Sometimes Silence is Golden: "Dell Compliance" Following Aruba III

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ABSTRACT

Speculation that interpersonal conflicts among Delaware judges influenced the adjudication of *Verition Partners v. Aruba Networks* has unfortunately chilled a more productive discussion of the three judicial opinions in this case – decisions whose subtext is key to interpreting the Delaware Supreme Court's final determination on the case rendered last month. That opinion, "*Aruba III*", simultaneously elevated the importance of the "*Dell Compliance*" standard – that threshold of M&A process adequacy above which the Chancery Court should lend weight to deal price in appraisal proceedings – while saying almost nothing about how that standard should be administered. *Aruba III* concluded a rich colloquy between Vice Chancellor Travis Laster and the Delaware

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Supreme Court that began with *Dell* in which both courts utilize reductionist arguments to debate the appropriate implications of modern ECMH theory for the adjudication of appraisal fair value in public company M&A. While often used to normatively criticize reasoning, **reductionism** – the practice of analyzing complex phenomenon by reference to simplified abstractions held to represent more fundamental principles –is simply used in its descriptive sense here (for want of a better term). While not inherent, reductionist reasoning in judicial opinions yields tricky precedent because the assumptions that underlie its abstractions are often poorly defined and evaluated for materiality, reducing confidence in how well they track reality. In the *Dell* and three *Aruba* decisions, reductionism in the translation of ECMH "principles" to economic reality is used so frequently and with such lax tracking of assumptions that analysis of the *literal* reasoning in these decisions provides little guidance on how the Chancery Court should determine *Dell Compliance*. Conversely, a review of their *styles of argumentation* is more illuminating. When evaluated in this light, *Aruba III* clarifies that, while couched in terms of the deference to "ECMH principles", the bounds on the Chancery Court's discretion found in *Dell* and *DFC* were motivated by the desire to focus public-company appraisal on *atypically* poor and *transaction-specific* process defects to avoid the categorical application of *de novo* valuation to broad categories of M&A transactions. By casting *Dell* and *DFC* as outlier cases in which identified process defects were simply too generically relevant and non-specific to the case record, *Aruba III* liberates the Chancery Court, should it so choose, to continue to utilize public company appraisal to police fiduciary misfeasance under a flexible "all relevant factors" standard, but only when process defects fall outside structural failings of "run-of-the-mill" processes and are linked to the deal price based on record evidence. By remaining silent on *Dell Compliance* beyond these requirements of atypicality and specificity, this bounded but consciously undefined standard appears designed to frustrate both the attempts of transaction attorneys to circumvent functional process review via formalism and the attempts of petitioners to *indiscriminately* pursue claims based on categorical case theories. Rather than an oversight, such silence may strike the perfect balance of preserving a useful role for public-company appraisal to improve the increasingly feckless state of post-*Corwin* fiduciary law, while discouraging unfettered appraisal "arbitrage".

Keywords: Appraisal, Efficient Capital Markets Hypothesis, Dell, Aruba, Chancery

I. INTRODUCTION

The frequently discussed but generally unwritten story underlying the three judicial opinions in *Verition Partners v. Aruba Networks*[2] involves a dispute between two luminaries of the Delaware Corporate Law – Vice Chancellor Travis Laster and Chief Justice Leo Strine.[3]

The story goes that Vice Chancellor Laster, fuming over his "rebuke" in *Dell,* [4] a decision not written but generally attributed to the Chief Justice, sought to force acknowledgement of the faults in that decision by adopting an extreme view of its logic and interpreting it *reductio ad absurdum* for a "result that no litigant would even ask for". He did so by (i) finding an odious transaction process involving rampant conflicts of interest, negotiating negligence and selective disclosure to be sufficiently reliable to evidence fair value ("FV") because its record of defects was, in his view, no worse than the one *in Dell,*[5] while, nevertheless, (ii) ruling that the cleanest measure of FV was the Company's so-called unaffected stock price ("USP"), a metric that was neither argued by any party at trial nor particularly well suited to the FV measurement objective, given strong evidence of conflicts of interest and the exploitation of material non-public information found in the trial record. Similar to the first holding, on process sufficiency (or what was subsequently coined by Vice Chancellor Glasscock as "*Dell Compliance*" in *AOL*),[6] the latter holding on "*USP Relevance*" was grounded in the Vice Chancellor's comparison of the factual record of *Aruba* against those in *Dell* and *DFC,*[7] and the Delaware Supreme

