

# Client Update

## Delaware Court of Chancery Determines Fair Value in Dell Appraisal

### NEW YORK

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In a 114-page opinion after a four-day appraisal trial, Vice Chancellor Laster determined that the fair value of Dell Inc.'s common stock at the time of its sale, by means of a merger, to Michael Dell and Silver Lake Partners was \$17.62 per share – approximately 28% more than the final merger consideration of \$13.75.<sup>1</sup>

The court rejected Dell's contention that the negotiated merger consideration was the best evidence of the Company's fair value. Vice Chancellor Laster identified three factors that lead merger prices to deviate – up or down – from fair value: (i) the passage of time between agreement on price and the closing of the merger (the latter being the date as of which fair value is calculated in an appraisal proceeding), (ii) the relative thinness of the M&A market relative to public trading markets, and (iii) the existence of synergies (which are not to be considered in appraisal). While acknowledging that the negotiated price was relevant – and despite observing that the transaction would “sail through” if reviewed under enhanced scrutiny and opining that Dell's special committee and its advisors did “many praiseworthy things, and it would burden an already long opinion to catalog them”<sup>2</sup> – the Vice Chancellor found that the sale process did not result in a fair value for the Company.

The court identified three principal reasons why the sale process failed to result in fair value. First, the Vice Chancellor found that the merger price had been limited by Silver Lake's “need to achieve IRRs of 20% or more to satisfy its own investors,” as well as by limits on the amount of leverage Dell could support. Second, he found “widespread and compelling evidence” that the market undervalued Dell's stock, creating an “anchoring effect” that resulted in an undervalued bid. Third, he believed there was a lack of meaningful price

<sup>1</sup> *In re: Appraisal of Dell Inc.* (Del. Ch. May 31, 2016).

<sup>2</sup> Debevoise represented Dell's special committee in connection with the transaction.

competition in the pre-signing phase of the transaction. The Vice Chancellor specifically criticized the special committee's decisions not to engage, prior to signing, with eventual go-shop bidder Blackstone or "obvious choice" potential strategic bidder Hewlett Packard (which declined to actively participate in the go-shop process despite being granted access to the data room). Vice Chancellor Laster noted that MBO go-shops rarely generate topping bids, and, in fact, found the two higher bids elicited by Dell's go-shop to be evidence that the original merger price was "relatively low" and "did not equate to fair value." According to the Vice Chancellor, the problem was not the design of the "relatively open" go-shop, but rather the sheer size and complexity of the Company.

Having found the outcome of the sale process not to be the most reliable evidence of fair value, the court reviewed the discounted cash flows analyses of the parties' valuation experts, concluding that fair value on the date of the merger was \$17.62 per share – substantially closer to the \$12.68 per share value proposed by Dell than the \$28.61 per share value proposed by the petitioners.

The financial impact to Dell of the appraisal decision has, for the time being, been limited by the court's May 11 ruling disqualifying most of the shares seeking appraisal because they were voted, albeit mistakenly, in favor of the merger.<sup>3</sup> However, unless overturned on appeal, the valuation decision may have a meaningful effect on future sale processes and appraisal proceedings. In particular, the Vice Chancellor appeared to call into question whether a financial sponsor requiring a 20% minimum IRR could ever be paying "fair value," at least in circumstances where leverage is constrained.

M&A practitioners and their clients should also focus on the Vice Chancellor's conclusion that the standards for reviewing fiduciary duty claims are different from those applicable to appraisal proceedings – and the court's willingness to question in an appraisal proceeding strategic choices made in a sale process even where it believes those choices would clearly pass muster in a fiduciary duty lawsuit.

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Please do not hesitate to contact us with any questions.

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<sup>3</sup> *In re: Appraisal of Dell Inc.* (Del. Ch. May 11, 2016).