# Dell Strongly Reinforces Importance Of Merger Price

By **Edward Micheletti, Paul Lockwood and Chad Davis**

Over the past several years, there has been a significant increase in appraisal actions, which has prompted statutory amendments and increased focus on appraisal law by academics and commentators. The increase in appraisal actions also has accelerated the development of case law guidance regarding the proper approach for the Delaware Court of Chancery to derive a subject company's statutory fair value. One of the more significant recent developments is the court's increased willingness to consider the deal price as the best evidence of appraisal value.

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This concept has led to mixed results in appraisal proceedings over the past few years, with inconsistent guidance over when deference to the merger price was appropriate. Last year, however, proved to be a watershed moment in the ongoing debate. Each post-trial appraisal decision issued by the Court of Chancery resulted in a finding that the fair value of the subject company was the merger price or less.[1] Similarly, the Delaware Supreme Court issued two appraisal opinions last year,[2] each of which reversed a Court of Chancery decision below that determined that fair value exceeded the deal price and remanded for further proceedings with the instruction to provide greater deference to the deal price. The Supreme Court's most recent appraisal decision, Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd,[3] provides the strongest support yet for the concept of deferring to the merger price as the best evidence of appraisal value.

Paul Lockwood

## The Dell Decision Strongly Reinforces the Notion of the Merger Price as the Best Indication of Appraisal Value

Chad Davis

In December 2017, in Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd, the Delaware Supreme Court reinforced the notion that merger price should not be disregarded as an indicator of appraisal value when the record supported such a conclusion. Specifically, in Dell, the Delaware Supreme Court reversed in part and remanded to the Court of Chancery for further proceedings the appraisal of Dell Inc. arising from a 2013 management-led buyout by a private equity firm. It found the Court of Chancery's "decision to rely 'exclusively' on its own [discounted cash flow] analysis [was] based on several assumptions that are not grounded in relevant, accepted financial principles."[4] The

Supreme Court cited extensively to its decision in DFC, and reaffirmed that while there is no mandate to give weight to the merger price in every appraisal action, when a factual record of a strong sale process is proven, as it was in Dell and DFC, the trial court must give weight to the merger price in its fair value calculation.

In Dell, the Court of Chancery relied exclusively on a DCF valuation and determined the fair value of Dell shares was $17.62, approximately 28 percent above the merger price of $13.75. The merger price itself represented a 37 percent premium over Dell's 90-day-average unaffected trading price. The Court of Chancery rejected arguments that the well-run deal process that led to the merger price was the most reliable indicator of fair value, concluding, among other things, that the market for Dell stock was inefficient and that because the transaction was a management-led buyout, the deal price could not be relied upon.

On appeal, the Supreme Court found that the Court of Chancery erred in relying exclusively on its DCF valuation and in giving no weight to the deal price. Specifically, the Supreme Court held that the trial court erred because its reasons for failing to give the deal price weight did "not follow from the court's key factual findings and from relevant, accepted financial principles."[5] The Supreme Court agreed "with the Company's core premise that, on this particular record, the trial court erred in not assigning any mathematical weight to the deal price. In fact, the record as distilled by the trial court suggests that the deal price deserved heavy, if not dispositive, weight."[6] The Supreme Court also agreed "with the petitioners that there is no requirement that the court assign some mathematical weight to the deal price."[7] However, it reversed "because there [was] a dissonance between the key underpinnings of the decision to disregard the deal price and the facts as found, and this dissonance distorted the trial court's analysis of fair value."[8]

In reversing the Court of Chancery, the Supreme Court identified three premises underlying the trial court's determination to not rely on deal price: (1) that a "'valuation gap' existed between Dell's stock price and the Company's intrinsic value," (2) "that the lack of strategic buyers in the sale process — and, accordingly, the involvement of only private equity bidders — also pushed the deal price below fair value," and (3) that "the court concluded several factors endemic to MBO go-shops further undercut the deal price's credibility."[9] The Supreme Court examined and rejected each premise on the facts present in the case, and found that without such premises the trial court's rationale "for disregarding the deal price collapses."[10] Among several important observations, the Supreme Court found that "the Court of Chancery's analysis ignored the efficient market hypothesis long endorsed by this Court."[11] Further, the Supreme Court explained that "[o]ne should have little confidence she can be the special one able to outwit the larger universe of equally avid capitalists with an incentive to reap rewards by buying the asset if it is too cheaply priced."[12]

Regarding the DCF analysis performed below, the Supreme Court noted that when "an appraisal is brought in cases like this where a robust sale process of that kind in fact occurred, the Court of Chancery *should be chary* about imposing the hazards that always come when a law-trained judge is forced to make a point estimate of fair value based on widely divergent partisan expert testimony."[13] The Supreme Court expressed doubt regarding the Court of Chancery's DCF calculation, noting that the facts suggested a "strong reliance upon the deal price" was warranted with "far less weight, *if any*, on the DCF analyses" upon remand.[14] Additionally, the court noted that the experts' valuations "landed galaxies apart" and expressed some concern regarding the Court of Chancery's ability to reconcile the "1,100 variable inputs in the competing DCFs" in constructing its own.[15] The Supreme Court highlighted that the Court of Chancery's DCF resulted in a price that no market participant was willing to pay and noted that "[t]his 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."[16] However, the Supreme