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[2] Verition Partners Master Fund, Ltd. v. Aruba Networks, Inc. ("*Aruba I*"), No. 11448-VCL, 2018 LEXIS 52 (Del. Ch. Feb 15, 2018); Verition Partners Master Fund, Ltd. v. Aruba Networks, Inc. ("*Aruba II*"), No. 11448-VCL, 2018 LEXIS 160 (Del. Ch. May 21, 2018); Verition Partners Master Fund, Ltd. v. Aruba Networks, Inc. ("*Aruba III*"), No. 368, 2019 LEXIS 197 (Del. 2019).

[3] *See*, *e.g.*, Jeff Montgomery, *Strine-Laster Clash In Spotlight With Del. Aruba Appraisal*, LAW360 (Apr. 17, 2019, 10:33 PM), https://www.law360.com/articles/1150977/strine-laster-clash-in-spotlight-with-del-aruba-appraisal.

[4] Dell, Inc. v. Magnetar Glob. Event Driven Master Fund, Ltd. (*Dell*) 177 A.3d 1 (Del. 2017) ("*Dell*").

[5] *Aruba I*, 2018 LEXIS 52 at *70.

[6] In re Appraisal of AOL Inc., No. 11204-VCG, 2018 WL 10374450 (Del. Ch. 2018).

[7] DFC Global Corp. v. Muirfield Value Partners (*DFC)*, 172 A.3d 346 (Del. 2017).

Court's heavy deference to observable market measures of value in those cases. Not to be outdone by this deft, "hoisted on your own petard" tactic by the Vice Chancellor, the Chief Justice returned the favor in a manner that only a superior tribunal can – by (a) reversing the Chancery Court on the *USP Relevance* holding via a scathing criticism of its reductionist argumentation, (b) affirming its *Dell Compliance* holding with virtually no discussion on the merits of the Chancery Court's adjudication of that issue, and (c) directing a verdict in reliance on the *Dell Compliance* holding – notwithstanding obvious conflicts in the trial record on the quantification of deductible synergies that, absent judicial gloss, would have frustrated such implementation. While motives remain opaque, the twin *effects* of this directed verdict are to establish finality (i.e., ensure there will be no *Aruba IV* or, more importantly, *Aruba V*) and, by implication, to set in stone the Vice Chancellor's findings of fact that implicitly sanction as "reliable" a very, very dirty deal.[8]

While certainly titillating in the context of an otherwise reserved forum, the ascription of personal motives to the judges in the above story is not merely unknowable and irrelevant – it is also unfortunate. While it is generally difficult for third parties to distinguish judges' personal motives from their argument styles, it is particularly difficult in situations such as *Aruba*, in which so much of the reasoning is reductionist.[9] On what basis, for example, could a practitioner distinguish whether the Vice Chancellor's "real" motivation in holding that *DFC/Dell*'s heavy emphasis on a particularly prescriptive view of the efficient capital market hypothesis ("ECMH") required deference to Aruba's USP was some form of animus or simply an effective means of cajoling further guidance from the high court on the ambiguities of how to implement their mandate to emphasize "market evidence" in appraisal cases. These

[8] *See Aruba I*, 2018 LEXIS 52, at *7-48, *83-101 (finding that "the HP-Aruba transaction was a third-party, arm's-length merger" despite, *inter alia*, (i) "HP [knowing] it did not face meaningful competition" and was internally resigned to pursue a deal due to negligent signaling by Aruba's conflicted CEO, (ii) a pre-signing canvas managed by a conflicted banker to only six potential strategic partners with no indicia of quality but simply the absence of responsiveness by those contacted followed by a no-shop, and (iii) a transaction announcement that was strategically timed by the parties to ensure that value-enhancing MNPI which remedies previous sand-bagged guidance was released to the public contemporaneously such that it could not be impounded into the USP).

