

# DELAWARE CORPORATE LAW BULLETIN

## Dell Appraisal Proceeding: Delaware Court of Chancery Finds Price Payable in Management Buyout Understates “Fair Value” by 28%

*Robert S. Reder\**  
*Loren D. Goodman\*\**

*Vice Chancellor Laster declines to give weight to transaction price  
negotiated by independent board committee and approved by unaffiliated  
stockholders*

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\* Robert S. Reder, Professor of the Practice of Law at Vanderbilt University Law School, has been serving as a consulting attorney at Milbank, Tweed, Hadley & McCloy LLP in New York City since his retirement as a partner in April 2011.

\*\* Vanderbilt University Law School, J.D. Candidate, May 2017. Upon graduation, Loren Goodman will join the Corporate group at Cahill Gordon & Reindel in New York City. Many thanks to Professor Reder for his invaluable mentorship and to the *Vanderbilt Law Review* for the opportunity to participate in this *En Banc* series.

## INTRODUCTION

The Delaware General Corporation Law (“DGCL”) grants the statutory remedy of appraisal to dissenting stockholders who object to the price payable to them in a majority-approved cash-out merger.<sup>1</sup> Any stockholder who does not vote in favor of the merger is entitled to dissent and seek a determination by the Delaware Court of Chancery (“Chancery Court”) of the “fair value” of the dissenting stockholder’s shares.<sup>2</sup> Notably, DGCL § 262(h) directs the Chancery Court to take into account “all relevant factors” when determining fair value, thus leaving the judicial inquiry quite open-ended.<sup>3</sup> The appraised value may be *greater than, the same as, or lower than* the negotiated transaction price. However, the statute prohibits any consideration of “value arising from the accomplishment or expectation of the merger.”<sup>4</sup>

Despite the apparent latitude to fix value granted by DGCL § 262(h) to the Chancery Court, the appraisal remedy was historically overlooked, considered too economically infeasible to pursue.<sup>5</sup> However, over the past decade, the M&A world has witnessed an explosive rise in the number of appraisal proceedings, with a nearly ten-fold increase in the dollar value of such claims.<sup>6</sup> This surge is due largely to the development and increased activity of so-called appraisal arbitrageurs, hedge funds and other sophisticated investors who seek to profit from the appraisal mechanism.<sup>7</sup>

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1. DEL. CODE ANN., tit. 8, § 262 (West). Under § 262(b), appraisal is not available to holders of publicly-traded stock who receive only shares of publicly-traded stock in exchange for their own shares.

2. *Id.*

3. *Id.*

4. *Id.*

5. See Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U.L. REV. 1551, 1553 (2015) (noting the historical existence of a “prevailing academic view that appraisal is ‘seldom utilized’ and that the hurdles involved make it too cumbersome for stockholders to call upon profitability”). Many suggest that the Chancery Court’s decision in *In re Appraisal of Transkaryotic Therapies, Inc.* is largely responsible for the uptick in modern appraisal litigation. See *In re Appraisal of Transkaryotic Therapies, Inc.*, 2007 WL 1378345 (Del. Ch. May 2, 2007).

6. See *supra* Korsmo & Myers, note 5 at 1568 (noting that 129 appraisal petitions were filed in Delaware courts from 2004–2013).

7. For a more detailed discussion of appraisal arbitrage and recent related Delaware case law, see Robert S. Reder & Stanley Onyeador, *Delaware Chancery Disqualifies Lead Petitioners in Dell Appraisal Who Inadvertently Voted “FOR” Management Buyout*, 69 VAND. L. REV. EN BANC 279 (2016). Because shares purchased after the announcement of a merger qualify for appraisal, the process is particularly ripe for exploitation by savvy investors. For a further discussion regarding the policy concerns associated with appraisal litigation, see Stanley Onyeador, *The*

The increased volume of appraisal litigation has in turn exposed fault lines in the Chancery Court's approach to DGCL § 262, including in the determination of the fair value of target company shares. While several decisions favored transaction price as a proxy for fair value,<sup>8</sup> Vice Chancellor J. Travis Laster's recent rejection of transaction price in *In re Appraisal of Dell, Inc.* ("*Dell*") signals a possible disruption in that trend.<sup>9</sup> In disregarding the negotiated premium price of \$13.75 per share in an appraisal triggered by the high-profile, management-led buyout ("MBO") of Dell Inc. ("Dell" or "Company") by founder Michael Dell and his private equity partner, the Vice Chancellor engaged in a thorough discussion of general market failures, the distinction between appraisal proceedings and breach of fiduciary duty claims, and the structural impediments throughout the MBO sales process which resulted, in the Vice Chancellor's view, in a lack of information, competition, accuracy, and ultimately, fair value. Instead, Vice Chancellor Laster conducted his own discounted cash flow ("DCF") analysis to arrive at a fair value of \$17.62 per share, in effect a determination that the MBO price fell short of fair value by nearly \$6 billion.<sup>10</sup>

