Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.
177 A.3d 1 (Del. 2017) (excerpted by Roberta Romano)

VALIUHURA, Justice:

The petitioners left standing in this long-running appraisal saga are former stockholders of Dell Inc. ("Dell" or the "Company") who validly exercised their appraisal rights instead of voting for a buyout led by the Company's founder and CEO, Michael Dell, and affiliates of a private equity firm, Silver Lake Partners ("Silver Lake"). In perfecting their appraisal rights, petitioners acted on their belief that Dell's shares were worth more than the deal price of $13.75 per share—which was already a 37% premium to the Company's ninety-day-average unaffected stock price.

. . .

The problem with the trial court's opinion is not, as the Company argues, that it failed to take into account the stock price and deal price. The trial court *did consider* this market data. It simply decided to give it no weight. But the court nonetheless erred because its reasons for giving that data no weight—and for relying instead exclusively on its own discounted cash flow ("DCF") analysis to reach a fair value calculation of $17.62—do not follow from the court's key factual findings and from relevant, accepted financial principles.

"When reviewing a decision in a statutory appraisal, we use an abuse of discretion standard and grant significant deference to the factual findings of the trial court. This Court 'will accept [the Court of Chancery's] findings if supported by the record . . . .'" We defer to the trial court's fair value determination if it has a "reasonable basis in the record and in accepted financial principles relevant to determining the value of corporations and their stock."

Here, the trial court gave no weight to Dell's stock price because it found its market to be inefficient. But the evidence suggests that the market for Dell's shares was actually efficient and, therefore, likely a possible proxy for fair value. Further, the trial court concluded that several features of management-led buyout ("MBO") transactions render the deal prices resulting from such transactions unreliable. But the trial court's own findings suggest that, even though this was an MBO transaction, these features were largely absent here. Moreover, even if it were not possible to determine the precise amount of that market data's imperfection, as the Court of Chancery concluded, the trial court's decision to rely "exclusively" on its own DCF analysis is based on several assumptions that are not grounded in relevant, accepted financial principles.

We REVERSE, in part, and AFFIRM, in part, and REMAND for these reasons and those that follow.

. . .

The Court of Chancery's Determination of Fair Value

The Court of Chancery acknowledged that "[t]he consideration that the buyer agrees to provide in the deal and that the seller agrees to accept is one form of market price data, which

Delaware courts have long considered in appraisal proceedings." However, the court believed that flaws in Dell's sale process meant that the deal price of $13.75 should not be afforded any weight here since it was "not the best evidence of [the Company's] fair value." Accordingly, the trial court disregarded both Dell's pre-transactional stock price and the deal price entirely. The Court of Chancery identified three crucial problems with the pre-signing phase of the sale process that contributed to its decision to disregard the market-based indicators of value.

First, the primary bidders were all financial sponsors who used an LBO pricing model to determine their bid prices—meaning that the per-share deal price needed to be low enough to facilitate an IRR of approximately 20%. As the court saw it, the prospective PE buyers, the Buyout Group, Mr. Dell, and the Committee never focused on determining the intrinsic value of the Company as a going concern.

Second, the trial court believed that Dell's investors were overwhelmingly focused on short-term profit, and that this "investor myopia" created a valuation gap that purportedly distorted the original merger consideration of $13.65. Thus, under the Court of Chancery's logic, the efficient market hypothesis—which teaches that the price of a company's stock reflects all publicly available information as a consensus, per-share valuation—failed when it came to Dell, diminishing the probative value of the stock price. This phenomenon also allegedly depressed the deal price by anchoring deal negotiations at an improperly low starting point.

Third, the trial court concluded that there was no meaningful price competition during the pre-signing phase as, at any given time during the pre-signing phase, there were at most two private equity sponsors competing for the deal, creating little incentive to bid up the deal price. The trial court especially faulted the Committee for declining to reach out to potential strategic bidders, such as HP, during the pre-signing phase, leaving the financial sponsors who were engaged without the incentive "to push their prices upward to pre-empt potential interest from that direction." According to the trial court, large private equity buyers such as those engaged here are notoriously averse to topping each other, and without the specter of a strategic buyer, the Committee lacked "the most powerful tool that a seller can use to extract a portion of the bidder's anticipated surplus"—the "threat of an alternative deal."

Next, the trial court evaluated the post-signing go-shop process, where it identified several additional issues that it believed further contributed to a deal price that fell short of fair value. Though two additional proposals to acquire the Company emerged during the go-shop period, from Blackstone and Icahn, the trial court dismissed their import given that these prospective buyers also operated within the "confines of the LBO model," and that the deal price ultimately increased by just 2% over the original merger consideration of $13.65 per share as a result of this go-shop.