[9] Merriam-Webster defines *reductionism* as "a procedure or theory that reduces complex data and phenomena to simple terms." MERRIAM-WEBSTER (2019), https://www.merriam-webster.com.

potential motivations are neither objectively distinguishable nor mutually exclusive. If the non-gratuitous purpose in divining judges' personal motives is to better understand their reasoning, such speculation serves no useful role here. Unfortunately, this speculation also has the perverse effect of discouraging forthright discussion of their reasoning styles when, as I contend, the interplay of those styles*, itself,* is key to understanding the functional meaning of these decisions.

This effect is particularly true with regard to the standard for *Dell Compliance* – the threshold for M&A process care and loyalty required for that process is to deserve evidentiary weight (whether simply probative or dispositive) in appraisal's fair value determination. Following *Aruba III*, this standard remains both more relevant and more amorphous than ever. By relegating USP to an informative data point rather than a direct measure of FV in most appraisal cases, *Aruba III* returns the battle lines in appraisal litigation to the fork of *Dell Compliance* to establish whether the more observable, and judicially less burdensome, metric of (adjusted) deal price is sufficiently reliable for adoption. Absent the availability of this "presumption-except-in-name only," the Chancery Court, by process of elimination, will still need to wrestle with fundamental economic analysis, in some form, to determine FV. At the same time, post-*Dell* Chancery Court decisions on this standard in *AOL*, *Aruba*, *Solera*, and *Norcraft* have reached wildly inconsistent – some would argue inverted[10] – results, and the Delaware Supreme Court's sparse treatment of this issue in *Aruba III* does nothing to clarify the standard.

On its face, the "black-letter law" *Aruba III* holding on *Dell Compliance* is rather anemic given the standard of review – **the Chancery Court did *not* abuse its discretion by giving decisive evidentiary weight to deal price (adjusted for its estimate of allocated synergies) despite the litany of process defects and conflicts it identified**. Contrary to the claims asserted in many a defense-firm client memo on the decision, the affirmance of lower court discretion does not equate to substantive agreement. However, while *Aruba III* consequently says little about how Chancery *should* administer the *Dell Compliance* standard, the Supreme

[10] It is, for example, difficult to reconcile how the transaction process at issue in *Aruba* can be deemed reliable as a price value discovery exercise with its myriad conflicts and their evidence in the actions of deal participants, while the one at issue in *AOL* was deemed unreliable merely because a similarly conflicted CEO made generalized statements on a cable news network stating commitment to the deal during the no-shop period.

Court's deliberate choice to avoid any meaningful discussion of that holding implies some guidance on how Delaware courts should *not* administer *Dell Compliance* – namely, they should avoid the type of relative case assessment regarding process adequacy that the Vice Chancellor utilized in *Aruba I* (comparing the sales processes of *Dell* and *DFC* to that of *Aruba*) and analyze process adequacy on an endogenous basis. Under this approach, *Dell* and *DFC* establish that this endogenous analysis must account for and explain otherwise contrary market evidence (consisting of both relevant share prices and transaction prices) and, more importantly, must do so for *case-specific* reasons not widely applicable across broad categories of M&A transactions. By so doing, *Aruba III* re-vests the Chancery Court's discretion in adjudicating *Dell Compliance* by confirming its breadth and clarifying the aberrance of *Dell* and *DFC* as outlier cases in which process failures and market failures in the record were simply too generic and typically present in "run-of-the-mill" M&A. Such a pro-discretion view of the *Aruba III* treatment of the *Dell Compliance* standard comports well with a continuing role for appraisal litigation – whether brought by historical or post-announcement shareholders – as a more surgical or lighter-touch private law mechanism to assist the Delaware courts in policing deviations from agency law less craven, than those addressable via fiduciary claims cognizable under current law. Conversely, an alternative view of *Dell Compliance* under *Aruba III*, which simply reads the decision as setting an unconscionably low bar for process adequacy, as other commentators have noted, would rob the availability of appraisal in the public company context of any cogent purpose, while also increasingly putting the Chancery Court in the unenviable position of blessing ambivalence to fiduciary principles.