Although several structural aspects unique to the *Dell* sales process potentially narrow the implications of the opinion, Vice Chancellor Laster's decision may profoundly affect the appraisal landscape moving forward. Although detailed, the following summary of the Vice Chancellor's 114-page opinion provides a useful explication of the factors the Chancery Court will consider in determining the weight to be given to negotiated transaction price in a DGCL § 262 appraisal proceeding.

## I. BACKGROUND

In 2013, Mr. Dell and his private equity partner Silver Lake Capital ("Silver Lake") sponsored an MBO of Dell.<sup>11</sup> Dell is the well-known manufacturer of PCs, servers, and storage devices. Throughout

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*Chancery Bank of Delaware: Appraisal Arbitrators Expose Need to Further Reform Defective Appraisal Statute*, 70 VAND. L. REV. 339 (2017).

8. See e.g., *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726, at \*1, \*23 (Del. Ch. Jan. 30, 2015); *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771, at \*1 (Del. Ch. Oct. 21, 2015), *judgment entered*, (Del. Ch. Nov. 3, 2015); *Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807, at \*1, \*13 (Del. Ch. Nov. 1, 2013), *judgment entered*, (Del. Ch. June 17, 2014).

9. *In re Appraisal of Dell, Inc.*, 2015 WL 3186538, at \*1 (Del. Ch. May 31, 2016).

10. See Andrew R. Sorkin, *Who Handles 'Fair Value'? In Dell's Case, a Judge*, N.Y. TIMES (June 6, 2016), <https://www.nytimes.com/2016/06/07/business/dealbook/who-decides-fair-value-in-dells-case-a-judge.html>.

11. Before the MBO, Mr. Dell owned approximately 15.4% of Dell's outstanding shares.

the mid-2000s, Dell faced repeated industry pressure, including threats from low-margin producers, Apple products, and cloud-based storage systems, leading Mr. Dell to rebrand the Company and pursue an extensive and rapid growth plan. Between 2010 and 2012, Dell acquired eleven businesses, including several non-PC businesses, for an aggregate cost of \$14 billion.

Throughout and following this acquisition period, Mr. Dell and his management team stressed that it would take time to integrate the acquired businesses and produce a value-add for the Company. Thus, they encouraged investors to concentrate on long-term prospects rather than revenue creation and short-term earnings. The public markets disagreed with this optimistic, long-term focus, particularly in the face of repeated quarterly declines in revenue and earnings, and consistently priced Dell stock far below management valuations. In fact, the stock market price fell below \$10 per share in the second half of 2012.

In mid-2012, several financial sponsors contacted Mr. Dell regarding the possibility of an MBO. Given the operational flexibility that would be afforded to Dell if it ceased to be a public company, Mr. Dell decided to proceed. At the same time, Mr. Dell remained “open to considering all alternatives” throughout the lengthy sales process to follow.<sup>12</sup> The Dell board of directors formed a special committee of independent directors (“Committee”) with broad powers to consider “strategic alternatives.”<sup>13</sup> The Committee in turn retained JPMorgan Chase & Co. (“JPMorgan”) as its financial advisor, with Evercore Partners Inc. (“Evercore”) later coming on board as a secondary financial advisor. Throughout the pre-signing period, Dell received valuation presentations from JPMorgan and Evercore, as well as from Goldman Sachs Group, Inc. (“Goldman Sachs”), who was brought in to assist management in preparing projections. These presentations relied on a base case prepared by another consultant retained by the board, Boston Consulting Group (“BCG”). The advisors’ guidance is summarized below. The consensus seemed to be that “[i]llustrative standalone valuation analyses result[ed] in [Company] value outcomes that [were] significantly higher than the current share price,”<sup>14</sup> and further, Dell’s “low valuation ‘did not match apparent company strengths,’ but instead reflected ‘investor concern.’”<sup>15</sup>

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12. *Dell*, 2015 WL 3186538, at \*30.

13. *Id.* at \*3.

14. *Id.* at\*15.

15. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*17 (Del. Ch. May 31, 2016). BCG’s projections were based on three cases: the BCG Base Case assuming no cost savings, the BCG 25%

<b>JPMorgan Initial Valuation – October 9, 2012</b>	
<b>Previous Day Closing Price: \$9.66</b>	
DCF September Case	\$20–\$27
DCF Street High	\$19.25–\$25.75
DCF Street Low	\$9.50–\$11.50
LBO Analysis	\$11.75–\$14.25

<b>Goldman Sachs Initial Valuation – October 10, 2012</b>	
<b>Previous Day Closing Price: \$9.56</b>	
LBO Analysis	\$16.00

<b>Evercore Initial Valuation – January 7, 2013</b>	
<b>Previous Day Closing Price: \$10.97</b>	
DCF Analysis	\$14.27–\$18.40
LBO Analysis	\$12.36–\$16.08

During the pre-signing phase, three potential financial bidders signed confidentiality agreements: Silver Lake, Kohlberg Kravis Roberts & Co. LLP (“KKR”), and Texas Pacific Group (“TPG”). Notably, no strategic bidders were contacted, consistent with JPMorgan’s advice that “there was a low probability of strategic buyer interest in acquiring the Company.”<sup>16</sup> While TPG quickly dropped out of the process, KKR and Silver Lake each submitted a bid. However, citing risks inherent to the PC industry, KKR soon withdrew, leaving Silver Lake and its partner Mr. Dell (together, the “Buyout Group”) with no pre-signing competition. Silver Lake’s initial offer of \$11.22–\$12.16 per share was eventually increased in the merger agreement signed on February 5, 2013 to \$13.65 (“Original Merger Consideration”). Although the Original Merger Consideration was either below or at the low end of the valuations provided by the Company’s advisors, it represented a significant premium to Dell’s \$9.35 per share trading price. The merger agreement provided for Mr. Dell to roll over his 15.4% stake in Dell (at

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Case under which 25% of a cost-savings initiative announced by Dell would be attained, and the BCG 75% Case under which 75% of the cost savings would be attained.

16. *Id.* at \*12.

a valuation lower than the price to be received by the public stockholders) and invest an additional \$500 million in the Company. As a result, “[p]ost-closing, Mr. Dell would own 74.9% of Dell and Silver Lake would own 25.1%.”<sup>17</sup> The key provisions of the merger agreement included (i) a 45-day go-shop period in which the Committee would solicit superior bids (“Go-Shop”), (ii) a one-time match right for the Buyout Group, and (iii) a \$180 million Go-Shop termination fee, followed by a post-Go-Shop termination fee of \$450 million.

During the Go-Shop, Evercore, acting on behalf of the Committee, contacted sixty parties, most notably financial sponsor Blackstone Management Partners LLC (“Blackstone”) and Hewlett-Packard Company (“HP”), Dell’s “closest competitor and peer.”<sup>18</sup> Despite executing a confidentiality agreement, “HP never accessed the data room and did not submit an indication of interest.”<sup>19</sup> However, Carl Icahn, a significant Company investor, and Blackstone both made submissions that qualified as superior bids under the merger agreement, valued at approximately \$13.37–\$14.42 per share and \$14.25 per share, respectively. However, further PC market setbacks led Blackstone to drop out. Then, in response to Mr. Icahn’s threatened proxy contest to unseat the incumbent directors and pursue an alternative transaction, the Buyout Group agreed to amend the merger agreement to raise the merger price to \$13.75 per share (“Final Merger Consideration”) and provide a cash dividend resulting in a total buyout price of \$13.96 per share. Mr. Dell agreed to finance this increase by further reducing the valuation for his rollover shares.

The Dell board approved the revised transaction on August 2, 2013 after issuance of fairness opinions by JPMorgan and Evercore and receipt of the Committee’s recommendation. On September 12, 2013, over Mr. Icahn’s objection, holders of 57% of the shares outstanding, representing 70% of the shares present and voting, voted to approve the MBO.<sup>20</sup> Closing occurred on October 29, 2013.

Thereafter, numerous stockholders asserted appraisal rights and sought a valuation of their shares by the Chancery Court. In the proceeding before Vice Chancellor Laster, Dell argued that the negotiated MBO price constituted fair value for purposes of DGCL § 262, while the dissenting stockholders presented expert testimony in favor of a much higher DCF valuation. Not surprisingly, Dell countered

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17. *Id.* at \*26.

18. *Id.* at\*13.

19. *Id.* at\*28.

20. Vice Chancellor Laster characterized these as “relatively low margins” of approval.

with expert testimony in favor of a significantly lower DCF valuation, in fact, one below the Final Merger Consideration. The issue was joined.

