

DELAWARE SUPREME COURT FURTHER CLARIFIES APPRAISAL PRINCIPLES APPLICABLE TO PUBLIC COMPANY BUY-OUTS

Last week, for the second time in six months, the Delaware Supreme Court reversed the Chancery Court's determination of fair value in a statutory appraisal proceeding, this time in the [Dell](#) case. That decision, and the Court's earlier [DFC](#) decision, have reshaped the law governing exercises of statutory appraisal rights in public company buy-outs. Notably, they clarify the extent to which the Chancery Court can or should rely on pre-transaction stock trading prices and the negotiated buy-out price when determining the fair value of the acquired company's shares.

The twin decisions make clear that in appraisal proceedings, the Chancery Court must consider all relevant factors and may not presume the negotiated buy-out price represents fair value; but at the same time, the Chancery Court normally should rely significantly on pre-transaction trading prices and the negotiated deal price – at least, if the market for the acquired company's stock is reasonably liquid, and the sale results from a process that passes muster under the well-developed body of law governing fiduciary obligations of boards of target companies. Provided the Chancery Court considers all relevant factors, it may (and apparently, in many instances should) rely primarily or exclusively on the negotiated buy-out price if the circumstances indicate it is the most reliable indicator of value. In these decisions the Delaware Supreme Court expressed great skepticism at the notion of rejecting market-based price signals in favor of an "intrinsic value" derived from a theoretically-based valuation model such as a discounted cash flow (DCF) model. Substantial reliance should be placed on those models only when no reliable market-based price signals can be found. The two decisions also make clear that for appraisal purposes, buy-out prices negotiated with private equity-backed acquirers are not inherently less reliable than prices negotiated with strategic acquirers.

These developments should be welcomed by prospective participants in public company buy-outs, because they help reduce the uncertainty potentially caused

"[A] company's stock price reflects the judgments of many stockholders about the company's future prospects, based on public filings, industry information, and research conducted by equity analysts." In these circumstances, a mass of investors quickly digests all publicly available information about a company, and in trading the company's stock, recalibrates its price to reflect the market's adjusted, consensus valuation of the company."

**Delaware Supreme Court,
December 14, 2017**

Attorney Advertising: Prior results do not guarantee a similar outcome

by the prospect of appraisal claims. The developments also serve to further reinforce the desirability of running a sale process that is as close to pristine as possible.

CHANCERY COURT DECISION

The Dell appraisal proceeding related to a private equity-backed management buy-out of Dell, Inc. The Chancery Court found the fair value of Dell's common stock at the closing of the buy-out was \$17.62 per share – 28% higher than the \$13.75 per share negotiated deal price, which itself represented a 37% premium to Dell's ninety-day-average unaffected stock price. Before the buy-out, the market for Dell's stock was liquid and the stock was extensively covered by analysts. And the Chancery Court found the Dell sale process was pristine. But it declined to place any reliance on the prices at which Dell's shares traded before the sale process became public, or on the negotiated deal price, finding neither reflected the intrinsic value of Dell's stock. The Chancery Court found the financial markets misunderstood Dell's "operating reality," and therefore its stock's trading history was an unreliable indicator of value and instead had caused the bidding for Dell to be anchored at an artificially low price. The Chancery Court found the negotiated buy-out price also was unreliable because the only active bidders were financial players using LBO pricing models and because the participation of Michael Dell in the acquiring consortium made the sale process inefficient as a price discovery mechanism. Having rejected the market-based price indicators, the Chancery Court found the DCF-based valuations presented by the parties in the proceeding also were unreliable, so it performed its own DCF analysis and relied on it exclusively for its fair value determination.

SUPREME COURT'S ANALYSIS

In *DFC*, the Delaware Supreme Court rejected the idea that trading prices generated in an apparently efficiently operating market nonetheless may not be reliable indicators of fair value because in the opinion of the Chancery Court, market participants had failed to appreciate the subject company's inherent value. The Supreme Court did so again in *Dell*. The Chancery Court found there was no evidence that information failed to flow freely or that management purposefully tempered investors' expectations for the company so that it could eventually take over the company at a fire-sale price. Rather, according to the Supreme Court, the record showed analysts and potential buyers understood Dell's long-term plans, but weren't buying Michael Dell's story about a future turnaround.

In *Dell* the Delaware Supreme Court also followed *DFC* in rejecting the Chancery Court's finding that prices paid by private equity-backed buyers are inherently unreliable indicators of fair value because of their reliance on LBO valuation models, asserting "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 *Dell* Court also dismissed the Chancery Court's finding that the negotiated deal price was an unreliable indicator of value because the only active participants in the sale process were financial bidders, finding instead that "if a company is one that no strategic buyer is interested in buying, it does not suggest a higher value, but a lower one."

"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."

**Delaware Supreme Court,
December 14, 2017**

The Supreme Court accepted the Chancery Court's assertion that deal prices negotiated in management buy-outs (MBOs) may prove unreliable as indicators of fair value. But it found that was not so in the *Dell* case. Rival bidders faced minimal structural barriers to a deal; extensive due diligence and cooperation from Dell helped address any information asymmetries, and Michael Dell had demonstrated a willingness to work with rival bidders.

As in *DFC*, the *Dell* Court declined to adopt a bright-line rule requiring deference to the negotiated deal price in appraisal cases, even when the sale process appears to have been appropriately robust. But at the same time, the Supreme Court made clear the Chancery Court should be reluctant to prefer valuations derived from DCF analyses over negotiated deal prices except when there is a clear basis to conclude market forces cannot be relied upon to generate a fair price and thereby ensure fair treatment of minority stockholders.

"When an asset has few, or no, buyers at the price selected,... [t]his 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."

**Delaware Supreme Court,
December 14, 2017**

AUTHORS

John Healy
Partner

T +1 212 878 8281
E john.healy
@cliffordchance.com

Robert Myers
Senior Counsel

T +1 212 878 3425
E robert.myers
@cliffordchance.com

Erika Bucci
Counsel

T +1 212 878 8142
E erika.bucci
@cliffordchance.com

Stephanie Kilmer
Associate

T +1 212 878 8286
E stephanie.kilmer
@cliffordchance.com

CONTACTS

David Brinton
Partner

T +1 212 878 8276
E david.brinton
@cliffordchance.com

Gary Boss
Partner

T +1 212 878 8063
E gary.boss
@cliffordchance.com

Joseph Cosentino
Partner

T +1 212 878 3149
E joseph.cosentino
@cliffordchance.com

Sarah Jones
Partner

T +1 212 878 3321
E sarah.jones
@cliffordchance.com

Kevin Lehpamer
Partner

T +1 212 878 4924
E kevin.lehpamer
@cliffordchance.com

Anand Saha
Partner

T +1 212 878 8301
E anand.saha
@cliffordchance.com

Benjamin Sibbett
Partner

T +1 212 878 8491
E benjamin.sibbett
@cliffordchance.com

Nick Williams
Partner

T +1 212 878 8010
E nick.williams
@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

© Clifford Chance 2017

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Bangkok • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.