II. PARALLEL REDUCTIONISM IN THE DELL AND ARUBA I AND ARUBA II DECISIONS

On both the issues of *USP Relevance* and *Dell Compliance*, the reasoning in *Aruba I* starts where *Dell's* reasoning ends. Both *Aruba I* holdings are reached via reductionist arguments with noticeable parallels to the Supreme Court's reasoning style in *Dell*.

A. Reductionism in the USP Relevance and Dell Compliance Holdings in Aruba I

In holding that Aruba's unaffected stock price was the best evidence of its fair value based on his reading of *Dell*, Vice Chancellor Laster adopted a highly literal reading of *Dell*'s many statements regarding the constraints that Delaware's adoption of ECMH places on adjudications of fair value that deviate materially from historical share prices. At the most simple level, carefully placed qualifiers within these *Dell* Court statements – words such as "generally" or "typically" – were excised or ignored in favor of expanding their predicates.[11] Viewed through such a narrow lens, Dell appears to counsel for adoption of an extreme version of ECMH rarely advocated even among Chicago-school economists, much less more broadly in academia, financial practice or judicial reference – that market prices of stocks trading in relatively informationally efficient markets should be presumed to be the most accurate measures of their fundamental economic value absent specific evidence of market failure. To those less familiar with the rich history of ECMH academic scholarship, it is important to acknowledge that nothing about this scholarship requires such a view. The contention that market price approximates fair economic value ("MP~FV") for a security that trades in relatively informationally-efficient markets exists squarely outside the ambit of economics as a science and solely as an article of faith among a subset of Chicago-school economists (themselves a subset of the larger academy). This assertion is true both because (i) economics as a science lacks a commonly-accepted asset valuation framework to determine fair value[12] and (ii) real world experience has turned up enough obvious counter-examples with varied underlying causes to debunk the notion that market prices are systematically correct[13]. As a result, even among the most ardent of faith-based "MP~FV" adherents,

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[11] *Compare, e.g.*, Dell, Inc. v. Magnetar Glob. Event Driven Master Fund, Ltd. (*Dell*) 177 A.3d 1, 24 (Del. 2017) ("[ECMH] teaches that the price produced by an efficient market is generally a more reliable assessment of fair value that the view of a single analyst . . ."), with *Aruba I* 2018 LEXIS 52 at *24 ("*DFC* and *Dell* teach that if a company's shares trade in a market having attributes . . . of the semi-strong form of [ECMH], then the unaffected trading price provides evidence of [its] fair value [that]… is more reliable that the single estimate of any one individual, be he a knowledgeable market participant, corporate insider, valuation professional, or trial judge.").

[12] *See, e.g.*, Lynn A. Stout, *How Efficient Markets Undervalue Stocks: CAPM and ECMH under Conditions of Uncertainty and Disagreement*, 19 CORNELL LAW FAC. PUBLICATIONS 445 (1997).

