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# *Dell* and Fair Value in Statutory Appraisal Actions

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The development of Delaware appraisal law has continued with the Delaware Supreme Court's highly anticipated December 2017 appraisal opinion in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*. In *Dell*, the court reiterated many of its August 2017 holdings in *DFC Global Corp. v. Muirfield Value Partners, L.P.* and provided the strongest basis yet for acknowledging that deal price is a reliable indicator of fair value in most cases involving an unhindered, informed and competitive sales process. (See our November 21, 2017, article "Delaware Courts Continue to Define Appropriate Valuation Methodologies for Statutory Appraisal.") Nonetheless, *Dell* reiterates that the Delaware Court of Chancery is statutorily required to consider "all relevant factors" without applying any presumption that favors any one indicator of fair value.

Post-*Dell*, the Court of Chancery has issued two appraisal decisions that both departed from the deal price and returned fair values below the deal price. In the February 15, 2018, case *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, the court determined that the most reliable indicator of fair value was the unaffected market price. The court attributed full weight to this indicator and found that Aruba's fair value at the time it was acquired was equivalent to its 30-day average unaffected market price. This price represented a more than 30 percent discount from the deal price. In *In re Appraisal of AOL Inc.*, decided on February 23, 2018, the court relied on a discounted cash flow (DCF) valuation to fashion its appraisal award but still found that the fair value was below the deal price, which it used as a check on its DCF valuation. The Court of Chancery used a DCF valuation because it had concerns about the sales process and determined that the deal price was not a reliable indicator of fair value. Coining the term "*Dell* compliant," the court determined that the sales process employed by AOL did not meet this new standard, and the court thus could not ascribe fair value solely to the deal price.

## *Dell* and the Continued Importance of Deal Price

In *Dell*, the Delaware Supreme Court rejected as an abuse of discretion the Court of Chancery's findings that deal price should be accorded no weight and that the fair value of the shares of Dell was more than 28 percent above the deal price. In reversing and remanding, the Supreme Court concluded that "the reasoning behind the trial court's decision to give no weight to any market-based measure of fair value runs counter to its own factual findings." The Supreme Court went on to state that the three central premises the Court of Chancery relied on in assigning no weight to the deal price were flawed.

First, the Supreme Court concluded that there was no valid basis to find that there existed a valuation gap between Dell's market value and the company's fundamental value. Notably, the Supreme Court stated that "the Court of Chancery's analysis ignored the efficient market hypothesis long endorsed by this Court." It explained, "[a] market is more likely efficient, or semi-strong efficient, if it has many stockholders; no controlling stockholder; 'highly active trading'; and if information about the company is widely available and easily disseminated to the market." The Supreme Court noted that in this case, the record did not indicate "that Dell lacked a vast and diffuse base of public

stockholders, that information about the Company was sparse or restricted, that there was not an active trading market for Dell's shares, or that Dell had a controlling stockholder — or that the market for its stock lacked any of the hallmarks of an efficient market."

Second, the Supreme Court concluded — consistent with its decision in *DFC* — that the Court of Chancery erred in failing to give weight to the deal price based on the identity of the buyer as a financial sponsor. In the words of the Supreme Court, "[g]iven the objective indicia of the deal price's reliability and our rejection of the notion of a private equity carve out, to the extent that the Court of Chancery chose to disregard Dell's deal price based on the presence of only private equity bidders, its reasoning is not grounded in accepted financial principles."

Third, the Supreme Court held that certain features of a management buyout, while theoretically factors that could undermine the deal price, were not present in this case. Specifically, the record did not support that any structural issues inhibited the effectiveness of the go-shop, that a "winner's curse" was present in this case or that the value of Dell's CEO, Michael Dell, imposed an impediment to rival bidders.

The Supreme Court also concluded that the market-based indicators of Dell's value, its stock price and the deal price, had substantial probative value. It noted that although the Court of Chancery stated that Dell had not established that the deal price was the most reliable evidence of the company's fair value, "[t]here is no requirement that a company 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." The Supreme Court highlighted that it was "not saying that the market is always the best indicator of value, or that it should always be granted some weight." However, "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. 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."

After considering several tax issues, the Supreme Court summed up its discussion of fair value by stating that "[d]espite 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." However, the Supreme Court noted that it was giving the Court of Chancery "the discretion on remand to enter judgment at the deal price if [it] so chooses, with no further proceedings."

## *Aruba* and Unaffected Market Price

The Court of Chancery's recent decision in *Aruba* found that the most reliable indicator of fair value was the 30-day average unaffected trading price of Aruba's stock on the Nasdaq composite — $17.13, below the deal price of $24.67. The court accorded full weight to this indicator and no weight to the deal-price-less-synergies estimate that the court concluded should be $18.20. The Court of Chancery's reasoning relied heavily on the Supreme Court's opinions in *Dell* and *DFC*, both of which it quoted extensively.

