The Advocate
FOR INSTITUTIONAL INVESTORS

The Shifting Meaning of "Fair Value"

From *Corwin* to *Dell*: Recent Rulings and Reversals in Delaware's Courts May Spell Trouble for Investors

By Mark Lebovitch, C. J. Orrico, and Alla Zayenchik

On December 14, 2017, the Delaware Supreme Court reversed and remanded the Court of Chancery's appraisal determination in *Dell et al. v. Magnetar Global Event Driven Master Fund et al.* (*"Dell"*). The Court's *Dell* decision follows a series of decisions narrowing the Court of Chancery's discretion to review corporate transactions through the discovery process in class action litigation. This trend of decisions may raise the risk of over-reaching by target managers and acquirers in corporate transactions.

By way of background, in the summer of 2013, Michael Dell teamed up with Silver Lake Partners to take private his namesake company, Dell, Inc., for $13.75 per share. A number of large Dell stockholders exercised their statutory right to seek an appraisal of their Dell shares. As the *Dell* opinion noted, the appraisal remedy was created in 1899 to address problems created by requiring unanimous stockholder approval of corporate mergers. By adopting majority shareholder voting standards, single dissenting stockholders could no longer block otherwise value-enhancing transactions. The appraisal remedy was a necessary corollary to eliminating unreasonable holdout risk by protecting dissenting investors whose personal property rights (i.e., their shares) were involuntarily taken by a mere majority vote. Appraisal assured dissenting stockholders they would receive judicially determined "fair value" for stock taken against their will.

In *Dell*, following trial, the Delaware Chancery Court issued a lengthy opinion explaining its bases for ruling that the fair value of Dell at the time the merger closed was $17.62 per share. The Court carefully assessed, and then thoughtfully declined, to give weight to the $13.25 deal price as "fair value," partly because the deal was a management buyout, in which subtle conflicts of interest invariably can affect any effort to sell to a true third party. Instead, the Court used a standard discounted cash

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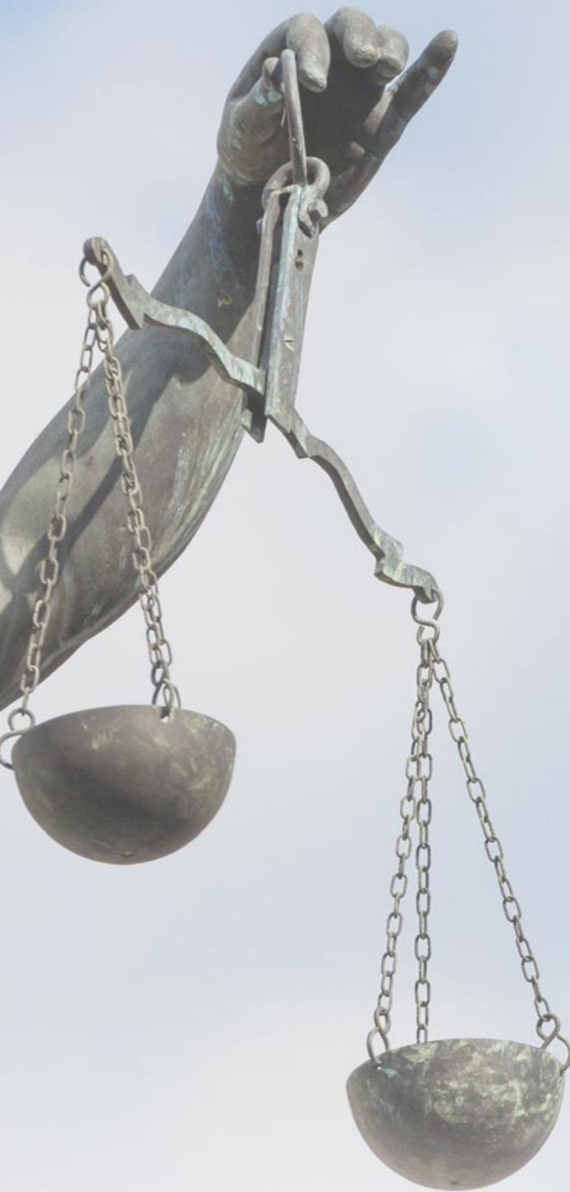

flow ("DCF") analysis to determine fair value. The Court's DCF analysis has been the default method for determining fair value for decades, resting on established financial principles and the Court of Chancery's world-renowned expertise and sophistication in matters of business.

The Delaware Supreme Court's *Dell* reversal opinion, rejecting the trial court's thoughtful analysis, expands on its recent ruling in *DFC Global Corp. v. Muirfield Value Partners, LP, et al.* (*"DFC Global"*). While *DFC Global* did not create an automatic presumption that the deal price resulting from a corporate sales process is the "fair value" of the shares for appraisal purposes, it effectively placed a high burden on the Chancery Court to justify decisions departing from the deal price in a true third party corporate sale. In *Dell*, the Delaware Supreme Court acknowledged the Chancery Court's concern with the inherent conflicts in a management buyout, but held that absent proof that management's conflict actually affected the deal price, the efficient market for Dell stock and a robust sales process with full disclosures mooted such concerns.

