace Aruba's public stockholders with a concentrated group of owners; rather, it would swap out one set of public stockholders for another: HP's. The Supreme Court found 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. In short, the Court of Chancery acknowledged that there were estimates of the synergies expected by HP, and the record provides no reason to believe that those estimates omitted any other added value HP thought it could achieve because of the combination." As part of the Supreme Court matter, Aruba presented the deal price minus synergies value of $19.10 per share as a reasonable estimate of Fair Value.

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Verition Partners Master Fund Ltd. And Verition Multi-Strategy Master Fund Ltd. v. Aruba Networks, Inc.,
C.A. No. 11448-VCL (Del. April 16, 2019)

Click here to view the opinion.

The Supreme Court rejected the Court of Chancery's suggestion that the Supreme Court's recent decisions in DFC and Dell indicated that "Aruba's unaffected market price is entitled to substantial weight" suggesting that "trading prices should be treated as exclusive indicators of fair value." The Supreme Court stated that those decisions found, in an efficient market, that the unaffected market price "can be a proxy for fair value- not the idea that an informationally efficient market invariably reflects the company's fair value in an appraisal or fundamental value in economic terms."

The Supreme Court found that the deal price reflected a better assessment of Aruba's going-concern value than the unaffected trading price because the unaffected trading 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." Similarly, the Supreme Court noted that HP had "material, nonpublic information that, by definition, could not have not been baked into the public trading price."

The Supreme Court also noted concerns regarding "due process and fairness problems in the proceedings." Prior to a supplemental post-trial briefing requested by the trial court, neither party had argued that the unaffected market price was the sole indicator of fair value. Because the Vice Chancellor "introduced this issue late in the proceedings, 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."

The Supreme Court stated that "Aruba's $19.10 deal price minus synergies value is corroborated by abundant record evidence," noting too that "there is no basis to think Aruba was being generous in its evaluation of deal price minus synergies." The Supreme Court found that "Aruba's estimate of $19.10 resulting from that method was corroborated by HP's and Aruba's real-time considerations and Aruba's DCF, comparable companies, and comparable transactions analyses." The Supreme Court accepted Aruba's calculation of Fair Value at $19.10 per share, 22.6% below the $24.67 per share deal price but above the Court of Chancery's $17.13 market price valuation.

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