Further, the trial court observed that the deal's structure as an MBO imposed several additional, supposedly insurmountable impediments to Dell's ability to prove at trial that the deal's "structure in fact generated a price that persuasively established the Company's fair value." The trial court emphasized that, to prove a go-shop's worth, it is crucial to show that prospective rival bidders had a "realistic pathway to success" so as to justify the time, expense,

and harm to professional relationships that might result from pursuing an offer. Though the trial court recognized that the "relatively open" structure of the Committee's go-shop "raised fewer structural barriers than the norm," the court believed such openness could not obviate the issues imposed by features "endemic to MBO go-shops," which "create a powerful disincentive for any competing bidder—and particularly competing financial bidders—to get involved." These features include a so-called "winner's curse" and the management team's inherent value to the Company.

The concept of a "winner's curse" reflects the notion that "incumbent management has the best insight into the Company's value, or at least is perceived to have an informational advantage," so if a financial buyer is willing to outspend management to win a deal, it must be overpaying because it must have overlooked some piece of information that dissuaded management from bidding as much. Further, the trial court inferred that "Mr. Dell's unique value and his affiliation with the Buyout Group were negative factors that inhibited the effectiveness of the go-shop process," despite evidence that suggested that neither Blackstone nor Icahn—nor anyone else, for that matter—believed that Mr. Dell's continued involvement with the Company was essential. Moreover, Mr. Dell appeared willing to work with any viable party.

In light of these apparent flaws in the sale process, both pre- and post-signing, the trial court found that the Company failed to establish that "the sale process offers the most reliable evidence of the Company's value as a going concern." Moreover, the Court of Chancery decided that "[b]ecause it is impossible to quantify the exact degree of the sale process mispricing," it was going to discount the final merger consideration of $13.75 entirely—giving it no weight when determining fair value.

But, given that the trial court deemed it "illogical" to believe that another bidder would not have topped the Buyout Group's offer if the Company were actually worth the $28.61 per share advocated by the petitioners, the Court of Chancery rejected petitioners' DCF and arrived at its "fair value" determination of $17.62 per share through its own DCF analysis, using a mix of the inputs proposed by the petitioners' and the Company's experts and adjustments of its own.
. . .

Analysis

We agree with petitioners that the trial court *did consider* all relevant factors presented, including Dell's stock price and deal price. But we reverse because the reasoning behind the trial court's decision to give no weight to any market-based measure of fair value runs counter to its own factual findings. . . .

[W]e agree with the Company's core premise that, on this particular record, the trial court erred in not assigning any mathematical weight to the deal price. In fact, the record as distilled by the trial court suggests that the deal price deserved heavy, if not dispositive, weight.

On the other hand, we also agree with the petitioners that there is no requirement that the court assign some mathematical weight to the deal price, and that the court fulfilled its statutory

obligation to take into account the deal price. The trial court's thorough examination of Dell's stock market dynamics and sale process demonstrates its consideration of these factors. But we reverse because there is a dissonance between the key underpinnings of the decision to disregard the deal price and the facts as found, and this dissonance distorted the trial court's analysis of fair value.

The three central premises that the Court of Chancery relied upon to assign no weight to the deal price were flawed. First, the court believed that a "valuation gap" existed between Dell's stock price and the Company's intrinsic value, and this conclusion— contrary to the efficient market hypothesis—led it to hypothesize that the bidding over Dell as a company was anchored at an artificially low price that depressed the ultimate deal price below fair value. Second, the court suggested that the lack of strategic buyers in the sale process—and, accordingly, the involvement of only private equity bidders—also pushed the deal price below fair value. Third, the court concluded that several factors endemic to MBO go-shops further undercut the deal price's credibility. We consider each of these premises in turn and find them untenable in view of the Court of Chancery's own findings of fact as considered in light of established principles of corporate finance. Without these premises, the trial court's support for disregarding the deal price collapses. Accordingly, the trial court's reliance on them as a basis for granting no weight to the market-based indicators of value constituted an abuse of discretion meriting reversal. . . .

The trial court believed that short-sighted analysts and traders impounded an inadequate—and lowball—assessment of all publicly available information into Dell's stock price, diminishing its worth as a valuation tool. But the record shows just the opposite: analysts scrutinized Dell's long-range outlook when evaluating the Company and setting price targets, and the market was capable of accounting for Dell's recent mergers and acquisitions and their prospects in its valuation of the Company.

Further, the Court of Chancery's analysis ignored the efficient market hypothesis long endorsed by this Court. It teaches that the price produced by an efficient market is generally a more reliable assessment of fair value than the view of a single analyst, especially an expert witness who caters her valuation to the litigation imperatives of a well-heeled client . . . [T]he record shows that Dell had a deep public float, was covered by over thirty equity analysts in 2012,118 boasted 145 market makers, was actively traded with over 5% of shares changing hands each week, and lacked a controlling stockholder. As noted in the expert reports, Dell's stock price had a track record of reacting to developments concerning the Company. . . .

There is also no evidence in the record that investors were "myopic" or shortsighted. Rather, the record shows analysts understood Dell's long-term plans. But they just weren't buying Mr. Dell's story . . . .

Further, the prospective bidders who later reviewed Dell's confidential information all dropped out due to their considerable discomfort with the future of the PC market. The record simply does not support the Court of Chancery's favoring of management's optimism over the public analysts' and investors' skepticism—especially in the face of management's track record of missing its own projections. And the Court of Chancery does not justify why it chose to do so.