## II. VICE CHANCELLOR LASTER'S LEGAL ANALYSIS

### A. *The "Fair Value" Determination*

Vice Chancellor Laster began his analysis by laying out the rules of the road for analyzing "fair value" under DGCL § 262. The Vice Chancellor described the process as "a limited legislative remedy" calling for "a judicial determination of the intrinsic worth" of the shares being appraised.<sup>21</sup> Unlike the typical Chancery Court proceeding, "both sides" in an appraisal hearing "have the burden of proving their respective valuation positions by a preponderance of the evidence."<sup>22</sup> For its part, the Chancery Court "has discretion to select one of the parties' valuation models"<sup>23</sup> or, "[w]hen . . . none of the parties establishes a valuation that is persuasive, the Court must make a determination based on its own analysis."<sup>24</sup>

Next, the Vice Chancellor noted that fair value is "a jurisprudential concept that draws more from judicial writings than from the appraisal statute itself."<sup>25</sup> It is not the same as the "economic concept of fair market value," but rather "a largely judge-made creation, freighted with policy considerations."<sup>26</sup> Basically, the dissenting stockholder "is entitled to be paid for that which has been taken from him, *viz.*, his proportionate interest in a going concern."<sup>27</sup> This includes consideration of "all factors and elements which reasonably might enter the fixing of value," including those "which throw any light on future prospects . . . ."<sup>28</sup> Further, fair value "is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all the

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21. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*41 (Del. Ch. May 31, 2016) (quoting Cede & Co. v. Technicolor, Inc. (*Technicolor I*), 542 A.2d 1182, 1186 (Del. 1988)).

22. *Id.* at \*42 (quoting M.G. Bancorporation, Inc. v. Le Beau, 737 A.2d 513, 520 (Del. 1999)).

23. *Id.* (quoting M.G. Bancorporation, 737 A.2d at 525-26).

24. *Id.* at \*43 (quoting Cooper v. Pabst Brewing Co., 1993 WL 208763, at \*8 (Del. Ch. June 8, 1993)).

25. *Id.* (quoting Del. Open MRI Radiology Assocs., P.A. v. Kessler, 898 A.2d 290, 310 (Del. Ch. 2006)).

26. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*43 (Del. Ch. May 31, 2016) (quoting Finkelstein v. Liberty Digital, Inc., 2005 WL 1074364, at \*12 (Del. Ch. Apr. 25, 2005)).

27. *Id.* at \*44 (quoting Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950)).

28. *Id.*

relevant evidence and based on considerations of fairness.”<sup>29</sup> Finally, this determination must be made “just before the merger transaction ‘on the date of the merger.’”<sup>30</sup>

Of course, the appraisal proceeding seeks only to evaluate the final price—“[t]he court does not judge the directors’ motives or the reasonableness of their actions, but rather the outcome they achieved.”<sup>31</sup> Thus, in the appraisal context, “[t]he sales process is useful to the extent—and only to the extent—that it provides evidence of the company’s value on the date the merger closed.”<sup>32</sup> As Vice Chancellor Laster explained, “it is entirely possible that the decisions made during a sales process could fall within *Revlon*’s range of reasonableness, and yet the process still could generate a price that was not persuasive of fair value in an appraisal.”<sup>33</sup> While admitting that Dell’s sales process “easily would sail through” any *Revlon* challenge, the Vice Chancellor concluded that “a combination of factors undercut the relationship between Final Merger Consideration and fair value, undermining the persuasiveness of the former as evidence of the latter.”<sup>34</sup>

### *B. Limitations on Transaction Price as Proxy for “Fair Value”*

According to Vice Chancellor Laster, if a “merger giving rise to appraisal rights ‘resulted from an arm’s-length process between two independent parties, and if no structural impediments existed that might materially distort the “crucible of objective market reality,”’ then a reviewing court should give substantial evidentiary weight to the merger price as indicative of fair value.”<sup>35</sup> On the other hand, he added, “the Delaware Supreme Court has eschewed market fundamentalism by making clear that market price data is neither conclusively determinative of nor presumptively equivalent to fair value.”<sup>36</sup>

Noting the fact-specific nature of establishing the reliability of transaction price as fair value, Vice Chancellor Laster remarked that, as a general matter, “a variety of factors may undermine the potential

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29. *Id.* at \*45 (quoting *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at \*2 (Del. Ch. July 9, 2004), *aff’d in part, rev’d on other grounds*, 884 A.2d 26 (Del. 2005)).

30. *Id.* at \*44 (quoting *Cede & Co. v. Technicolor, Inc. (Technicolor I)*, 542 A.2d 1182, 1186 (Del. 1988)).

31. *Id.* at \*58.

32. *In re Appraisal of Dell, Inc.*, 2015 WL 3186538, at \*58 (Del. Ch. May 31, 2016).