The Court of Chancery in *Aruba* held that under *Dell* and *DFC*, "when the subject company's shares are 'widely traded on a public market based upon a rich information base,' then the fair value of a proportionate interest in the company as a going concern would 'likely be best reflected by the prices at which [the] shares were trading as of the merger.'" Put differently, "when the market for a company's shares has the requisite attributes [associated with market efficiency], the stock price is 'likely a possible proxy for fair value.'" Thus, the Court of Chancery reasoned that "[u]nder *Dell* and *DFC*, the critical question is whether the market for the subject company's shares has attributes associated with market efficiency." Because Aruba's stock price exhibited the same requisite attributes of market efficiency as those found sufficient in *Dell* and *DFC*, the court held that "Aruba's market price provides reliable evidence of the going concern value of the firm."

Analyzing the reliability of deal price, the Court of Chancery interpreted *Dell* and *DFC* to hold that a sales process is not "sufficiently bad to warrant discounting the deal price" so long as "the deal in question was an arm's-length transaction," and that a court should not inquire "into whether a different transaction process might have achieved a superior result." In addition, "the key inquiry is whether the dissenters got fair value and were not exploited." Although under *Dell* and *DFC*, the deal price in *Aruba* "has substantial probative value," the court found that "[p]articularly given the inclusion of synergies, there is good reason to think that the deal price exceeded fair value and, if anything, should establish a ceiling for fair value." The court calculated a deal-price-less-synergies value of $18.20.

While finding that the unaffected market price and the deal-price-less-synergies value were the two probative indications of value, the Court of Chancery framed the more difficult question of "how to choose between, weigh, or otherwise exercise my discretion non-abusively when evaluating the two probative valuation indications." The court identified issues in each indication, but it found that the deal-price-less-synergies valuation was more unreliable because, among other uncertainties, it would require excluding both synergies and the value of a reduction in agency costs, which both constituted "value expected from the merger" that must be excluded from fair value. In the Court of Chancery's view, any attempt to estimate an appropriate reduction of deal price would require the same sort of subjective valuation that the Supreme Court had warned against in admonishing the use of DCF analyses.

The Court of Chancery reiterated the Supreme Court's precaution that when reliable market evidence is available, "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." The Court of Chancery, thus, held that the Supreme Court's "expressed preference in *Dell* and *DFC* for market indicators over discounted cash flow valuations counsels in favor of preferring market indicators over the output of a similarly judgment-laden exercise of backing out synergies." The Court of Chancery accorded full weight to the unaffected market price of $17.13, which it found "provides the more straightforward and reliable method for estimating the value of the entity as a going concern," but noted that its approach "does not elevate 'market value' to the governing standard under the appraisal statute."

Vice Chancellor J. Travis Laster, the author of the *Aruba* decision, has expressed elsewhere that the decision in *Aruba* was not a significant departure from Delaware precedent, especially not from the holdings in *Dell* and *DFC* endorsing the efficient market hypothesis. In a March 7, 2018, order denying a motion to stay proceedings in *In re Appraisal of Columbia Pipeline Group*, the Court of Chancery denied a request to extend the discovery deadline until the resolution of an appeal in *Aruba*, endorsing the respondent's arguments that the opinion in *Aruba* "did not independently break new ground" and noting that "Delaware courts have long considered a company's unaffected stock market price as evidence of fair value in an appraisal proceeding." The Court of Chancery characterized its finding:

> The *Aruba* decision held that, on the facts presented in that case, the company's unaffected market price provided the most reliable evidence of fair value, particularly when the other reliable valuation indicator consisted of a deal price that had to be adjusted to eliminate synergies and other elements of value arising from the accomplishment or expectation of the merger. The *Aruba* decision did not introduce a new valuation methodology or analytical approach. It simply gave exclusive weight to a type of valuation evidence that Delaware courts had long considered and which the Delaware Supreme Court had emphasized in *DFC* and *Dell*.

In a lengthy decision issued on May 21, 2018, the court considered and rejected eight grounds for reargument by petitioners in *Aruba*. Of note, the court rejected an objection to the use of the 30-day average unaffected trading price (as opposed to another time period) as well as a claim that there was information about

the value of the company that had not been incorporated into the market price because those represented new arguments by petitioners that were not cognizable under Court of Chancery Rule 59(f). In addressing petitioners' challenge to the use of market price to determine fair value, the court found that the Delaware Supreme Court did adopt a "semi-strong form of the efficient capital markets hypothesis" in *Dell* and *DFC*, and while that does not require the Court of Chancery to give weight to the unaffected market price, those cases "endorsed the reliability of the unaffected market price as an indicator of value, at least for a widely traded company, without a controlling stockholder, where the market for its shares has attributes consistent with the assumptions underlying the efficient capital markets hypothesis." The court observed that, as a result, "trial courts now can (and often should) place heavier reliance on the unaffected market price."

