ALERT MEMORANDUM

Delaware Supreme Court's *Dell* Decision Further Reduces Appraisal Risks for Buyers

December 18, 2017

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Last week, the Delaware Supreme Court issued another highly anticipated appraisal decision, *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*. *Dell* builds on the Court's *DFC* decision earlier this year,[1] discussed here, in which the Court held that the merger price will generally be entitled to significant, if not dispositive, weight in an appraisal action involving the sale of a public company pursuant to an open, competitive, and arm's-length bidding process, regardless of whether the buyer is a financial or strategic bidder. *Dell* extends and applies this principle to mergers involving a relatively limited pre-signing bidding process, at least where that process is competitive and does not exclude logical potential bidders. Significantly, *Dell* also expands *DFC* to cases involving management buyouts (MBOs), at least where management is not a controlling stockholder and is committed to working with rival bidders who are given full access to necessary information about the company. As *Dell* makes clear, while process is extremely important in determining whether to defer to (or give substantial weight to) deal price in an appraisal case, it will take more than merely theoretical doubts about an arm's-length and competitive process to justify departing from the deal price.

[1] *DFC Global Corp. v. Muirfield Value Partners*, --- A.3d ----, 2017 WL 3261190 (Del. Aug. 1, 2017).

By way of background, Silver Lake, a financial sponsor, and Michael Dell, the company's founder, CEO and 15% stockholder, acquired Dell in 2013 for $13.75 per share in cash—a 37% premium to the unaffected price. In its post-trial decision, the Court of Chancery found the fair value of Dell's shares as of the merger date to be $17.62, 28% above the deal price—thus implying the deal undervalued Dell by nearly $7 billion. This fair value finding was based entirely on the court's own discounted cash flow analysis, having concluded that neither party's expert's DCF analysis was persuasive. The court assigned no weight to the negotiated deal price, despite finding that the sale process would "sail through" an "enhanced scrutiny" analysis if the court were deciding whether to enjoin the transaction.[2]

On appeal, the Delaware Supreme Court once again declined to create a mandatory rule or even a presumption in favor of deal price in appraisal cases meeting particular conditions. In a unanimous opinion by Justice Valihura, it nonetheless reversed the Court of Chancery's fair value determination because the lower court's reasons for giving the deal price no weight were not supported by that court's own factual findings and "relevant, accepted financial principles."[3] *Dell* thus indicates that only compelling evidence of market failure will justify departing from deal price in cases involving arm's-length mergers. In *Dell*, the Supreme Court found the evidence relied on by the Court of Chancery to be insufficient and, in many respects, to be inconsistent with the court's factual conclusions:

— **"Investor myopia."** The Court of Chancery had perceived a significant "valuation gap" between Dell's market value and its intrinsic value, caused by the market's purported focus on disappointing short-term performance, which the court thought distorted the merger negotiations. The Supreme Court, however, rejected this finding as inconsistent with the efficient market hypothesis where the record demonstrated that there was a deep and actively traded public float, coverage by over 30 equity analysts, evidence that the market price responded quickly to new information, no controlling stockholder, and "no evidence that information failed to flow freely [to the market] or that management purposefully tempered investors' expectations for the Company so that it could take over the Company at a fire-sale price."[4]

— **Financial-sponsor buyer**. The Court of Chancery had found that it could disregard the deal price because the buyer here (Silver Lake) was a financial sponsor as opposed to a strategic bidder. As it did in *DFC* (decided after the Chancery Court's *Dell* decision), the Supreme Court rejected this reasoning, finding "no rational connection" between "a buyer's status as a financial sponsor and the question of whether the deal price is a fair price,"[5] reiterating the Court's statement in Chief Justice Strine's *DFC* opinion that both strategic and financial bidders make investment decisions based on IRR targets.[6]

— **Limited pre-signing canvass**. The Court of Chancery had faulted Dell's pre-signing sale process because "at any given time during the pre-signing phase, there were at most two private equity sponsors competing for the deal, creating little incentive to bid up the deal price."[7] The Supreme Court rejected this finding, too, because Dell's independent and empowered special committee took reasonable steps designed to ensure that the pre-signing process was competitive, and noted that the committee persuaded Silver Lake to increase its bid six times. As for the Court of Chancery's criticism that the special committee should have solicited strategic

[2] *In re Appraisal of Dell, Inc.*, C.A. No. 9322-VCL, 2016 WL 3186538, at *29 (Del. Ch. May 31, 2016).