33. *Id.*

34. *Id.*

35. *Id.* at \*47–48 (quoting *Highfields Capital, Inc. v. AXA Fin., Inc.*, 939 A.2d 34, 42 (Del. Ch. 2007)).

36. *Id.* at \*48.

persuasiveness of the deal price as evidence of fair value.”<sup>37</sup> These factors, not unique to the Dell MBO, include:

*Delayed Closings.* Although the market may accurately value a transaction *at the time of signing*, “the valuation date for an appraisal is the date of closing.”<sup>38</sup> Thus, where the post-signing period is particularly drawn out due to required regulatory approvals or a stockholder vote, changes in circumstance may alter the value of the business, rendering the originally negotiated deal price a flawed proxy of fair value.

*M&A Markets vs. Public Trading Markets.* The lack of liquidity and fungibility in the M&A market, particularly in the context of an MBO, understates “the reality that the M&A market for an entire company has different and less confidence-promoting attributes than the public markets.”<sup>39</sup> Due to “fewer buyers” and “the dissemination of critical, non-public due diligence information” only to “participants who sign confidentiality agreements,” it is “erroneous to ‘conflate the stock market (which is generally highly efficient) with the deal market (which often is not).’”<sup>40</sup>

*Synergies.* Because the appraisal statute demands that fair value be determined based on going concern value *without* regard to perceived value enhancements related to expectation of a merger, any synergies priced into the consideration must be disregarded.

In sum, the Vice Chancellor noted that the foregoing “three factors suggest that even with a public company target, deal price will not inevitably equate to fair value”; rather, fair value “could be higher or lower.”<sup>41</sup>

### *C. Failure of Dell Sales Process to Achieve “Fair Value”*

Turning to recent history, the Vice Chancellor pointed to five decisions since 2010 in which “the Court of Chancery has found the deal price to be the most reliable indicator of the company’s fair value, particularly when other evidence of fair value was weak.”<sup>42</sup> In a

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37. *Id.* at \*51.

38. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*51 (Del. Ch. May 31, 2016).

39. *Id.* at \*52 (quoting Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1320 (2016)).

40. *Id.* at \*52–53.

41. *Id.* at \*54

42. *Id.* at 50. (citing *BMC v. Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *LongPath Capital, LLC v. Ramtron Int’l Corp.*, 2015 WL 4540443 (Del. Ch. June 30, 2015); *Merlin P’rs LP v. AutoInfo, Inc.*, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015); In re Appraisal of Ancestry.com, Inc., 2015 WL 399726 (Del. Ch. Jan. 30, 2015); *Huff Fund Inv. P’ship v. CKx, Inc.*, 2013 WL 5878807 (Del. Ch. Nov. 1, 2013)).

footnote, however, he distinguished these decisions from the facts before him in the Dell appraisal.<sup>43</sup> Based on market failures and the difficulty of achieving fair value in even the most well-run MBO sales process (not to mention one involving a company of Dell's size and complexity), the Vice Chancellor found that Dell failed to carry its burden of proving that either the Original Merger Consideration of \$13.65 or the Final Merger Consideration of \$13.75 was an adequate proxy for fair value.

### 1. Pre-Signing Period

In this connection, Vice Chancellor Laster first examined the entirety of the sales process leading to the original signing of the merger agreement. He identified three structural impediments that, in his view, artificially depressed the Original Merger Consideration:

*LBO Models.* Given that only financial sponsors were engaged in the first phase of bidding, their use of leveraged buyout pricing models ("LBO Models") dominated the valuation discussions. And because LBO Models focus solely on sponsors' ability to extract a desired rate of return (usually 20% or more) from the investment—constrained by the amount of leverage that the target company's cash flow can support—the Vice Chancellor postulated that the range of prices produced is often unrelated to the true enterprise value of the investment.<sup>44</sup> Simply put, "the highest price a bidder is willing to pay is not the same as fair value."<sup>45</sup> Further, he explained that the use by all potential bidders of essentially the same LBO Model effectively extinguished any possibility of meaningful price competition. The Vice Chancellor also noted that the Committee itself relied heavily on LBO modeling when evaluating the bids for the Company, rather than the long-term, intrinsic value previously championed by Mr. Dell and Company management. As such, the Vice Chancellor concluded that "the Original Merger Consideration was dictated by what a financial sponsor could pay and still generate outsized returns," rather than considering the Company's fair value as a going concern.<sup>46</sup>

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43. *Id.* at 50, n.13 ("Unlike the current case, none of these decisions involved an MBO. And unlike the current case, reliable projections and persuasive evidence of a significant valuation gap did not exist . . . . All the cases either involved a more active pre-signing market check or the process was kicked off by an unsolicited third party bid.").

