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Delaware Supreme Court Reverses *Dell* Appraisal Decision, Urging Reliance on Deal Price

In *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, the Delaware Supreme Court reversed in part the Court of Chancery's determination of fair value of Dell, Inc., which was based entirely on the lower court's own discounted cash flow ("DCF") analysis. The Supreme Court held that, based upon the factual record, the Court of Chancery erred in affording no weight to the deal price in determining fair value. On remand and in line with other recent Delaware precedent, the Supreme Court urged the Court of Chancery to rely on deal price in determining fair value.

Background

In October 2013, Dell was taken private by a group led by Michael Dell and the investment firm Silver Lake. A special committee of the Dell board negotiated and approved the transaction with Mr. Dell and Silver Lake. During the go-shop period, several other parties conducted diligence on the company, including Carl Icahn, who ultimately launched a competing bid for Dell. When the special committee was informed that stockholders were unlikely to approve the merger with Mr. Dell and Silver Lake, it negotiated an increased purchase price of \$13.75 per share, a special cash dividend and a reduced termination fee in the event stockholders rejected the merger in favor of a leveraged recapitalization or similar proposal in the next 12 months. At the special stockholder meeting to approve the deal, 57% of Dell shares approved the merger with Mr. Dell and Silver Lake.

Court of Chancery Opinion

Numerous Dell stockholders demanded appraisal of their shares in connection with the merger. Last year, the Delaware Court of Chancery issued an opinion determining that the fair value of Dell's common stock as of the closing date was \$17.62 (nearly 30% higher than the deal price). The Court of Chancery reached this fair value by solely relying on its own DCF analysis. Although the court acknowledged the robust sales process and several recent Court of Chancery decisions holding that the deal price is the most reliable indicator of fair value (particularly when other evidence of fair value was weak), it chose to afford no weight to the company's pre-transactional stock price and deal price in its fair value analysis.

For more on the Court of Chancery's decision, click [here](#).

Supreme Court Opinion

On appeal, the Delaware Supreme Court, sitting *en banc*, in an opinion by Justice Valihura, reversed the Court of Chancery's decision in pertinent part.

- *The Supreme Court found that the reasoning behind the Court of Chancery's decision to give no weight to the deal price did not follow from the record.* The Supreme Court acknowledged that the Court of Chancery fulfilled its statutory obligation to consider all relevant factors, including the deal price. However, while there is no strict requirement that any weight be assigned to the deal price, the Supreme Court found that the Court of Chancery's decision to afford no weight to the deal price here did not follow from its own findings of fact, in particular as follows:
 - The Supreme Court rejected the Court of Chancery's finding that Dell's investors suffered from "investor myopia" by being unduly focused on short-term profit, which—combined with "short-sighted analysts and traders"—led to a fundamental disconnect or "valuation gap" between Dell's inherent value and its market price. The Supreme Court concluded that the record "provides no rational, factual basis for such a 'valuation gap,'" particularly given that Dell was publicly traded, had a deep float, had no controlling stockholder and was extensively followed by industry analysts, all of which resulted in a market that appeared efficient and responsive in valuing Dell.
 - The Supreme Court rejected the Court of Chancery's discounting of the deal price because the primary bidders for Dell were financial sponsors who used an LBO pricing model—with a built-in internal rate of return of roughly 20%—to determine their bid prices. The Supreme Court stressed that there is "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 Supreme Court noted that all bidders, whether financial or strategic, presumably expect some rate of return that makes a major M&A transaction worthwhile. Further, the Supreme Court noted that nothing in the record suggested that any strategic party was interested in acquiring Dell and that "[t]he Court of Chancery ignored an important reality: if a company is one that no strategic buyer is interested in buying, it does not suggest a higher value, but a lower one."
 - The Supreme Court rejected the Court of Chancery's holding that a management buyout may present certain "structural issues" which impede reliance on the deal price. The Supreme Court found that the concerns with management buyouts identified by the Court of Chancery—for example, that third-party bidders may be unwilling to outbid management, which presumably knows the company better than anyone—were all "theoretical" and "not supported by the facts here," particularly given that Mr. Dell expressed willingness to participate with any rival third-party bidder.

The Supreme Court further stated that market indicators are not always the best indicators of fair value and should not necessarily be granted weight in all circumstances. 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 . . . abuses even the wide discretion afforded the Court of Chancery [in appraisal cases].”

- *The Supreme Court encouraged full or partial reliance on the deal price on remand.* Given its conclusions that the Court of Chancery’s key reasons for disregarding market data were erroneous, the “obvious” lack of credibility of the petitioner’s DCF analysis and the questions regarding the reliability of the projections underlying all of the relevant DCF projections, the Supreme Court urged the Court of Chancery to rely on the deal price and made clear that it must “justify” affording any weight to a DCF analysis on remand. The Supreme Court also addressed specific issues that the parties raised with respect to the Court of Chancery’s DCF analysis, including issues relating to tax inputs to the DCF analysis, projections adjustments, and working capital and restricted cash deductions.

Observations

The *Dell* decision continues the recent general trend of Delaware appraisal decisions, including the Delaware Supreme Court’s decision in *DFC Global Corporation v. Muirfield Value Partners, L.P.* in August of this year, to rely on deal price as the best evidence of fair value in arm’s-length mergers. Absent evidence suggesting that the sales process was tainted or unreliable, Delaware courts are likely to continue to afford the deal price considerable if not exclusive weight in their fair value appraisal determinations.

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