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Another Vice Chancellor Considers Appraisal in Light of *Dell* and *DFC* and Another Appraisal Petitioner Gets Less than Deal Price

However, This Time, the Court of Chancery Relies on DCF Analysis and Not Deal Price or Market Price.

SUMMARY

The Delaware appraisal carousel continued with *In re Appraisal of AOL Inc.*,[1] where Vice Chancellor Glasscock had an opportunity to rethink the appraisal analysis in light of the Delaware Supreme Court's decisions in *Dell*[2] and *DFC*.[3] In his decision, the Vice Chancellor did not rely on deal price in determining fair value because he had concerns that the AOL sale process was short of being what he called "*Dell* Compliant" -- sufficiently "unhindered, informed, and competitive."[4] The Vice Chancellor also did not choose AOL's unaffected market price as the best evidence of fair value as Vice Chancellor Laster did in his recent decision in *Verition Partners Master Fund Ltd.* v. *Aruba Networks, Inc.*,[5] because neither party had argued that the market price was determinative or presented evidence as to the efficiency of the market for AOL's shares. Instead, the Court examined the discounted cash flow ("DCF") analysis presented by AOL of $44.85 per share, adjusted it upward to account for some analytical decisions made by AOL's expert with which the Court did not agree, and concluded that the fair value of AOL at the time of the merger was $48.70 -- $1.30 per share less than the deal price of $50.

BACKGROUND FACTS

At issue was the June 2015 merger between AOL and Verizon. The merger followed several months of talks that started in December 2014 and leaked to the market in January 2015. AOL chose not to

conduct an auction, as it did not want to be seen as "for sale" because, as a technology and media company, doing so would, in its view, materially damage its business relationships.[6] It also believed that the universe of potential buyers was small, and, indeed, despite the leak of the merger negotiations many months before the deal closed, no competing bidder for the company as a whole ever emerged.

In early May 2015, Verizon began its bidding for the company at $47.00 per share and bumped the offer to $50 within a day, but then remained firm at that level throughout the remainder of the negotiations. On May 12, 2015, a deal was announced at $50 per share, with a 3.5% termination fee and a "no-shop" provision although AOL could accept a "superior proposal" subject to Verizon's unlimited three-day matching rights.[7] It was contemplated that, after the merger, AOL's CEO and other senior management would stay on at Verizon. On the day the deal was announced, AOL's CEO gave an interview to CNN in which he stated that:

> I'm committed to doing the deal with Verizon and I think that as we chose each other because that's the path we're on. I gave the team at Verizon my word that, you know, [w]e're in a place where this deal is going to happen and we're excited about it.[8]

No topping bidder emerged during the "no-shop" period, and the merger closed on June 23, 2015.

THE DECISION

Unlike the *Aruba* court, Vice Chancellor Glasscock did not start with a discussion of unaffected market price or market efficiency because, according to a footnote in the opinion, no party had advocated for market price or presented evidence as to the efficiency of the market for AOL shares. The Court thus declined to consider market price because "the use of trading price to determine fair value requires a number of assumptions that, to my mind, are best made or rejected after being subject to a forensic and adversarial presentation by interested parties."[9]

The Court then turned to deal price and noted that, under *Dell*, to be afforded material weight in the "fair value" analysis, the deal price must result from "(i) information [being] sufficiently disseminated to potential bidders, so that (ii) an informed sale could take place, (iii) without undue impediments imposed by the deal structure itself."[10] The Court coined the term "*Dell* Compliant" for a deal price that satisfied these factors.[11]

The Court found that the AOL/Verizon merger fell short of being *Dell* Compliant. The Court accepted AOL's decision not to conduct an auction but was troubled by its decision to agree to a "no-shop" provision instead of a "go-shop" period because "if front-end information sharing is truncated or limited, the post-agreement period should be correspondingly robust."[12] The Court was also concerned that the robustness of the post-signing market was chilled by AOL's CEO's public commitment to the Verizon deal as reflected in his CNN interview and future employment with Verizon, the matching rights, and the discrepancy between the length of time from signing to closing—42 days—and the due diligence period

Verizon was afforded—71 days. Thus, the Court decided to give no weight to deal price in its fair value consideration except as a check on the Court's ultimate conclusion. The Court then turned to the only other evidence of fair value presented by the parties, the DCF analysis of their experts.

