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The New New Regime in Delaware Appraisal Law

A recent spate of appraisal decisions signals that the Delaware courts will be skeptical of claims that the "fair value" of a company's stock, as determined in a judicial proceeding brought by a dissenter from the merger, will be higher than the price paid in the transaction. To the contrary, in the context of strategic transactions—which may include synergy value to which dissenting stockholders are not entitled under the appraisal statute—Delaware has made clear that the appraised value may well be less than the deal price.

These decisions follow the important and welcome rulings of the Delaware Supreme Court in *DFC* and *Dell* last year. *DFC* and *Dell* were the high court's first detailed appraisal guidance in several years. In *DFC*, the Supreme Court stressed the significance of "real world evidence" and held that the Court of Chancery should defer to the market's view of value rather than a "guess" by a valuation expert hired by a party to the litigation. In *Dell*, the Supreme Court reiterated these points and strongly suggested that the price paid by a third party in a transaction should act as a ceiling in an appraisal valuation: "Fair value entails at a minimum a price some buyer is willing to pay—not a price which no class of buyers in the market would pay."

Last week the Delaware Supreme Court issued its first appraisal decision since *DFC* and *Dell*. In *Merlin Partners, LP* v. *SWS Group, Inc.*, No. 295, 2017 (Del. Feb. 23, 2018), the court summarily affirmed the decision of the Court of Chancery to value SWS, a Texas-based bank acquired by Hilltop Holdings, at $6.38 per share—8% below the merger price. The petitioners were hedge funds that bought shares of SWS solely to dissent from the merger. Their investment was not based on a belief in the value of SWS's business but instead in the value of the lawsuit. Indeed, the only risk the petitioners identified in their SWS investment was that the deal would not be consummated and they would be left holding stock worth less than the purchase price. The Court of Chancery, while not directly relying on the market evidence, noted in its decision that it was "not surprising" that the fair value of the company was below the deal price, as the acquiror had shared some of the value of the synergies it hoped to realize from the deal with SWS's stockholders.

On the same day as the decision in *SWS*, the Court of Chancery issued its post-trial opinion in *In re Appraisal of AOL Inc.*, C.A. No. 11204-VCG (Del. Ch. Feb. 23, 2018), which arose out of the merger of AOL with Verizon. As in *SWS*, hedge funds had purchased shares of AOL's stock after the merger was announced, at above the merger price, solely to seek appraisal; as in *SWS*, the petitioners foresaw "downside" if the deal was not completed and they were forced to hold their shares. The court valued AOL at $48.70 per share—again a meaningful discount to the merger price—and again observed that the deal price likely included synergies that were not properly considered part of the company's fair value as a standalone enterprise.

The *SWS* and *AOL* decisions followed the Court of Chancery's decision earlier this month in [*Verition Partners Master Fund Ltd.* v. *Aruba Networks, Inc.*, C.A. No. 11448-VCL (Del. Ch. Feb. 15, 2018)], in which arbitrageurs bought stock in Aruba to dissent from its announced merger with Hewlett-Packard. The *Aruba* court, interpreting the Supreme Court's teachings in *DFC* and *Dell*, ruled that the most reliable estimate of the fair value of Aruba's stock was the company's 30-day average pre-announcement stock price—a discount of over 30% to the merger price. Yet again, the court noted that this discount was consistent with the holdings of *Dell* and *DFC* that acquirors in strategic mergers typically pay more than fair value for their targets. Importantly, the court observed that aside from typical synergies in strategic transactions, appraisal fair value should also exclude the more general value of reducing agency costs.

While the Court of Chancery deployed different routes to arrive at each of these below-deal price valuations, the results suggest common lessons. Most important is that market evidence matters, and the courts will not readily accept pie-in-the-sky valuations prepared by hired litigation experts that do not correspond to the price investors and buyers with actual money were prepared to put at risk. In an arm's-length deal with a private equity buyer, the merger price should now be seen a reliable indicator of fair value, if not a ceiling, and in a third-party deal with a strategic merger partner, courts may often appraise fair value below the deal price because of the likely presence of synergies in the merger price. These decisions indicate that an investor who does not want to be a long-term stockholder in the target, but instead buys shares only to pursue a lawsuit, cannot confidently be expected to be rewarded in an appraisal. The recent cases may thus be an important step along the way to limiting most appraisal litigation to private company transactions and controller squeeze-outs—the context to which, as many have argued, it should be confined.

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