[13] *See generally* ANDREW W. LO, ADAPTIVE MARKETS: FINANCIAL EVOLUTION AT THE SPEED OF THOUGHT 12–65 (Princeton University Press, 2017); *see also* CFA INSTITUTE, CFA PROGRAM CURRICULUM 2017: LEVEL III VOLUME 2 - BEHAVIORAL FINANCE, INDIVIDUAL INVESTORS, AND INSTITUTIONAL INVESTORS (John Wiley & Sons, Inc., 2016).

this claim is invariably preceded by qualifiers such as "generally" or "approximately" and recognized as a *belief* of general validity rather than as a *fact* of specific validity. Conversely, serious scholarship about ECMH centers on information efficiency (whether characterized as the rapid incorporation of [public] information into securities prices, or the inability to earn arbitrage profits trading on said information), because informational efficiency is an objective that economists can measure. It is also worth pausing to note that, even where such a "MP~FV" view of EMCH is empirically provable as a *general* proposition, appraisal litigation occurs in a subset of transactions where this principle is *particularly* unlikely to hold. Appraisal petitions are not randomly distributed across M&A transactions but, whether brought by pre-announcement shareholders or so-called "arbitrageurs", have historically targeted transactions with other indicia of undervaluation.[14] Consequently, even amid a hyper-literal reading of *Dell*'s admonition that "the efficient market hypothesis [has] long [been] endorsed by this Court", such a reading merely calls for treating market prices as another piece of *circumstantial* evidence of the fair value fact-finding exercise and, like other circumstantial evidence, subjects its relevance to the context in which it occurs.[15]

Against this over-interpreted proposition, *Aruba I* also over-construed the scope of its applicability by interpreting the *Dell* Court's discussion of *Cammer* and *Krogman* factors for the general proposition that Dell's stock traded in a relatively efficient market as *the* test of market efficiency courts should employ for a binary test of *USP Relevance*. It did so despite a genuine academic consensus that (i) informational market efficiency is a graduated and non-binary characteristic of markets[16] and (ii) most of these factors have never been empirically validated as indicia of informational efficiency. Indeed, the simple fact that one of the eight distinct *Cammer/Krogman* factors -- "a cause-and-effect relationship, over time between [incremental information] and an immediate response in a stock's price" — is essentially a tautological restatement of the definition of information market efficiency, confirms the "boot-strapped" nature of these standards. Much like appraisal "fair

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[14] *See* Jonathan Kalodimos & Clark Lundberg, *Shareholder Rights in Mergers and Acquisitions: Are Appraisal Rights Being Abused?*, 22 FIN. RES. LETTERS 53, 57 (2017).
[15] *Dell*, 177 A.3d at 24.
[16] *See, e.g.*, Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70(3) AM. ECON. REV. 393, 404 (1980).

value," they are a jurisprudential construction, not one grounded in economics. The fact that judges use them to identify a different concept of "market efficiency" (informational) for a very different purpose (securities law violation damages), should not reasonably constrain judicial inquiry in a wholly distinct context.[17] Consequently, this narrow reading of the *Dell* Court's view of ECMH suffers from being both overly prescriptive and over-applied.

Finally, the inevitability of this reading of *Dell* was further attenuated by the fact that the Delaware Supreme Court had referenced ECMH, not to support market prices as evidence of fair value absent material non-public information, but to find that "heavy, if not dispositive, weight" be accorded to the resulting deal price from a compliant M&A process (regardless of MNPI if shared with or even available to prospective bidders).[18] Given that ECMH generally speaks to the capital markets and not the M&A markets – markets with far less liquidity and depth and far higher transaction costs, reflexivity and heterogeneity of actors – its endorsement by the Supreme Court, whether "long" held or newfound, provides only attenuated support for the proposition that market prices will generally be good evidence for the FV of a company that was subsequently sold (generally at a premium).

These attenuations cast doubt on whether the Vice Chancellor was truly compelled by the "traditional" framing of the ECMH he read as adopted by the High Court in *Dell* to arrive at the *USP Relevance* holding. At the same time, the now-infamous "footnote 257," in which the Vice Chancellor solicits the development of counter-records in future cases to

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[17] It is important to distinguish how the relevance of securities prices in an appraisal's FV determination differs from similar use in the securities law "fraud on the market" context in which these factors have been historically utilized. In the latter context, the relevant questions of causality and damages are inherently limited to concerns over informational efficiency because the injury claimed by the plaintiff is one actually perpetrated through the impounding of (mis-) information into stock prices. In this context, it is irrelevant whether such stock prices accurately measure value because, right or wrong, the markets measure is the mechanism of injury. Conversely, as the *Aruba III* court notes, appraisal's fair value standard is more properly viewed as valuation of the shares as pro rata ownership of a going concern (i.e., operating entity). This directly implicates fundamental value efficiency (MV~FV).