44. In this connection, the Vice Chancellor noted JPMorgan's explanation that a financial sponsor employing an LBO Model would be unable to pay an amount even close to Dell's going-concern value, given constraints on minimum returns and permissible leverage.

45. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*62 (Del. Ch. May 31, 2016) (citing Appraisal of Orchard, 2012 WL 2923305, at \*1, \*5 (Del. Ch. 2012)).

46. *Id.* at \*32.

*Valuation Gap.* The Committee’s continued reliance on Dell’s stock market price as an indicator of value, despite the “significant valuation gap” between fair value and stock market value, also was of concern to the Vice Chancellor. He found this valuation gap was “driven by (i) analysts’ focus on short-term, quarter-by-quarter results and (ii) the Company’s nearly \$14 billion investment in its transformation, which had not yet begun to generate the anticipated results.”<sup>47</sup> In this vein, the Vice Chancellor noted the opportunistic timing of the MBO, given that “the optimal time to take a company private is after it has made significant long-term investments, but before those investments have started to pay off and market participants have begun to incorporate those benefits into the price of the Company’s stock.”<sup>48</sup> This valuation gap in turn had an “anchoring effect” on all valuations and the related bidding, in bid price, exacerbated by the “market myopia” surrounding Dell’s prospects.<sup>49</sup>

*Lack of Competition.* Vice Chancellor Laster also decried what he saw as a lack of meaningful pre-signing competition in the MBO process. Because “[g]o-shops in MBO transactions rarely produce topping bids, [ ] the bulk of any price competition occurs before the deal is signed.”<sup>50</sup> Inasmuch as the Committee engaged only three potential financial sponsors—to the exclusion of any strategic bidders, including “the obvious choice” HP—and KKR and TPG quickly dropped out, the Vice Chancellor identified minimal pre-signing competition.<sup>51</sup> Thus, “[w]ithout a meaningful source of competition, the Committee lacked the most powerful tool that a seller can use to extract a portion of the bidder’s anticipated surplus.”<sup>52</sup>

## 2. Go-Shop Period

Next, turning to the post-signing Go-Shop period, Vice Chancellor Laster identified three more structural impediments that artificially depressed the Final Merger Consideration:

*“Price Bump.”* Given that the two serious Go-Shop bidders, Blackstone and Mr. Icahn, employed LBO Models, the fact that their

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47. *Id.* at \*70 (“During the sales process, despite the Company’s depressed and erratic sock price, the Committee and its advisors used the Company’s market price as a key input. In fact, trading price was the only quantitative metric the Committee cited in the Company’s proxy statements when explaining its recommendation that stockholders approve the Merger.”).

48. *Id.* at \*70

49. *Id.* at \*73

50. *Id.* at \*78–79

51. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*82 (Del. Ch. May 31, 2016).

52. *Id.*

topping bids exceeded the Final Merger Consideration “not only help[ed] confirm that the Original Merger Consideration did not provide fair value, but . . . also undercut the notion that the Final Merger Consideration provided fair value.”<sup>53</sup> Although the Go-Shop produced a 2% increase in value, the Vice Chancellor characterized this increase as insufficient to establish fair value, given that the value was constrained by LBO modeling: “[t]he fact that the holders of just over half of the unaffiliated shares outstanding took the price does not mean it is equivalent to fair value.”<sup>54</sup>

*Structural Impediments.* Despite the “relatively open” structure of the Go-Shop, the fact that the transaction was an MBO, coupled with the Company’s size and complexity, led the Vice Chancellor to label the Go-Shop a failure for purposes of producing fair value. Further, he pointed out that “the threat of the winner’s curse,” driven largely by the informational asymmetries present in an MBO, often discourages financial bidders from participating in a Go-Shop.<sup>55</sup> Although generally “endemic to MBO go-shops,” the winner’s curse in this instance was exacerbated by the nature and depth of Mr. Dell’s stature and intimate knowledge not only of the Company but of the personal computing industry.<sup>56</sup> Despite Mr. Dell and the Committee’s cooperation and responsiveness in providing other bidders with appropriate information, the Vice Chancellor believed the “practical hurdle” created by the winner’s curse further diminished the efficacy of the Go-Shop.

*Mr. Dell’s Participation in the Buyout Group.* The Vice Chancellor also considered whether Mr. Dell’s value to the Company and inclusion in the Buyout Group created further impediments for potential bidders: “[a] competing bidder that did not have Mr. Dell as part of its buyout group would be bidding for a company without that asset and would end up with a less valuable company.”<sup>57</sup> Given Mr. Dell’s willingness to entertain other bids and “evidence that Blackstone and Icahn did not regard Mr. Dell as essential to their bids,” however, the Vice Chancellor characterized Mr. Dell’s value and association with the Buyout Group as “impediments, but not insuperable ones.”<sup>58</sup>

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53. *Id.* at \*74

54. *Id.* at \*87

55. *Id.* at \*94. In effect, a winning financial bidder who has not teamed with management and outbids the management buyout group is faced with the conundrum whether it somehow understands the company better than management or in fact overpaid.

