

Delaware Supreme Court reverses Court of Chancery's Dell appraisal decision

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Introduction

In *Dell Inc v Magnetar Global Event Driven Master Fund Ltd*(1) the Delaware Supreme Court reversed and remanded the Court of Chancery's valuation of Dell in an appraisal case arising from the 2013 management buyout of Dell by Michael Dell and Silver Lake Partners. The Delaware Supreme Court unanimously held that the Court of Chancery had abused its discretion by failing to give weight to market-based measures of Dell's fair value, including the company's stock price and the deal price. Together with the Delaware Supreme Court's prior decision in *DFC Global Corp v Muirfield Value Partners*,(2) *Dell* further underscores the court's willingness to give significant weight to the deal price as the best measure of fair value when the record establishes that the transaction resulted from a robust and competitive sales process.

Facts

This litigation ensued after Mr Dell and Silver Lake took Dell private in a transaction that paid stockholders \$13.75 per share, a nearly 40% premium on the unaffected stock price. A number of dissenting stockholders sought appraisal. Following trial, the Court of Chancery held that the deal price was not an appropriate measure of fair value, even though the sales process would have "easily... sail[ed] through if reviewed under enhanced scrutiny".(3) Instead, the court conducted its own discounted cash flow (DCF) analysis, concluding that the fair value of Dell was \$17.62 per share – a nearly \$4 increase over the transaction price. The parties cross appealed, with Dell principally arguing that the Court of Chancery had erred by failing to defer to the deal price in determining fair value, and with both sides disputing aspects of the trial court's DCF analysis.

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By statute, the Court of Chancery must consider "all relevant factors" in determining fair value in an appraisal proceeding. Nevertheless, the Delaware Supreme Court reaffirmed that when – as here – the Court of Chancery concludes that a transaction was the product of a robust and untainted sales process, it should be reluctant to ignore market-based measures of fair value. Indeed, as the Delaware Supreme Court explained, when a robust sales process has occurred, it is especially difficult to justify a valuation substantially above the deal price, as "[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".(4) Accordingly, the Court of Chancery's decision to give no weight to the deal price was unupportable in light of its findings that the sales process was robust and competitive.

Further, the Delaware Supreme Court specifically rejected the trial court's arguments as to why it would have been inappropriate to give weight to the deal price.

First, the Delaware Supreme Court rejected the Court of Chancery's conclusion that there was a

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"valuation gap" between Dell's market price and the company's intrinsic value. The Delaware Supreme Court observed that the record evidence simply did not suggest there was an inefficient market for Dell. Although Dell's management and the market clearly disagreed as to the company's value and future prospects, that was not attributable to market ignorance or inefficiency. Rather, as the Delaware Supreme Court explained, the market was fully informed but simply remained sceptical of Dell's management's optimistic forecasts. Moreover, the court observed that the market had good reason to be sceptical, in light of Dell's management's historic track record of missing its own forecasts.

Second, the Delaware Supreme Court rejected the Court of Chancery's conclusion that the deal price was an unreliable measure of fair value because the principal participants in the company's market check process were financial sponsors that were supposedly driven by a desired internal rate of return and therefore less likely to produce a deal price that appropriately measures fair value. As in its earlier decision in *DFC Global*, the Delaware Supreme Court dismissed this concern, explaining that whether a potential buyer is a financial sponsor or strategic bidder bears "no rational connection" to "whether the deal price is a fair price".⁽⁵⁾ Moreover, although Dell was ultimately sold to a financial bidder, a wide range of potential bidders were contacted during the go-shop period – including 20 potential strategic bidders – and the most likely strategic buyer declined to bid. As the Delaware Supreme Court explained, the fact that no strategic bidders were willing to submit a topping bid should, if anything, have given the Court of Chancery considerable pause in determining that the deal price undervalued Dell.

Third, the Delaware Supreme Court critiqued the Court of Chancery's rejection of the deal price because the transaction was a management buyout. The trial court identified a number of characteristics of management buyouts that made, in its view, the deal price a poor proxy for fair value. For example, the Court of Chancery posited that fear of a 'winner's curse' deterred potential acquirers from submitting topping bids. While the Delaware Supreme Court acknowledged that a winner's curse (or other structural elements of a management buyout) could potentially deter topping bids in some transactions, there was no evidence that this had occurred in the Dell transaction. As the Delaware Supreme Court explained, the potential effect of a winner's curse in this case was mitigated by the fact that the other would-be acquirers had conducted extensive due diligence and had access to significant amounts of confidential information. In addition, Mr Dell had pledged to cooperate with other bidders and the record evidence showed that not all bidders particularly valued the participation of him and other incumbent officers in the post-closing entity.

The Delaware Supreme Court left little doubt as to its belief that the transaction price offered sufficient evidence of Dell's fair value, stating that – on remand – the vice chancellor was free to simply enter judgment at the deal price, without the need for further proceedings.⁽⁶⁾ Further, while the Delaware Supreme Court was sceptical that reliance on an above-market, DCF-based valuation would be justified (ie, given the robust and competitive sales process that had occurred), it allowed that on remand the Court of Chancery might nonetheless conduct a revised DCF analysis in determining fair value. Accordingly, the Delaware Supreme Court also addressed certain aspects of the Court of Chancery's DCF analysis.

Comment

Ultimately, the Delaware Supreme Court's *Dell* decision – much like the *DFC Global* ruling before it – indicates that although the Court of Chancery retains wide flexibility in determining fair value in an appraisal proceeding, there is good reason to place exclusive weight on the deal price as the most reliable evidence of fair value where it results from a robust sales process.

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Endnotes

(1) *Dell Inc v Magnetar Global Event Driven Master Fund Ltd (Dell II)*, 2017 WL 6375829 (Del

December 14 2017).

(2) *DFC Global Corp v Muirfield Value Partners*, 2017 WL 3261190 (Del August 1 2017).

(3) *In re Appraisal of Dell Inc (Dell I)*, 2016 WL 3186538 at 29 (Del Ch May 31 2016).

(4) *Dell II*, 2017 WL 6375829 at 27 (slip op).

(5) *Id* at 20 (quoting *DFC Global*, 2017 WL 3261190 at 2, 22).

(6) See *id* at 34: "[W]e give the Vice Chancellor the discretion on remand to enter judgment at the deal price if he so chooses, with no further proceedings."

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