

## Securities Litigation Alert

December 21, 2017

### Key Points

- For the second time in 2017, the Delaware Supreme Court reversed a Chancery Court's decision to assign little or no weight to deal price in appraisal cases
- In both cases, the court remained firm in its decision not to adopt a presumption in favor of deal price
- The decision leaves some confusion as to whether or not deal price should be the default standard absent mitigating factors



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### Delaware Supreme Court Clarifies Significance of Deal Price in Appraisal Cases

When Delaware Chancery courts consider the “fair value” of shares transacted in a merger, they need not consider deal price—except when they must. On December 14, 2007, the Delaware Supreme Court issued its opinion in *Dell, Inc. v. Magnetar Global Event Driven Master Fund, Ltd.*, Case No. 565, 2016, the latest in a series of noteworthy “appraisal arbitration” cases that made their way through Delaware Chancery Courts in 2017.

Appraisal arbitration cases involve stockholders who complain, as a matter of right under Delaware statutory law, that the price per share to be paid upon the close of a merger is too low and does not reflect the shares' actual value. Under Delaware law, the Chancery Court is empowered to appraise the shares and determine their fair value. However, the law provides little guidance as to whether, or to what extent, the negotiated deal price should be considered in the court's assessment. This ambiguity led to two high-profile 2017 Delaware Supreme Court cases.

In an earlier 2017 appraisal decision styled *DFC Global Corp. v. Muirfield Value Partners LP*, Chancellor Bouchard discounted the negotiated deal price in that case as unreliable for calculating the company's fair value, opting to give the price little weight. On appeal, the Delaware Supreme Court rejected the Chancery Court's reasoning for discounting the deal price, separately noting that “second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous.”

Critically, however, the Delaware Supreme Court in *DFC* expressly refused to craft a statutory presumption in favor of deal price and instead instructed the Chancery Court on remand to “exercise its considerable discretion” in determining fair value. The Delaware Supreme Court further cautioned the Chancery Court to avoid the temptation of taking competing valuations and simply averaging them

together, noting that, under certain circumstances, the most appropriate action may be giving no weight to certain factors or complete deference to others.

Although far from identical to the *DFC* case, the Dell appraisal dispute presented similar problems for the Delaware Supreme Court only a few months later. In *Dell*, former stockholders of the company challenged the fair value of Dell shares purchased for \$13.75 per share in a management-sponsored, leveraged buyout. Following a trial, the Chancery Court determined that the fair value of the shares was actually \$17.62 each, which, as noted by the Delaware Supreme Court, meant a company valuation of roughly \$7 billion more than the original transaction price.

In the trial court opinion, Vice Chancellor Laster explained in detail his decision to give no weight to negotiated deal price in his fair value calculations. In particular, the Vice Chancellor highlighted at least three chief concerns with the deal process. First, the market value of Dell's stock was unduly depressed by the short-term focus of the company's investor base, which yielded a "valuation gap" between Dell's fundamental and market values. Second, the lack of competition from strategic buyers meant that the deal price unduly leaned toward the investment goals of financial sponsors, who are more concerned with obtaining a favorable return on their investment rather than achieving a fair value for the company shares themselves. Third, the prices resulting from the deal process were unreliable because they resulted from a management-led buyout, which carries a number of problems in fairly approximating fair value.

On appeal, the Delaware Supreme Court rejected each of the Chancery Court's reasons for disregarding the deal price of the Dell shares. In its opinion, the Delaware Supreme Court repeatedly suggested that the deal price in that case should be given heavy, "if not overriding, probative value." However, like in the *DFC* opinion, the Delaware Supreme Court expressly declined to adopt "a presumption that the deal price reflects fair value if certain preconditions are met," citing the statutory requirement that the Chancery Court consider "all relevant factors" in determining fair value. Accordingly, the Delaware Supreme Court limited its holding to the facts in that case, stating that the overwhelming evidence surrounding the Dell merger favored using deal price as a substantial factor in determining fair value of the Dell shares. Thus, it was an abuse of discretion for the Chancery Court to completely discount deal price in its calculations.

It is unclear yet whether *Dell* represents the definitive, or merely the latest, appraisal arbitration case considering the importance of deal price. As in *DFC*, the Delaware Supreme Court's opinion in *Dell* does little to ease the tension that currently exists between the statutory requirement that the Chancery Court consider "all relevant factors" in appraisal arbitration cases and the Delaware Supreme Court's apparent emphasis on one factor—deal price—so long as the circumstances do not clearly undermine it as an approximation of fair value. However, the detailed reasoning set forth in the *DFC* and *Dell* opinions provides clear guidance of at least one thing: if the Chancery Court declines to give any weight to deal price in calculating fair value, it must provide good reason for doing so, or it will likely be called by the Delaware Supreme Court to try again.

## Contact Information

If you have any questions concerning this alert, please contact:

**Michelle A. Reed**

[mreed@akingump.com](mailto:mreed@akingump.com)

214.969.2713

Dallas

**Scott M. Barnard**

[sbarnard@akingump.com](mailto:sbarnard@akingump.com)

214.969.4299

Dallas

**Matthew Vernon Lloyd**

[mvlloyd@akingump.com](mailto:mvlloyd@akingump.com)

214.969.4776

Dallas