56. *Id.* at \*43.

57. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*43 (Del. Ch. May 31, 2016).

58. *Id.* at \*98.

*D. The Vice Chancellor's DCF Analysis*

Following his lengthy takedown of the sales process and rejection of the MBO price as a proxy for fair value, Vice Chancellor Laster turned to the competing DCF analyses presented to the Court. According to the Vice Chancellor, a “DCF analysis is a well-established method of determining the going concern value of a corporation. ‘[T]he DCF . . . methodology has featured prominently in this Court because it is the approach that merits the greatest confidence within the financial community.’”<sup>59</sup> Unlike the LBO Model, which “solves for the [bidder’s] internal rate of return,” a DCF analysis “solves for the present value of the firm.”<sup>60</sup>

However, the respective experts retained by the parties presented wildly disparate DCF values for Dell. The dissenting stockholders’ expert claimed that the \$13.75 Final Merger Consideration undervalued the Company by more than 100%. The Vice Chancellor rejected this valuation out-of-hand, explaining “[h]ad a value disparity of that magnitude existed, then HP or another technology firm would have emerged to acquire the Company on the cheap.”<sup>61</sup> On the other hand, because (as explained above) the Vice Chancellor concluded that the MBO price understated going concern value, he also rejected the Dell expert’s \$12.68 per share DCF valuation.<sup>62</sup>

Accordingly, Vice Chancellor Laster performed his own DCF analysis, relying on a mix of his own assumptions and assumptions used by the respective experts in their analyses. The Vice Chancellor ran two separate DCF models: one based on the Dell expert’s more conservative case that relied on the analysis prepared by BCG, generating a valuation of \$16.44 per share, and the other based on the Dell expert’s more optimistic case that relied on an analysis prepared for the Buyout Group’s lenders, generating a valuation of \$18.81 per share.<sup>63</sup> “Having no reason to prefer one realistic case over the other,” the Vice Chancellor took the mean average of the two DCF valuations to

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59. *Id.* at \*99 (quoting *Owen v. Cannon*, 2015 WL 3819204, \*1, \*16 (Del. Ch. June 17, 2015)). As opposed to LBO Models, the DCF Model focuses on the intrinsic, long-term value of a company. In its most distilled form, the DCF valuation relies on projections of future free cash flows of the company, which are then discounted back to determine the present value of the modeled company.

60. *Id.* at \*63.

61. *Id.* at \*98–99.

62. Notably, despite using similar models, the differing assumptions utilized by the experts resulted in a \$28 billion divergence in their conception of “fair value.”

63. For a more detailed discussion of these assumptions, see Appendix A.

generate a fair value of \$17.62 per share, constituting a 28% premium over the \$13.75 per share MBO price.<sup>64</sup>

#### CONCLUSION

By finding a nearly \$6 billion discrepancy between the Company's fair value for purposes of DGCL § 262 and the negotiated transaction MBO price in *Dell*, Vice Chancellor Laster threw a curve ball at M&A practitioners who had become used to relying on transaction price as the best evidence of fair value. The Vice Chancellor's comprehensive explanation of the reasons underlying his rejection of the MBO price and the DCF valuations of the rival valuation experts in favor of his own DCF analysis should be informative for the pricing and structuring of future transactions.

However, the full implications of this opinion have yet to be tested. Assuming a broad reading, *Dell* may in fact signal a shift of Delaware law away from deference to negotiated transaction price, further instigating appraisal arbitrageurs to capitalize on the appraisal process. On the other hand, *Dell* may be narrowly confined to the context of MBOs, where the structural impediments to fair value warrant more careful consideration by the court to determine whether, and the extent to which, negotiated transaction prices should influence calculation of fair value.

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64. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*51 (Del. Ch. May 31, 2016).

