KIRKLAND **M&A UPDATE**

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Post-*Dell* Appraisal – Still Work to be Done

Recent appraisal decisions show that the Supreme Court guidance in Dell has left some open issues that the trial courts continue to confront.

In the aftermath of the long-awaited Delaware Supreme Court appraisal decisions in *Dell* (which we reviewed in a previous note) and *DFC*, there was cautious optimism that the court's guidance would eliminate or at least significantly reduce the uncertainty that surrounded appraisal proceedings in Delaware courts in recent years. It was hoped that the decisions would improve predictability and consistency in the application of different valuation metrics used to appraise the fair value of target companies.

In both *Dell* and *DFC*, the Supreme Court held that if the deal price resulted from a robust, informed and competitive process and arm's-length negotiations, the trial judge would be required to assign substantial weight to the deal price as evidence of fair value in subsequent appraisal proceedings. While the Supreme Court did not take the final step of adopting a presumption in favor of deal price as the sole measure, the decisions strongly suggested that, if a deal resulted from a well-designed and competitive process, parties could expect that the deal price would be decisive in appraisal.

However, three post-*Dell* and *DFC* appraisal decisions from the Delaware Court of Chancery show that the Supreme Court guidance left some open issues that the trial courts continue to confront.

In *AOL*, VC Glasscock applied the Supreme Court decision by defining a "*Dell* compliant" process — i.e., a sale process in which "economic principles suggest that the best evidence of fair value was the deal price". In his view, the key components were that "(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".

The court noted that AOL entered into a merger agreement with Verizon without first conducting an auction and that the deal protection terms included a customary no-shop, a 3.5% break-up fee, and matching rights. The court also noted a post-signing public statement by AOL's CEO in response to a reporter's question that "I gave the team at Verizon my word, that… this deal is going to happen". VC Glasscock determined that this combination was sufficient to dissuade potential bidders from proactively making a topping bid for AOL and that the process was therefore not "*Dell* compliant". As a result, he dismissed deal price as providing evidence of fair value and instead relied solely on the court's own discounted cash flow analysis (which, perhaps ironically, produced an appraised value per share that was below deal price).

Much like the *Corwin* line of cases has moved fiduciary duty litigation to a post-closing assessment of the adequacy of shareholder disclosure to benefit from the deferential treatment accorded to a fully informed vote of disinterested stockholders, this process assessment means that the appraisal landscape will include a post-closing review of the target's sale process and deal terms to benefit from the deferential treatment accorded to deal price. By determining that fairly customary deal protection terms and public statements (which arguably were consistent with the contractual no-shop) were indicative of a process that was not sufficiently robust to entitle the parties to deference to deal price, the *AOL* decision implies that the determination of whether a sale process was "*Dell* compliant" will be a subjective, fact-specific exercise rather than measurement of the process against an objective and predictable list of factors.

In two recent appraisal decisions by VC Laster in *Aruba Networks* applying his reading of the Supreme Court guidance, the court relied solely on the target's pre-deal unaffected market price (based on the "efficient capital markets hypothesis") and dismissed both deal price and discounted cash flow as less reliable indicators of fair value in this case. He also proposed a different framework for testing the adequacy of the deal process for purposes of gaining deference to the deal price as the best indicator of fair value, laying out a set of four bands of possible grades for the sale process (with the different bands earning an ascending level of respect for the deal price). Notably, the new valuation metric — unaffected market price — potentially could be used even if the sale process was not "*Dell* compliant" if the court determines that the market for the target company stock was efficient prior to the deal announcement.

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The Supreme Court's guidance in *Dell* and *DFC* means that deal price likely will play a significant, and often dispositive, role in appraisal proceedings for deals that result from a well-structured sale process. However, based on the post-*Dell* appraisal decisions, we expect that stockholders seeking appraisal will continue to attack the sale process as a way of overcoming the Supreme Court's clear bias in favor of relying on deal price and instead introducing the traditional discounted cash flow analysis as a means to seek a higher appraisal award. In addition, the use in *Aruba* of unaffected market price as an alternative to deal price leaves open how the Chancery Court will interpret the Supreme Court's guidance as to the preferred valuation metric — deal vs. market price.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

Gilad Zohari
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/gzohari
+1 212 909 3321

Daniel E. Wolf
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dwolf
+1 212 446 4884