[3] *Dell*, slip op. at 1.

[4] *Id.* at 42.

[5] *Id.* at 45.

[6] *Id.* at 45-46 (citing *DFC*, 2017 WL 3261190, at *22)

[7] *Id.* at 24.

bidders, the Supreme Court noted that the committee's financial advisor concluded "none was likely to make an offer,"[8] which was vindicated by subsequent events, as only one of 20 strategic bidders approached during the go-shop showed any interest—and that one, Hewlett-Packard, signed an NDA but never actually accessed the data room.

— **Structural limitations on go-shops in MBOs**. Finally, the Court of Chancery had found that the go-shop in this case was ineffective—even though it involved the special committee's financial advisors soliciting 67 potential bidders (including 20 strategic bidders), and fewer structural barriers to such other potential bidders making offers than usual—because this was an MBO. In particular, the court cited the problem of the "winner's curse," whereby bidders are discouraged from bidding against management because of management's superior knowledge of the company. The court also pointed to the value of Michael Dell to the company as deterring rival bidders from seeking to outbid him and his private equity partner. The Supreme Court, however, held that, while such concerns could potentially undermine the rationale for relying on deal price in some cases, they did not here because "rival bidders faced minimal structural barriers to a deal; extensive due diligence and cooperation from the Company helped address any information asymmetries that might otherwise imply the possibility of a winner's curse; and, assuming his value, Mr. Dell would have participated with rival bidders."[9] The Supreme Court also noted that the two financial bidders that actually made bids during the go-shop both were prepared to proceed without Mr. Dell; the go-shop period was for 45 days and any bidder which had become an Excluded Party during that initial period could continue to perform diligence and qualify to pay only the low go-shop break-up fee; and the fee structure of one of the special committee's financial advisors heavily incentivized it to obtain a higher price through the go-shop process.

The Supreme Court authorized the Court of Chancery on remand to find fair value equal to deal price without further proceedings, but did not require it to do so, allowing the lower court to elect to "weigh a variety of factors in arriving at fair value" as long as that court "explain[ed] that weighting based on reasoning that is consistent with the record and with relevant, accepted financial principles."[10] The Supreme Court also cautioned that, "[a]lthough widely considered the best tool for valuing companies when there is no credible market information and no market check," DCF valuations are often unreliable, particularly when compared to objective market data.[11] In the words of the Court,

> When an asset has few, or no, buyers at the price selected [by a DCF valuation], that is not a sign that the asset is stronger than believed—it is a sign that it is weaker. This fact should give pause to law-trained judges who might attempt to outguess all of these interested economic players with an actual stake in a company's future. This is especially so here, where the Company worked hard to tell its story over a long time and was the opposite of a standoffish, defensively entrenched target as it approached the sale process free of many deal-protection devices that may prevent selling companies from attracting the highest bid. Dell was a willing seller, ready to pay for credible buyers to do due diligence, and had a CEO and founder who offered his voting power freely to any topping bidder.
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> Given that we have concluded that the trial court's key reasons for disregarding the market data were erroneous, and given the obvious lack of credibility of the petitioners'

[8] *Id.* at 47.

[9] *Id.* at 59.

[10] *Id.* at 78.

[11] *Id.* at 65.

> DCF model—as well as legitimate questions about the reliability of the projections upon which all of the various DCF analyses are based—these factors suggest strong reliance upon the deal price and far less weight, *if any*, on the DCF analyses.[12]

Dell signals that certain types of mergers may not qualify for significant, or even any, deal-price reliance in appraisal cases, such as controlling stockholder squeeze outs or MBOs without the mitigating facts discussed above. It remains to be seen whether different combinations of market indicators as present in *Dell* (*e.g.*, post-signing go-shop vs. window-shop; level of pre-signing solicitation; CEO's commitment to work with other buyers; fewer or no actual competing bids being received despite a good process) will justify 100% reliance on deal price. Nevertheless, we believe that *Dell*, like *DFC*, continues the reduction of appraisal risk for most arm's-length mergers going forward, including MBOs and financial-sponsor deals. These decisions may also support an argument that deal price should be given some weight in an appraisal action involving a controlling stockholder buyout, if the buyer complied with the requirements of *Kahn v. M&F Worldwide Corp.*[13]

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[12] *Id.* at 64 (emphasis added).

[13] *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014); *see id.* at 644 ("[W]here the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote, the controlled merger then acquires the shareholder-protective characteristics of third-party, arm's-length mergers[.]").