[18] *Dell*, 177 A.3d at 23.

such an infallible view of the market as a valuation scale, strongly suggests that he personally disagrees with it.

Vice Chancellor Laster similarly employed a reductionist argument in holding that Aruba's deal process was "Dell Compliant". He found this despite a forty-one-page section of factual findings regarding the deal process that included conflicts of interest, negligent price signaling by Aruba's management and bankers to the buyer, the announcement timing discussed above and a highly limited pre-signing check of only five strategic bidders with immaterial engagement. This was followed by a relatively brief post-signing "no-shop" period with highly constraining deal protections (e.g., no shop limited by reference to fiduciary out, matching rights) that the Delaware Supreme Court, perhaps cheekily, referred to as a "passive market check".[19] As with *USP Relevance*, the Vice Chancellor reached this holding by elucidating categorical principles from the high court's reasoning underlying his reversal in *Dell*, necessarily focusing on some facts while de-contextualizing others by omission, applies them to the facts of *Aruba I,* and concludes that the Aruba process, odious as it may be, meets a minimalist "arms-length" standard for process adequacy he infers as established by the *Dell* Court.

As with the reasoning underlying the USP Relevance holding, it is similarly tempting to extract, in isolation, statements made in the course of this reasoning and castigate the ruling as disingenuously issued so that it may be appealed.

> *The HP-Aruba merger looks like a run-of-the-mill, third-party deal. Nothing about it appears exploitive.*[20]

Really? Collusion among a selling company's management and a buyer to time deal announcement to prevent the impounding of previously non-public information into share prices prior to announcement sounds "exploitive" in the lay sense. So too do back-channel communications by its advisors to the buyer to curry favor seem exploitive, as does a CEO signaling the absence of other options in negotiations with a buyer he knew was about to hire him. Put differently, if the *Aruba* transaction is truly a "run-of-the-mill" deal in the sense that it is the result of a process that the Chancery Court should bless as a probative arbiter of

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[19] *Aruba III*, LEXIS 197, at *3.
[20] *Aruba I*, 2018 LEXIS 52, at *87.

value, what does this say about the feckless state of Delaware fiduciary law? Is the Chancery Court really willing to overlook this quantum of malfeasance and still conclude that a sale process deserves substantial evidentiary weight? If so, is there one sufficiently grotesque that the refusal of the high court to erect a "deal price presumption" in public company appraisal cases carries a functional/non-symbolic meaning?

B. Reductionism in Dell

Indeed there is a general temptation to recount why the *USP Relevance* and *Dell Compliance* holdings in *Aruba I* and *Aruba II* do not logically follow from the literal text of the Supreme Court's opinion in *Dell* in order to infer that these holdings must have been rendered disingenuously.[21] However, such an inference ignores how closely the reductionism in their reasoning parallels the high court's own reasoning in its criticism of the Vice Chancellor process reliability holding in *Dell*. Taken in this context, the holdings in *Aruba I* and *Aruba II* are better read as honest attempts by a lower court to employ parallel reasoning as a tool to spur guidance from a higher court on a hot-button issue following a complicated case. Indeed, to Vice Chancellor Laster, his reversal in *Dell* under a facially lenient "abuse of discretion standard" in administering a similarly open-ended evidentiary scope to "take into account all relevant factors"[22] must have suggested that the high court found his determination that Dell's sale process was unreliable as a valuation measure – not simply wrong – but *very wrong*.[23] This was despite a pain-staking, forty-one-page section on findings of fact and a fifty-two-page legal analysis that was both highly fact-specific, and leveraged extensively modern behavioral finance and game theory literature to detail flaws in Dell's sale process that, in his view, rendered

