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Delaware Supreme Court Reverses Controversial Dell Appraisal Ruling

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Seyfarth Synopsis: *The Delaware Supreme Court issued its much-anticipated unanimous decision last Thursday in the "long-running appraisal saga" that took place following the 2013 management-led buyout of Dell. In reversing the lower court's ruling that had awarded stockholder petitioners a 28 percent premium over the deal price, the Court emphasized that the Vice Chancellor erred in relying exclusively on the Chancery Court's own discounted cash flow analysis to reach a fair value calculation, where, as here, the decision to give no weight to either the stock price or the deal price was not supported by the court's key factual findings or by relevant, accepted financial principles. The Supreme Court suggested that the Chancery Court on remand should instead give "heavy weight" to the deal price due to the compelling "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."*

Background

Dell, a computer technology company, announced on February 5, 2013 that the Company's founder and CEO Michael Dell and affiliates of a private equity firm, Silver Lake Partners, would take the company private. In March 2013, the Blackstone Group and Carl Icahn offered to buy the Company. In April 2013, the Blackstone Group withdrew from bidding due to an unprecedented 14 percent market decline in PC volume in the first quarter of 2013 and the eroding financial profile of the Company. Two months later, Mr. Icahn disclosed that he and affiliates had purchased 72 million Company shares and that he planned to nominate his own slate of directors who would launch a self-tender for 1.1 billion shares. Mr. Dell and Silver Lake Partners increased their proposal and closed the acquisition. Holders of over 38 million Company shares exercised their appraisal rights.

In the lower court's appraisal decision, it acknowledged that the deal price is "one form of market price data, which Delaware courts have long considered in appraisal proceedings[,]" but the court concluded that several purported flaws in Dell's sale process meant that the deal price should not be afforded any weight and therefore disregarded Dell's deal price and pre-transactional stock price entirely.

The Company argued on appeal, *inter alia*, that the lower court committed legal error in failing to assign any weight to the deal price because (1) there is no requirement under Delaware law that the deal price be the "best" evidence of fair value in order for it to be given any weight; (2) there is no requirement that the Court of Chancery disregard the deal price entirely if it cannot unequivocally quantify the precise amount of sale process mispricing; and (3) the Court of Chancery also erred in creating what seems akin to a bright-line rule that the deal prices in management-led buyout transactions are distorted and should be disregarded.

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In reversing and remanding the Chancery Court's decision, the Delaware Supreme Court acknowledged that due to "the human element in the appraisal inquiry" "[t]here may be no perfect methodology for arriving at fair value for a given set of facts[.]" Nonetheless, a lower court's conclusions as to fair value will only be upheld "if they follow logically from those facts and are grounded in relevant, accepted financial principles." The Delaware Supreme Court found that neither of those guideposts were met here. The record itself suggested that "the deal price deserved heavy, if not dispositive, weight." The Court of Chancery lacked a valid basis for finding a "valuation gap" between Dell's market and fundamental values because the record showed that analysts had scrutinized Dell's long-range outlook in evaluating the Company and that the market was capable of accounting for Dell's recent M&A activity and its prospects in valuing the Company. Likewise, the court's complete discounting of the deal price due to the buyer's status as a private equity firm rather than a strategic buyer was error. As the Court found in its recent decision in *DFC Global Corp. v. Muirfield Value Partners*, -- A.3d --, 2017 WL 3261190 (Del. Aug. 1, 2017), the notion of a "private equity carve out" stands "on especially shaky footing where other objective indicia suggested the deal price was a fair price." Nothing in the record suggested that increased competition would have produced a better result than the special committee reached in persuading Silver Lake Partners to raise its bid six times. While the Court of Chancery felt that more bidders should have been involved in the sale process, the Delaware Supreme Court stated that assessment ignored the important reality that "if a company is one that no strategic buyer is interested in buying, it does not suggest a higher value, but a lower one."

Takeaways

1. Reaffirmation that when certain conditions are met the deal price will be deemed strong evidence of fair value. The Delaware Supreme Court held that where a Company is sold as the result of a robust sale process, the Court of Chancery must give the deal price "heavy weight" in its ruling. The Court reiterated that it will reject the lower court's methodology for determining fair value if it has not adequately justified its methodology based on the record before it and relevant, accepted financial principles. The Court also noted that the Court of Chancery in its own opinion suggested that the deal price deserved weight by characterizing the sale process as one that "easily would sail through if reviewed under enhanced scrutiny" and observing that "[t]he Committee and its advisor did many praiseworthy things" that were too numerous to catalog in its opinion.

2. Outlined pitfalls in Court of Chancery's reliance on its own DCF analysis. The Delaware Supreme Court expressed concern with the Court of Chancery's decision to give no weight to Dell's stock price or the deal price and instead to arrive at its own value of nearly $7 billion above the transaction price. The Court took the lower court to task for settling on a DCF value that "did not reflect a value deemed attractive to the buyers of Dell's [] publicly traded shares" and "did not reflect the value that private equity buyers (including the biggest players such as KKR, TPG, and Blackstone) put on it, as it was too high for any of them to pay." The Court went on to note that "[w]hen an asset has few, or *no*, buyers at the price selected, 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."

3. Rejection of expert testimony claiming that management-led buyouts suffer from structural problems that diminish reliability of deal price. The Court of Chancery focused on three problems purportedly present in all management-led buyouts in finding the deal price was not evidence of fair value: (a) structural issues; (b) the "winner's curse"; and (c) management's perceived value to the company. The Delaware Supreme Court held that "none of these theoretical characteristics detracts from the reliability of the deal price on the facts presented here." The main "structural problem" identified did not result from the sale process itself, but from the inherent size and complexity of the Company. The threat of a "winner's curse," *i.e.*, the phenomenon of a buyer likely overpaying for a company in outbidding incumbent management, who presumably would have paid more if a company were really worth it, can be mitigated, as the Court found was done here, through the provision of extensive due diligence to prospective buyers. The Court determined that "[t]he more likely explanation for the lack of a higher bid is that the deal market was already robust and that a topping bid involved a serious risk of overpayment." The Delaware Supreme Court likewise rejected the lower court's presumption that Mr. Dell's value to the Company imposed another impediment to the likelihood of rival bidders succeeding. The record instead showed that,

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inter alia, Blackstone and Mr. Icahn did not regard Mr. Dell as essential to their bids, and there was no indication that Mr. Dell would have stopped serving the Company if another reputable buyer had prevailed.

For a copy of the opinion, click here.

If you have any questions, please contact Gregory Markel at *gmarkel@seyfarth.com* or Heather Murray at *hmurray@seyfarth.com*.

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