## APPENDIX A

Vice Chancellor Laster explained that the basic DCF analysis involves three discrete steps: (1) valuing future projected cash flows for a discrete period, (2) fixing a terminal value for the entity based on projected cash flows expected after the end of the discrete period, and (3) applying a discount to determine the present value of items (1) and (2).<sup>65</sup> The Vice Chancellor based his DCF assumptions on many of those utilized by Professor Bradford Cornell, the dissenting stockholders' expert, and Professor Glenn Hubbard, Dell's expert. The Vice Chancellor also noted the 126% discrepancy between the two experts' valuation, however, a "recurring problem" in appraisal proceedings. For the sake of comparison, the tables below list the points of substantial disagreement between the experts, as well as Vice Chancellor Laster's assessment of the correct metric for each assumption:

<u>Assumption</u>	<u>Professor Cornell</u>	<u>Professor Hubbard</u>	<u>Vice Chancellor Laster</u>
<b>Forecasts of Project Cash Flows</b>	<ul style="list-style-type: none"> <li>• BCG 25%</li> <li>• BCG 50%</li> <li>• Bank Case</li> </ul>	<ul style="list-style-type: none"> <li>• Adjusted BCG 25%<sup>66</sup></li> <li>• Adjusted Bank Case<sup>67</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Adjusted BCG 25%</li> <li>• Adjusted Bank Case</li> </ul>
<b>Perpetuity Growth Rate for Terminal Period</b>	<ul style="list-style-type: none"> <li>• 1%</li> </ul>	<ul style="list-style-type: none"> <li>• 2%</li> </ul>	<ul style="list-style-type: none"> <li>• 2%</li> </ul>

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65. *Dell*, 2015 WL 3186538, at \*99.

66. To account for the fact that the BCG 25% case was never updated from its original preparation date using projections from January 2013, Professor Hubbard adjusted the amount by updating revenue projections for desktop PC and notebook sales, updated revenue projections from secondary product sales, adjusted for tax-based compensation, and created "a five-year transition period in projections from FY 2018 through FY 2022." *Id.* at \*102. While noting that, "our appraisal jurisprudence is skeptical of litigation-driven adjustments to management projections," the Vice Chancellor found that "Hubbard persuasively justified his changes and this court has used adjusted projections when the expert has provided sufficient support for the modifications." *Id.*

67. Adjusted for non-recurring restructuring expenses and stock-based compensation. *Id.* at \*104.

<b>Taxes</b>	• 21%	• 17.8% (projection period & transition period) • 35.8% (terminal period)	• 21%
<b>Weighted Average Cost of Capital*</b>	• See below	• See below	• 9.46%
<b>Adjustments to Cash**</b>	• + \$6.158B	• See below	• See below

\*Weighted Average Cost of Capital

In determining the Weighted Average Cost of Capital (“WACC”), the Vice Chancellor noted the experts “disputed every input except for the risk free-rate of 3.31%.”<sup>68</sup> To generate his own WACC of 9.46%, Vice Chancellor Laster used the following inputs:<sup>69</sup>

	<u>Professor Cornell</u>	<u>Professor Hubbard</u>	<u>Vice Chancellor Laster</u>
<b>Cost of Debt<sup>70</sup></b>	—	—	• 4.95% (based on BBB rated bonds)
<b>Capital Structure</b>	• 75.25% equity	• 74.75% equity	• 75.0% equity
<b>Beta<sup>71</sup></b>	• 1.35	• 1.31	• 1.31
<b>Equity Risk Premium</b>	• 5.50%	• 6.41%	• 6.11%

68. *Id.* at \*108.

69. *Id.*

70. The precise cost of debt utilized by the respective experts is unclear from the Opinion.

71. Professor Cornell’s beta was based upon an analysis of peer companies, whereas Professor Hubbard’s was based on weekly observations of the company over a two-year period. In re Appraisal of Dell, Inc., 2015 WL 3186538, at \*108 (Del. Ch. May 31, 2016). Given the lack of companies that could be considered true peers to Dell, Vice Chancellor Laster favored Professor Hubbard’s company-specific beta. *Id.*

**\*\*Adjustments to Cash**

The experts also disputed the appropriate amount of excess cash to be added to their valuations. “At the time of the Merger, the Company had \$11.040 billion in cash and \$5.054 billion in debt on its balance sheet. After adding back \$172 million in transaction-related expenses, the Company had net cash of \$6.158 billion.”<sup>72</sup> While Professor Cornell added back the full amount of net cash, both Professor Hubbard and Vice Chancellor Laster made several adjustments, listed below:

	<b><u>PROFESSOR CORNELL</u></b>	<b><u>PROFESSOR HUBBARD</u></b>	<b><u>VICE CHANCELLOR LASTER</u></b>
<b>Working Capital</b>	—	• (\$3 billion)	• (\$3 billion)
<b>Restricted Cash</b>	—	• (\$2 billion)	• (\$1.2 billion)
<b>Deferred Taxes</b>	—	• (\$2.24 billion)	—
<b>Contingent Taxes</b>	—	• (\$3 billion)	—

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72. *Id.* at \*109.