

Delaware Supreme Court Reverses Dell's Merger Appraisal Price & Bump

December 19, 2017

On December 14, 2017, the Delaware Supreme Court reversed and remanded the Court of Chancery's appraisal of the fair value of Dell Inc. The trial court's 2016 ruling, which found that a \$25 billion management-led buyout undervalued the computer giant by about \$7 billion, sent shock waves across the M&A landscape and emboldened some hedge funds to continue devoting significant time and resources to "appraisal arbitrage." The Supreme Court's opinion seems designed to restore a sense of order and calm to appraisal litigation, and to reassure potential M&A targets and buyers that the Delaware courts appreciate and respect market realities and good-faith efforts to run fair sale processes. However, the Supreme Court stopped short of adopting a presumption that deal price equals fair value for purposes of appraisal analysis, or a categorical requirement that deal price must always be an element of the analysis. Arbitrageurs thus may view the *Dell* ruling as narrowing their window of opportunity, but not closing it entirely.

Dell was taken private in October 2013 by a group led by founder and CEO Michael Dell and investment fund Silver Lake Partners. The deal price of \$13.75 per share represented a 37% premium over Dell's 90-day unaffected stock price and a 25% premium over its one-day unaffected stock price. Dell faced industry and competitive headwinds for years before the deal, and repeatedly failed to meet its financial targets. While Mr. Dell voiced confidence that the company could survive and thrive by pivoting away from its eponymous hardware and towards enterprise software and services, analysts were dubious and the stock price suffered accordingly. The concept of a management-led buyout originated with Mr. Dell, but the deal was negotiated and approved by a special committee of independent directors, and a post-signing go-shop led to two more competitive proposals. Stockholders voted for Mr. Dell and Silver Lake's deal. But, following an appraisal trial, the Court of Chancery decided to give no weight to Dell's stock price and deal price in evaluating the company's "fair value." Instead, the Court of Chancery prepared its own discounted cash flow analysis and determined that the fair value of Dell at the time of its sale was \$17.62 per share, or approximately 28% above the deal price. *In re Appraisal of Dell Inc.*, 2016 WL 3186538 (Del. Ch. May 31, 2016).

These are the key elements of the Delaware Supreme Court's decision:

- The trial court concluded that there was a "valuation gap" between Dell's market value and intrinsic value, because investors were too short-sighted to appreciate Mr. Dell's vision for the company's future. The Supreme Court rejected this conclusion, finding that the record showed that Dell's trading market could and did efficiently digest key information about the company's prospects, such as Mr. Dell's hopes and plans for long-term growth, and the stock price incorporated that information. In particular, the Supreme Court took note of Dell's large public float, extensive analyst coverage, high trading volume, stock price reaction to news, and lack of controlling stockholder.
- The trial court concluded that Dell's sale process, while robust and open, did not reliably indicate fair value because the primary bidders were financial firms, rather than companies interested in a strategic combination with Dell. Because of their nature, the primary bidders had used a leveraged buyout pricing model to determine their bid prices. Consistent with its ruling earlier this year in *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 2017 WL 3261190 (Del. Aug. 1, 2017), the Supreme Court rejected this logic and found "no rational connection between a buyer's status as a financial sponsor and the question of whether the deal price is a fair price."
- The trial court concluded that several structural issues inherent in management buyouts undercut the effectiveness of Dell's go-shop. In particular, the trial court credited an expert's view that a "winner's curse" dissuades competition when a buyout group includes management (who are expected to have the best insight into a company's prospects), and that bidders may be unwilling to pursue an acquisition aggressively if key officers may not stay on. The Supreme Court did not reject out of hand the notion that a management-led buyout may entail troubling competitive dynamics, but found that under the circumstances of this case – where Dell's sale process and Mr. Dell's behavior were both praiseworthy – there was no basis to doubt the deal price.
- The Supreme Court declined to adopt a blanket presumption in favor of deal price, and it emphasized that there is no

requirement that a trial court assign any specific mathematical weight to deal price when conducting an appraisal analysis. Nevertheless, following its close examination of the record evidence about Dell's sale process, the Supreme Court found that under the circumstances the deal price should be given "heavy, if not overriding, probative value."

- The Supreme Court left the trial court with discretion to either enter judgment at the deal price with no further proceedings, or to "follow another route" on remand. But the Supreme Court cautioned that, if the trial judge "chooses to weigh a variety of factors in arriving at fair value, he must explain that weighting based on reasoning that is consistent with the record and with relevant, accepted financial principles."

To M&A participants, the Supreme Court's *Dell* opinion should underscore the significance and value of designing and executing robust and exemplary sale processes. To appraisal arbitrageurs, the ruling should be taken as a warning to focus on transactions whose process infirmities are visible to the naked eye, rather than detectable only through the lens of partisan expert testimony.

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