Court engaged in an analysis of certain DCF inputs to assist the Court of Chancery if it finds that granting any weight to its DCF is appropriate on remand. The Supreme Court found, among other things, that "the Court of Chancery erred in its conclusion that the effective tax rate accounted for the inevitable taxes that the Company would have to pay upon repatriating its foreign earnings and profits" and instructed the Court of Chancery to consider the proper repatriation deduction.[17]

Regarding Dell's fair value, the Supreme Court concluded that:

> 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 so chooses, with no further proceedings. If he decides to follow another route, the outcome should adhere to our rulings in this opinion, including our findings with regard to the DCF valuation. If he 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.[18]

## Implications

In Dell, the second of two such opinions last year, the Delaware Supreme Court strongly signaled that while not a bright-line rule, greater deference to the deal price should be observed in appraisal cases where a company is well-shopped and the merger price is the result of arms-length bargaining with the opportunity for topping bidders. Short of a statutory amendment, the Dell opinion provides very strong authority to defend future appraisal actions involving a strong underlying deal process.

Although Dell turned on the specific factual record before the court, certain general principles can be extracted from the Supreme Court's analysis. For example, if the Court of Chancery declines to use the merger price in its fair-value determination where the subject company was well-shopped, the court must articulate valid reasons supported by generally accepted financial principles for not providing some level of deference to the merger price. Further, the Supreme Court has now squarely rejected the premise that financial buyers, such as private equity firms, or management-led buyouts preclude a reliance on the deal price, holding that such notions are not supported by financial literature or Delaware law.

Importantly, Dell emphasized that statutory fair value does not require extraction of the "highest possible bid" or that a company must "prove that the sale process is the most reliable evidence of its going concern value in order for the resulting deal price to be granted any weight."[19] As the court ultimately put it, in the context of the Dell case, "when the evidence of market efficiency, fair play, low barriers to entry, outreach to all logical buyers, and the chance for any topping bidder to have the support of Mr. [Michael] Dell's own votes is so compelling, then failure to give the resulting price heavy weight because the trial judge believes there was mispricing missed by all the Dell stockholders, analysts, and potential buyers abuses even the wide discretion afforded the Court of Chancery in these difficult cases."[20]

Going forward it will be interesting how the Court of Chancery applies the teachings of Dell to different factual scenarios and how the case will impact the Court of Chancery's approach to appraisal actions more generally. At a minimum, the decision may signal to the Court of Chancery that while it is still required by the appraisal statute to consider "all relevant factors,"[21] when a company is well-shopped in a relatively clean sales process the price reached by the market will often be the most reliable indicator of statutory fair value.

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[1] ACP Master Ltd. v. Sprint Corp., 2017 WL 3421142 (Del. Ch. July 21, 2017); In re SWS Group Inc., 2017 WL 2334852 (Del. Ch. May 30, 2017); In re PetSmart, 2017 WL 2303599 (Del. Ch. May 26, 2017).

[2] The first decision, DFC Glob. Corp. v. Muirfield Value Partners LP, 2017 WL 3261190 (Del. Aug. 1, 2017), held that while there is no bright-line or default rule that the merger price is the best indicator of appraisal value, the Court of Chancery in DFC erred by failing to give adequate weight to the merger price where the record reflected that the merger price was the result of an open process, was informed by robust public information, and included many parties with a profit motive that had a chance to submit a bid. The Court of Chancery had given one-third weight to the deal price, one-third weight to a discounted cash flow (DCF) analysis and one-third weight to a comparable companies analysis. The Supreme Court reversed because the decision was not "explained" and it could not "discern the basis for this allocation" in part because "economic principles suggest that the best evidence of fair value was the deal price." The Supreme Court also held that it did "not understand the logic" of the Court of Chancery's conclusion that a "deal price resulting in a transaction won by a private equity buyer is not a reliable indicator of fair value."

[3] 2017 WL 6375829 (Del. Dec. 14, 2017).

[4] Id. at *1.

[5] Id.

[6] Id. at *16.

[7] Id.

[8] Id.

[9] Id.

[10] Id.

[11] Id. at *17.

[12] Id. at *21 (quoting DFC Glob. Corp., 2017 WL 3261190 at *15).

[13] Id. at *26 (emphasis added).

[14] Id. at *28(emphasis added).

[15] Id. at *26.

[16] Id. at *27.

[17] Id. at *29.

[18] Id. at *34.

[19] Id. at *24-25; see also DFC Glob. Corp., 2017 WL 3261190 at *18 (explaining that fair value "does not mean the highest possible price that a company might have sold for had Warren Buffett negotiated for it on his best day and the Lenape who sold Manhattan on their worst").

[20] Dell, 2017 WL 6375829, at *26.

[21] 8 Del. C. § 262(h).

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