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Delaware Supreme Court Reverses *Dell* Appraisal Decision in Continuation of *DFC* Reasoning

Court Rejects Court of Chancery's Failure to Ascribe Weight to Deal Price or Market Price in Appraisal but Stops Short of Establishing a Deal-Price Presumption

SUMMARY

In *Dell, Inc.* v. *Magnetar Global Event Driven Master Fund Ltd.*, the Delaware Supreme Court's most recent decision on appraisal, the Court rejected the Delaware Court of Chancery's conclusion that, based on the Dell record, the deal price was not a useful metric for determining "fair value" under 8 *Del. C.* § 262, Delaware's appraisal statute.[1] The Court reaffirmed its decision in *DFC Global Corporation* v. *Muirfield Value Partners, L.P.* not to establish a presumption that deal price constitutes "fair value"[2] yet joined *DFC* in strongly suggesting that deal price—assuming a reasonable sale process—merits substantial, and perhaps dispositive, weight.

BACKGROUND

Dell experienced a period of sagging stock performance as the market failed to respond favorably to founder and CEO Michael Dell's strategy, as an answer to the advent of new technologies, to acquire eleven companies between 2010 and 2012 for approximately $14 billion. As a result, Mr. Dell suggested the Dell Board consider a management buyout ("MBO") and, in response, the Board established a special committee to consider strategic alternatives.

The Committee chose to explore an MBO, determining that there was a low probability strategic buyers would be interested in the company. It spoke to a number of potential financial buyers, notably KKR, Silver Lake, and Texas Pacific Group. Mr. Dell cooperated in the process throughout. On February 5, 2013, the Company signed a merger agreement with the Silver Lake group calling for cash consideration of $13.65 per share. The agreement also provided for a 45-day go-shop and a commitment by Mr. Dell, who owned 15.4% of Dell's stock, to vote his shares for any "Superior Proposal" that arose from the go-shop in the same proportion as the unaffiliated shares. Were the Silver Lake deal to close, Mr. Dell would have owned 74.9% of Dell and Silver Lake the remaining 25.1%.

During the go-shop period, the Committee's financial advisor contacted 67 parties, including both prospective strategic and financial buyers. Blackstone (with due diligence led by a former Dell senior executive), Carl Icahn, and GE Capital (for Dell's financial services business) made bids during this period. Mr. Dell made himself available to all bidders for due diligence and indicated to the Board he was willing to work with whichever buyer the Board chose. At the end of the process, the Silver Lake buyout group agreed to bump its price to $13.75 cash per share with a one-time cash dividend of $0.13 per share (financed by Mr. Dell taking less consideration for his shares). Dell's shareholders approved the deal on September 12, 2013 and the deal closed in October. Holders of over 38 million shares sought appraisal.

THE COURT OF CHANCERY'S DECISION

Rejecting the fair value assessments of both parties—$12.68 by Dell (but conceding fair value could be as high as the deal price) and $28.61 by the shareholders—the Court of Chancery created its own DCF analysis by modifying those presented by the parties and arrived at a fair value of $17.62 per share. The Court disregarded Dell's pre-transactional stock price and the deal price in reaching its fair value determination because of its perception of the pre-transaction trading dynamics in Dell shares and a view that price discovery in the sales process was not reliable.

The Court found that the initial marketing period was flawed because no strategic buyers were solicited and the Board's focus on obtaining a premium to market price did not recognize the "valuation gap" caused by "investor myopia" concerning the short term rather than the potential long term benefits of Mr. Dell's acquisition strategy. The Court's decision, which came out before *DFC*, also asserted that bids by financial buyers should be discounted because of the internal rates of return expected by such buyers. The Court also found that the go-shop did not cure these flaws because go-shops in MBOs of complex companies receive lackluster responses attributable to, among other things, the "winner's curse"—a concern that outbidding management, which must know the company better, is foolish—and that, in the case of Dell, Mr. Dell would be perceived as a critical part of any post-transaction company.

THE SUPREME COURT'S DECISION

The Supreme Court reversed the Court of Chancery and remanded for further consideration because it found that the Court of Chancery's decision to give no weight to the deal price "runs counter to its own factual findings."[3] In fact, the Court found that "the record, as distilled by the trial court, suggests that the deal price deserved heavy, if not dispositive, weight."[4] The Court reiterated its holding in *DFC* that creating a presumption in favor of the deal price was not consistent with the appraisal statute's directive to consider all relevant factors. Yet, it explained this did not mean that, in a particular case, one such factor, such as the deal price, may not rise above the others in significance. Here, the Supreme Court found, "the weight of evidence shows that Dell's deal price has heavy, if not overriding, probative value."[5]