The Court did not focus on the petitioners' DCF valuation of $68.98 per share, cryptically explaining that, because AOL "questioned [the petitioners' expert's] impartiality," petitioners were "content to use the DCF model presented by the Respondent's expert as a starting point for [the Vice Chancellor's] analysis."[13] The Court then analyzed that model, accepting part of it but disagreeing with other aspects of it. The Court agreed with the expert's decision to use AOL management's long-term plan projections in the cash flow analysis rather than more optimistic projections prepared for the sale process or a set prepared for a tax-impairment analysis. The Court found that the sale-process projections were more of a "marketing tool" than management's best estimate of future performance and that the tax-impairment projections were driven by a "host of required assumptions that should not, in these circumstances, be used for a DCF analysis."[14] It then reviewed three planned AOL transactions that had been ignored in the expert's analysis and decided that two should be added to the valuation because they were part of AOL's "operative reality" at the time of the merger as they were nearly done deals.[15] The Court also increased to an extent the perpetuity growth rate in AOL's DCF, but agreed with the amount of cash withheld from the DCF as working capital. It made these adjustments to the DCF model and found that they increased the fair value implied by that analysis from $44.85 per share to $48.70 per share, still $1.30 below the $50 deal price. The Court then chose $48.70 as the fair value of AOL as of the date of the merger.

The irony of this result was not lost on Vice Chancellor Glasscock:

> I am cognizant, however, that I am saying two seemingly incongruent things; namely, that AOL's deal process was insufficient to warrant deal price deference at $50 per share—because, due to deal deficiencies, the sales price may not capture the full fair value of the Company—while also holding, based on my DCF analysis, that the value of AOL stock is even *lower*, at $48.70 per share. One explanation for this incongruity is that a deal price may contain synergies that have been shared with the seller in the deal but that are not properly included in fair value.[16]

IMPLICATIONS

AOL takes a different approach to the appraisal analysis than *Aruba*, driven in part by the fact that no party argued that the market price was a proxy for fair value. The most notable takeaways from the decision are that:

- *AOL* is a reminder that process is important, a principle that might be lost in reading *Aruba*, which chose to focus on *Dell*'s and *DFC*'s statements that the objective of appraisal is not to determine whether the shareholder got the "highest conceivable value."[17] These statements do not change the fact that an open sales process is and always has been entitled to more respect in the Delaware courts than one that is closed.

- The Vice Chancellor's footnote about his reluctance to consider market price in the fair value analysis without a forensic presentation would seem to support *Aruba*'s suggestion that, after *Dell*, expert evidence on market efficiency is appropriate in an appraisal case.
- And, finally, *AOL* is another example, similar to *Aruba*, of a court finding that the price in a strategic merger is likely higher than fair value because of synergies, which should not be part of the fair value analysis, and it should thus caution a shareholder seeking appraisal in the strategic merger context.

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ENDNOTES

[1] C.A. No. 11204-VCG, 2018 WL 1037450 (Del. Ch. Feb. 23, 2018).

[2] Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd, --- A.3d ---, 2017 WL 6375829 (Del. Dec. 14, 2017).

[3] DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017).

[4] In re Appraisal of AOL Inc., 2018 WL 1037450, at *1.

[5] C.A. No. 11448-VCL, 2018 WL 922139 (Del. Ch. Feb. 15, 2018).

[6] In re Appraisal of AOL Inc., 2018 WL 1037450, at *4–5.

[7] Id. at *7.

[8] Id.

[9] Id. at *10 n.118.

[10] Id. at *8.

[11] Id.

[12] Id. at *9.

[13] Id. at *11.

[14] Id. at *14.

[15] Id. at *15.

[16] Id. at *21 (emphasis in original).

[17] Verition Partners Master Fund Ltd., 2018 WL 922139, at *41 (quoting DFC Glob. Corp., 172 A.3d at 370).

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