Perhaps one lesson from *Dell* is that the Supreme Court is further limiting the Chancery Court's discretion to award relief to investors, even when a transaction involves inherent conflicts of interest. Going forward, *Dell* and *DFC Global* strongly suggest that, absent a controlling stockholder transaction or a fundamental shift in the market post-signing, investors pursuing appraisal rights will need to show that the sales process was tainted by a breach of fiduciary duty to obtain "fair value" above the deal price for the stock that is being taken from them.

Looking beyond appraisal rights alone, investors and acquirers should weigh the significance of *DFC Global* and *Dell* against the backdrop of the Supreme Court's 2015 ruling in *Corwin v. KKR Financial Holdings LLC* (*"Corwin"*). *Corwin* holds that stockholder approval of a merger effectively "ratifies" director or management disloyalty and bad faith embedded into the sales process, so long as the misconduct was properly disclosed in the proxy statement. Under *Corwin*, opportunistic acquirers and corporate insiders may rationally infer that as long as the premium offered in a deal suffices to achieve 50 percent investor support, there is a reduced risk of judicial accountability for misconduct embedded in a corporate sales process.

This creates a "moral hazard" that could have the effect of redistributing corporate wealth to acquirers. This is because fiduciary duty class actions, which even a small investor can pursue on behalf of all other target stockholders, may no longer be a sufficient deterrent to would-be wrongdoers. Instead, the primary means to ensure payment of fair value may now be the appraisal action, which is available on an "opt-in" basis, but is typically not a realistic option for small investors. Accordingly, if buyers perceive a reduced threat of fiduciary liability on a class-wide basis, they may be tempted to lure managers to sell on the cheap for personal gain, knowing they will not face class-wide liability as long as the conflict is disclosed and the premium offered is sufficient to convince 50 percent of the out-

standing shares to be voted in favor of the premium. Buyers may be more than happy to bear the cost of paying fair value to the subset of investors who seek appraisal in exchange for the gains from underpaying those who do not.

This development in Delaware law increases the importance of appraisal actions in corporate transactions where there are conflicts and/or breaches of fiduciary duty, as appropriate disclosure under *Corwin* does not insulate misconduct in an appraisal action. On December 16, 2017, Professor Ann Lipton, a prominent securities and governance law professor at Tulane, published a comment explaining that appraisal litigation has effectively replaced breach of fiduciary duty litigation in Delaware's regime for balancing the rights of investors, insiders and bidders in corporate law. If Professor Lipton is correct, then the Delaware Supreme Court may be limiting the ability of small investors to receive "fair value" for their shares.

In sum, the arc of Delaware law from *Corwin* to *Dell* may result in under-enforcement of fiduciary duties through representative litigation, and may unintentionally entice increasingly aggressive breaches of fiduciary duties. It is therefore even more important for institutional investors to remain vigilant and to exercise their appraisal rights where signs of misconduct are present. Thoughtful and strategic pursuit of appraisal litigation is an increasingly critical check on corporate actors and sales processes to ensure payment of fair value.

UPDATE:

Shortly after this article was written, Vice Chancellor Laster issued a decision in *Veriton Partners Master Fund Ltd. v. Aruba Networks, Inc.*, awarding Petitioners in the *Aruba* appraisal action just $17.13 per share — ***$7 below*** the deal price. The Vice Chancellor noted that in light of the Delaware Supreme Court's opinions in *Dell* and *DFC*, the Supreme Court endorsed using the market price of a widely traded company as evidence of fair value. Applying those rulings, VC Laster found that Aruba stock appeared to be traded on an efficient market, making Aruba's unaffected market price of $17.13 per share a sufficient proxy for fair value. This drastic outcome may be the Delaware Supreme Court's — a court which has taken an increasingly hostile view of appraisal — desired result. More likely, however, is that Vice Chancellor Laster has highlighted, through *argumentum ad absurdum*, the inherent flaws in the Supreme Court's recent rulings. The *Aruba* petitioners will inevitably appeal the ruling, giving the Supreme Court an opportunity to weigh in on this new application of *Dell* and *DFC*. The Supreme Court's decision will be a landmark one for the quickly developing legal landscape of Delaware appraisal law.

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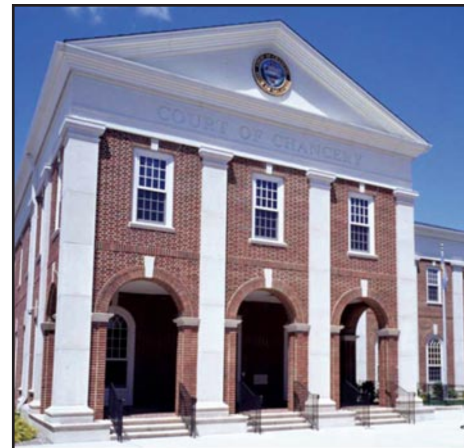

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