As in *DFC*, the Supreme Court rejected the notion that the price of a deal with a financial sponsor should be discounted because of the sponsor's need to achieve a specified internal rate of return, especially in circumstances such as Dell where the Special Committee "choreographed the sale process to involve competition with Silver Lake at every stage, both pre-signing and during the go-shop."[6] The Court quoted *DFC*'s reasoning that "all disciplined buyers, both strategic and financial, have internal rates of return that they expect in exchange for taking on the large risk of a merger, or for that matter, any sizeable investment of its capital."[7]

The Supreme Court also found no record basis for the Court of Chancery's perceived "valuation gap" between Dell's trading price and "fair value." The Supreme Court stated that the record demonstrated that the market, aided by the many analysts who followed Dell, had efficiently processed Mr. Dell's pitch for long-term success and simply did not buy it.[8] The Court's reasoning was a ringing endorsement of the "efficient market hypothesis" and the Court devoted significant space in its decision to quoting analyst reports that clearly formed a view on Dell's long term prospects.

As for the Board not pursuing strategic buyers, the Court noted that none came forward before the deal was originally signed even though rumors of the sales talks were broadly discussed in the press. Further, Dell pursued strategic buyers during the go-shop period, but only one, HP, showed any interest in the whole company and withdrew without even visiting the data room. The go-shop record thus vindicated the Board's original conclusion that interest from strategic buyers would be limited and did not support the Court of Chancery's conclusion that not approaching strategic buyers had a material impact on the sale process.

The Supreme Court also found that the Court of Chancery's conclusions about the go-shop process were unsupported by the record. The fact that this was an MBO of a complex company did not appear to have had any impact on the sale process, as interested bidders were given sufficient time to due diligence Dell's complexities. The "winner's curse" also seemed to have been overcome by due diligence, especially in the case of Blackstone, whose due diligence was led by a former Dell executive. Finally, the Court of Chancery's concern that the bidding process was affected by Mr. Dell's inherent value to the company was disproved by the fact that both Blackstone and Icahn appeared prepared to proceed without him.[9]

The Supreme Court next considered the Court of Chancery's valuation analysis and described it as "the antithesis of any economist's definition of fair market value" in that it was a higher value than what the public was paying for Dell stock in the market or that private equity could be persuaded to pay in the sales process, and the Court of Chancery conceded that no strategic buyer had come forward to pay that value either, likely because of the "massive integration risk" that could not justify a higher price.[10] "When an asset has few, or no buyers at the price selected," the Supreme Court concluded, "that is not a sign that the asset is stronger than believed—it is a sign that it is weaker."[11]

The Supreme Court then reversed and remanded the Court of Chancery's determination of fair value with a strongly worded suggestion that the deal price was indeed fair:

> Despite the sound economic and policy reasons supporting the use of the deal price as the fair value award on remand, we will not give in to the temptation to dictate that result. That said, we give the Vice Chancellor the discretion on remand to enter judgment at the deal price if he chooses, with no further proceedings.[12]

IMPLICATIONS

It seems intuitively correct that a deal price reached at arm's length after a reasonable process is the best proxy for "fair value," especially where it is at a premium to an efficient market price. It seems equally intuitive that thrusting judges into the role of valuation experts is not a good idea. *Dell* is another indication that the Delaware Supreme Court agrees with those two intuitive principles but struggles to harmonize them with the language of the appraisal statute. Thus, the state of the law appears to be that the Supreme Court clearly endorses deal price as a strong indicator of fair value but has left sufficient room for judicial discretion should circumstances demand that deal price be ascribed less weight. Nevertheless, when the evidence shows that a merger price was the product of a well-run, conflict free, and robust sale process, "then failure to give the resulting price heavy weight" is likely to run afoul of "even the wide discretion afforded to the Court of Chancery in these difficult cases."[13]

The extent to which the Supreme Court second-guessed the Court of Chancery's reading of the record—and expressed a readiness to base its decision on its own reading of that record—is notable as it demonstrates a willingness of the Court to "get into the weeds" in appraisal cases, perhaps in recognition of the "odd" status of appraisals in Delaware jurisprudence:

> Appraisals are odd. Unlike other cases, where one side loses if the other side fails to persuade the court that the evidence tilts its way, appraisals require the court to determine a number representing the fair value of the shares after considering the trial presentation and submissions of parties who have starkly different objectives: petitioners contend fair value far exceeds the deal price, and the company argues that fair value is the deal price or lower. In reality, the burden "falls on the [trial] judge to determine fair value, using 'all relevant factors.'"[14]

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ENDNOTES

[1] No. 565, 2016 (Del. 2017).

[2] 2017 WL 3261190, at *12-15 (Del. 2017).

[3] No. 565, 2016, at 30.

[4] *Id.* at 37.

[5] *Id.* at 51.

[6] *Id.* at 46.

[7] *Id.* at 45-46.

[8] *Id.* at 39-45.

[9] *Id.* at 52-59.

[10] *Id.* at 63.

[11] *Id.* at 64.

[12] *Id.* at 77.

[13] *Id.* at 60.

[14] *Id.* at 31.

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