In short, the record does not adequately support the Court of Chancery's conclusion that the market for Dell's stock was inefficient and that a valuation gap in the Company's market trading price existed in advance of the lengthy market check, an error that contributed to the trial court's decision to disregard the deal price.

The trial court's complete discounting of the deal price due to financial sponsors' focus on obtaining a desirable IRR and not "fair value" was also error. Although the trial court did not have the benefit of our opinion in *DFC*, we rejected this view there and do so again here given we see "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 Committee, composed of independent, experienced directors and armed with the power to say "no," persuaded Silver Lake to raise its bid six times. Nothing in the record suggests that increased competition would have produced a better result. JPMorgan also reasoned that any other financial sponsor would have bid in the same ballpark as Silver Lake.

The bankers canvassed the interest of sixty-seven parties, including twenty possible strategic acquirers during the go-shop. The go-shop's forty-five-day window afforded potential bidders enough time to decide whether to continue to explore a transaction by submitting a non-binding indication of interest that qualified as a "Superior Proposal," which accordingly would lower the termination fee from $450 million to $180 million. . . .

The Court of Chancery stressed its view that the lack of competition from a strategic buyer lowered the relevance of the deal price. But its assessment that more bidders—both strategic and financial—should have been involved assumes there was some party interested in proceeding. Nothing in the record indicates that was the case. Fair value entails at minimum a price some buyer is willing to pay—not a price at which no class of buyers in the market would pay. . . .

Overall, the weight of evidence shows that Dell's deal price has heavy, if not overriding, probative value. The transaction process exemplifies many of the qualities that Delaware courts have found favor affording substantial, if not exclusive, weight to deal price in the fair value analysis. Even the Court of Chancery's own summary remarks suggest the deal price deserves weight as the court characterized the sale process as one that "easily would sail through if reviewed under enhanced scrutiny" and observed that "[t]he Committee and its advisors did many praiseworthy things," too numerous to catalog in its opinion, as the trial court noted. Given the objective indicia of the deal price's reliability and our rejection of the notion of a private equity carve out, to the extent that the Court of Chancery chose to disregard Dell's deal price based on the presence of only private equity bidders, its reasoning is not grounded in accepted financial principles, and this assessment weighs in favor of finding an overall abuse of discretion. As explained below [omitted], there are other reasons that lead us to this conclusion. . . .

[The other reasons in the omitted section involved the Court's rejection, as not present in this specific case, features of MBOs, discussed by the Chancery court, which could theoretically undermine the "probative value of the deal price." - Ed.]

[W]e are not saying that the market is always the best indicator of value, or that it should always be granted some weight. We only note that, 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 missed by all the Dell stockholders, analysts, and potential buyers abuses even the wide discretion afforded the Court of Chancery in these difficult cases. . . .

We pause to note that this appraisal case does not present the classic scenario in which there is reason to suspect that market forces cannot be relied upon to ensure fair treatment of the minority. Under those circumstances, a DCF analysis can provide the court with a helpful data point about the price a sale process would have produced had there been a robust sale process involving willing buyers with thorough information and the time to make a bid. When, by contrast, an appraisal is brought in cases like this where a robust sale process of that kind in fact occurred, the Court of Chancery should be chary about imposing the hazards that always come when a law-trained judge is forced to make a point estimate of fair value based on widely divergent partisan expert testimony. . . .

[The experts'] valuations landed galaxies apart—diverging by approximately $28 billion, or 126%,. . . .The Court of Chancery . . . even believed the "market data is sufficient to exclude the possibility, advocated by the petitioners' expert, that the Merger undervalued the Company by $23 billion." Thus, the trial court found petitioners' valuation lacks credibility on its face. We agree. Yet, the trial court believed it could reconcile these enormous valuation chasms caused by the over 1,100 variable inputs in the competing DCFs and construct a DCF that more appropriately reflected the fair value of Dell's stock than the market data. . .

When 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. This is especially so here, where the Company worked hard to tell its story over a long time and was the opposite of a standoffish, defensively entrenched target as it approached the sale process free of many deal-protection devices that may prevent selling companies from attracting the highest bid. Dell was a willing seller, ready to pay for credible buyers to do due diligence, and had a CEO and founder who offered his voting power freely to any topping bidder.

Given that we have concluded that the trial court's key reasons for disregarding the market data were erroneous, and given the obvious lack of credibility of the petitioners' DCF model—as well as legitimate questions about the reliability of the projections upon which all of the various DCF analyses are based—these factors suggest strong reliance upon the deal price and far less weight, if any, on the DCF analyses.

In addition to the relatively sound economic reasons, there are also important policy reasons supporting this result. If the reward for adopting many mechanisms designed to minimize conflict and ensure stockholders obtain the highest possible value is to risk the court adding a

premium to the deal price based on a DCF analysis, then the incentives to adopt best practices will be greatly reduced. . . .