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[21] For example, the Aruba petitioners implied this fairly clearly in their motion for reconsideration. *Aruba II*, 2018 LEXIS 160, at*6 ("The Reargument Motion [claims] I misapprehended the law due to my 'frustration with many of the Supreme Court's pronouncements [in Dell].'")
[22] *Dell*, 177 A.3d at 1-21-2.
[23] *Aruba I*, 2018 LEXIS 52 at *56; *59-63 (noting the endorsement of ECMH and its "predictions about the reliability of securities prices" as endorsed in *Dell* and *DFC;* and noting that in neither such case had the Delaware Supreme Court heard any expert testimony on the market efficiency of the respondents' stock and analyzing on a comparative basis the *Cammer* and *Krogman* factors referenced in those decisions).

the result of that process unworthy of evidentiary value.[24] Nevertheless, the Delaware Supreme Court disagreed and, in doing so, employed a reductionist reasoning familiar to any student of economics – assuming the principles underlying economic models are natural laws rather than useful abstractions and thereby converting analytical assumptions deemed *generally true* into so-called "principles" that are self-proven in the absence of contrary evidence. Much of the Supreme Court's critique of the Vice Chancellor's finding that Dell's sale process was too deficient to deserve evidentiary weight takes the form of (i) asserting that a subjective belief not susceptible to positive proof but believed by and written about by some economists as *generally* true as a "well established principle", (ii) implying that this, now "scientific" principle's applicability then requires specific negative proof to be abandoned in the instant case, and, then, (iii) evaluating the Vice Chancellor's factual findings as insufficient (or, under the AOD standard, *clearly* insufficient) to this task.[25] Contrary to the high court's numerous pronouncements in *Dell*, none of the following propositions are "established principles of corporate finance":[26]

- Securities prices do not suffer "valuation gaps" in the absence of discrete market failures because ECMH "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 . . . ."[27]

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[24] *In re* Appraisal of Dell Inc., No. 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016) *aff'd in part*, *rev'd in part sub nom*. Dell, Inc. v. Magnetar Glob. Event Driven Master Fund, Ltd. (*Dell*) 177 A.3d 1, 2-40, 61-99 (Del. 2017).

[25] *See* DFC Global Corp. v. Muirfield Value Partners (*DFC)*, 172 A.3d 346, 45-46 (Del. 2017) (noting that "Market prices are *typically viewed* superior to other valuation techniques" because of their capacity to amalgamate across investor valuation judgements and referencing many academics claiming subjective beliefs in this proposition (e.g., "For many purposes no formal theory of value is needed. We can take the market's word for it.")).

[26] *Dell*, 177 A.3d at 382.

[27] *Id.*at 41. Rather, an entire branch of finance – behavioral finance – focuses scholarship on how, even within the rubric of an informationally efficient market, behavioral biases and other so-called market failures can, and often do, generate such gaps – both large and small.") *See*, *e.g.*, Lo, Andrew W. & A. Craig MacKinlay, "Stock Market Prices Do Not Follow Random Walks: Evidence from a Simple Specification Test," 1 THE REVIEW OF FINANCIAL STUDIES 41 (1988); Burton G. Malkiel, *The Efficient-Market Hypothesis and the Financial Crisis*, *in* Rethinking Finance: Perspectives on the Crisis (2012).

- There is "no rational connection" between a buyer's status as a financial sponsor and the question of whether a deal price is a fair price.[28]
- "If deal price is at a level where the next upward move by a topping bidder has a material risk of being a self-destructive curse, that suggests the price is already at a level that is fair."[29]

To be sure, subjective beliefs, like the ones above, may be widely shared by some subset of influential economists but they do not rationally follow from any scholarly analysis those same economists have undertaken, much less scholarship evaluated and adopted by a wider set of peers. Beliefs don't become scientific principles merely because well-credentialed luminaries commit them to text. This idea is particularly true in economics – where the discipline's framework for deductive reasoning begins with an idealized construct, the perfectly efficient market, which is likened to an "invisible hand" borrowing imagery of theology and, if sloppily pursued, suffers from the same oppressive subjectivity that motivates Establishment Clause concerns regarding employment of religious reasoning in judicial opinions.