## *AOL* and Discounted Cash Flow Valuation

While much of the attention paid to Delaware appraisal law has centered on the appropriate weight to give to deal price, the Court of Chancery in *AOL* showed the continued viability of DCF analyses when the court has concerns about the sales process. Notably, following *Dell* and *DFC*, the decision in *AOL* demonstrates that cases employing DCF analyses may not result in a fair value determination above the deal price.

In its decision in *AOL*, the Court of Chancery determined that the fair value of AOL's stock was below the deal price of $50 per share. The court began its opinion by acknowledging the Delaware Supreme Court's recent decisions in *Dell* and *DFC*. Vice Chancellor Sam Glasscock III then stated that those cases, "in distilled form," hold that "where a petitioner is entitled to a determination of the fair value of her stock, the trial judge must consider all relevant factors, and that no presumption in favor of transaction price obtains." But "[w]here, however, transaction price represents an unhindered, informed, and competitive market valuation, the trial judge must give particular and serious consideration to transaction price as evidence of fair value." Furthermore, "[w]here information necessary for participants in the market to make a bid is widely disseminated, and where the terms of the transaction are not structurally prohibitive or unduly limiting to such market participation, the trial court ... must take into consideration the transaction price as set by the market." Vice Chancellor Glasscock referred to transactions compliant with such conditions as "*Dell* compliant" and noted that in such transactions, a competitive market value is "at least first among equals" in determining fair value.

On the facts of the case, the Court of Chancery stated that it was a "close question" as to whether the transaction for AOL was "*Dell* compliant." While finding that many of the indicia of a competitive market process were present, the court determined that certain statements made by AOL's CEO, the lead negotiator of the deal, signaled to the market that there was no other deal to be made and that no topping offers would therefore be successful. The court held that the "unusually preclusive" public statements of the CEO — specifically that he was "committed to doing the deal" and that he had given his "word" to the acquirer that the deal would happen — rendered the deal price unreliable as the sole indicator of fair value when combined with other attributes of the transaction. The court went on to say that because it could not rely on deal price as the sole determinant of fair value, it was unable to find a principled way to assign the deal price any weight in its fair value analysis. Therefore, the court assigned full weight to its own DCF valuation and "relegate[d] transaction price to a role as a check on that DCF valuation. ..." The result of the DCF analysis was $48.70 per share, $1.30 per share below the deal price. Although the deal was not "*Dell* compliant," the court noted that the deal price served as a "check" and did not deviate significantly from the DCF valuation. The court explained that this difference in value could possibly be attributed to synergies that were included in the deal price but that are not properly included in fair value.

## Affirmance of *Sprint*

The *AOL* decision is not the only recent appraisal decision showing the continued viability of DCF analyses and demonstrating that cases employing such analyses may result in a fair value determination below the deal price. On April 23, 2018, the Delaware Supreme Court summarily affirmed the Court of Chancery's decision in *ACP Master, Ltd., et al. v. Sprint Corp., et al.* In *Sprint*, the Court of Chancery had determined that the fair value for Clearwire on the date of the merger was $2.13 per share based exclusively on a DCF analysis. Neither party argued for the deal price, and the court explicitly did not consider deal price while finding that the transaction generated considerable synergies, estimated at $1.95 to $2.60 per share. The $2.13 per share fair value determination was less than half the merger price of $5 per share.

# Implications

Directors and officers of corporations considering a transaction that gives rise to appraisal rights should evaluate the following implications of these recent decisions:

- Delaware courts have increasingly used the deal price minus synergies for a determination of fair value when the sales process and the market for the company's stock exhibit the characteristics identified by the Supreme Court in *Dell* and *DFC*.
  - The *Dell* decision solidifies the benefit in an appraisal proceeding of a robust and competitive sales process, because if the market for the company and its stock was efficient, the merger price is often found to be the most reliable indicator of fair value.
  - While the Supreme Court has now repeatedly refused to hold that there is a judicial presumption in favor of deal price, the *Dell* and *DFC* rulings underscore that deal price is often the best indication of appraisal value, and the Court of Chancery has subsequently recognized in that same vein that a competitive market price is "at least first among equals."
- The Court of Chancery confirmed that a determination that the deal price is not a reliable indicator of fair value does not necessarily result in a fair value determination above deal price.
  - While justifiable concern may persist that the court might find the process inadequate and resort to a DCF valuation, the *AOL* and *Sprint* decisions show that even in such scenarios, the Court of Chancery may still find fair value below the deal price. The Court of Chancery in both *AOL* and *Sprint* attributed some of the difference between deal price and its fair value determination to synergies in the deal, demonstrating that deal synergies (which should be excluded from appraisal value) remain an important consideration.
- The *Dell* decision confirmed that the Delaware Supreme Court has rejected a "carve-out" for private equity buyers. The Supreme Court's reiteration of its holding in *DFC* — that a private equity carve-out is not grounded in economic literature or generally accepted financial principles — means that petitioners will be unable to argue that a deal price is not a reliable indicator of fair value simply based on the buyer's identity as a private equity buyer.
- Recent Delaware opinions finding fair value below deal price may deter some stockholders from seeking appraisal in transactions.