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CLIENT ALERT

Clarifying the Scope of *Dell*, Delaware Chancery Court in AOL Appraisal Decision Applies DCF Analysis to Arrive at Fair Value 2.6% Below Deal Price

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As the Delaware Chancery Court continues to grapple with the implications of last year's seminal Delaware Supreme Court decision in *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.*,[1] last Friday Vice Chancellor Sam Glasscock III rejected *Dell*-endorsed market indicators and ascribed full weight to a DCF analysis in *In re Appraisal of AOL Inc.* Finding that the relatively closed process that preceded Verizon Communications Inc.'s 2015 purchase of AOL for $50 per share precluded reliance on deal price as a persuasive indicator of "fair value," Vice Chancellor Glasscock modified the DCF analysis of AOL's expert to reach a per-share value of $48.70, or 2.6% below the deal price.

AOL comes on the heels of Vice Chancellor J. Travis Laster's February 15, 2018 ruling in *Verition Partners v. Aruba Networks, Inc.*[2] Relying explicitly on *Dell*, the *Aruba* decision gave full weight to unaffected pre-deal stock price as the proper measure of fair value, signaling a move away from DCF analyses. In *AOL*, however, Vice Chancellor Glasscock determined that the particulars of the AOL deal process—namely, the no-shop and matching right provisions in the merger agreement and public statements by AOL's CEO that could have impacted the likely emergence of other prospective buyers—negated the legitimacy of transaction price as a measure of AOL's value.

1 For more information, please see our client alert entitled, "Delaware Supreme Court Reverses Chancery Court Decision in Closely Watched *Dell* Appraisal Proceeding" (Dec. 15, 2017), available here.

2 For more information, please see our client alert entitled, "Delaware Chancery Court Embraces Market Price in the First Post-*Dell* Public Company Appraisal Decision" (Feb. 22, 2018), available here.

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In the *AOL* opinion, Vice Chancellor Glasscock identified the following criteria that a transaction must meet before *Dell*'s focus on market indicators becomes applicable: 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." If a transaction is not *Dell* compliant, then, according to Vice Chancellor Glasscock, deal price may not represent "an unhindered, informed, and competitive market valuation," and, therefore, may not offer persuasive evidence of fair value.

In analyzing whether the AOL merger was *Dell* compliant, Vice Chancellor Glasscock found "the matter a close question," as there were several indicia of reasonable competition. At the time of the merger, it was widely known that AOL was "likely in play," AOL spoke with numerous other potential purchasers, there were no major conflicts of interest, and the post-agreement period was not protected by a prohibitive breakup fee. Still, the Verizon merger agreement—unlike the transaction in *Dell*—included a no-shop period and unlimited three-day matching rights, and AOL declined to conduct an auction or actively shop the company once Verizon emerged as a buyer. More concerning, as Vice Chancellor Glasscock repeatedly emphasized, were statements made at the time by AOL CEO Tim Armstrong. After the Verizon transaction was announced, Mr. Armstrong stated publicly that he was "committed to doing the deal with Verizon" and had given the company "his word" that "the deal is going to happen." In the court's view, this "signaled to potential market participants that the deal was done, and that they need not bother making an offer."

Due to these concerns, the AOL merger was deemed not *Dell* compliant. Vice Chancellor Glasscock further concluded that deal price not only warranted no deference, but should not be given any weight at all, as there is no "principled way to use deal price under [such] circumstances." Instead, as the parties themselves both advocated, the court undertook a DCF analysis in order to determine fair value, with transaction price relegated to the role of "a check on that DCF valuation."

Vice Chancellor Glasscock began his DCF analysis by dismissing the plaintiff's expert valuation—$68.98 per share—as unreasonable and potentially the result of impartiality. Instead, he used the valuation provided by the defendant's expert—$44.85 per share—as a starting point. The court next adjusted that price based on four items: "(1) the proper cash flow projections for the DCF; (2) the operative reality assumed in the DCF with regard to two deals [pending with AOL]; (3) the proper projection period and terminal growth rate; and (4) how much of AOL's cash balance must be added back after the DCF." After an extensive analysis of each of these factors, Vice Chancellor Glasscock arrived at a final DCF-based fair value of $48.70 per share, and gave dispositive weight to this result.

The *AOL* opinion did not seriously consider pre-merger stock price as a factor in its analysis, which is especially noteworthy considering the complete reliance on market price in *Aruba*. In a footnote, Vice Chancellor Glasscock acknowledged the *Aruba* decision and the potential usefulness of "an efficiently derived stock trading price" as "a check on fair value analysis," and noted that the unaffected AOL stock price was $42.59. However, no party in *AOL* advocated a position based on market price or provided evidence concerning the efficiency of the market for AOL stock, and therefore the court did not consider it further.

Appraisal jurisprudence in the Delaware courts is in a relative state of flux after the *Dell* decision. While some commentators announced the death knell of judicial DCF analyses after *Dell*, there is no doubt that the *AOL* decision will reignite this debate. In future appraisal decisions, the Delaware Supreme Court will also likely address the use of the unaffected market price as a proxy for fair value as set forth in *Aruba*. 2018, therefore, will likely be a year for further development of these issues.

If you have any questions about the *AOL* decision or appraisal generally, please contact the following attorneys or the attorney with whom you regularly work.

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