Ironically, the policy imperative for this sophistry in *Dell* is actually fairly straightforward and eminently practical – *the Delaware Supreme Court doesn't want appraisal litigation to indiscriminately attach to every eligible transaction involving a Delaware target acquired by private equity*. The high court has gone to exceptional efforts over the prior decade to curtail the breadth of fiduciary duty litigation. It continues to similarly wrestle with the proper role of appraisal litigation in the administration of Delaware corporate law of public companies because, among other factors, its continued imposition by statute despite countless attempts to extinguish it legislatively requires, by implication, that *some* such role attach. Any constructive role, however, amid the hurdles erected to moderate the volume of fiduciary litigation, requires that petitions for appraisal of public company transactions be targeted around a small subset of genuinely "dirty" deals. As a result, the scope of process "defects" that qualify to undermine *Dell Compliance* cannot be construed so broadly that it renders whole generic categories of M&A transactions subject to non-compliance, the appraisal equivalent of "strict scrutiny". This is necessary for reasons of simple administrability and docket control, but it is also consistent with a more moderate and

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[28] *Dell*, 177 A.3d at 45.
[29] *Id.* at 57.

appropriate view of how ECMH "principles" should bind the appraisal of publicly-traded shares. As discussed above, there actually *is* a general consensus among both academics and practitioners, and there is substantial empirical evidence for the proposition that the market prices for assets trading in informationally efficient markets are ***relevant*** to their true economic value. The trouble comes in equating relevance with proxy value. To impute the latter requires one to move beyond analyzing why the relationships between two measures should *generally* be correlated, and begin analyzing why, in a *specific* instance, they might not. The more generic and categorical such exceptions are, however, the more the exceptions undermine the general truth of proposition.

Considered in this vein, the *Dell* Court's quibble with Vice Chancellor Laster's findings that market price and deal price were insufficiently relevant in the *Dell* transaction because market failure or process defects – like the market's short-term myopia and investment fatigue, winners' curse concerns in the context of MBO dynamics, and the absence of strategic bidders – weren't due to any conceptual issue, grounded in ECMH with these dynamics undermining the relevance of this "market evidence." Rather, it was the absence of record evidence that could limit this attenuation to the case at hand because the high court was simply unwilling to open the gates of *de novo* value adjudication to every MBO involving a Delaware public company. And the facts of *Dell*, as found by the Vice Chancellor did not provide such atypicality. Dell's process was exceptionally long and notorious, and several bidders not only had the opportunity to engage, but also, in fact, spent considerable resources kicking the tires. Dell *paid* a potential topping bidder (Blackstone) to perform due diligence. There was enough circumstantial evidence that Dell's board and Michael Dell took some (though not all) steps to level the playing field among bidders, and that the transaction, while imperfect, wasn't "dirty." Indeed, the Delaware Supreme Court was clear that, not only was their rejection of the Vice Chancellor's rejection of market evidence in *Dell* not categorical and limited to the specific market and process defects he focused on, but they even indicated that these particular defects might adequately support such a finding *if there had been more specific record evidence to show their impact in action in the case itself.*[30]

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[30] *See, e.g.*, *id.* at 49 (explaining that in its finding of a valuation gap, "[t]he record simply does not support the Court of Chancery's favoring of management's optimism over the public analysts' and investors' skepticism. . ."); *id.* at 47 (noting that the absence of reverse inquiry over such a long period

Indeed, while the high court in *Dell* and *DFC* understandably avoids explicit discussion of how such judicial economy concerns counsel against crediting the process defects the Chancery Court in those cases cites as supporting its decision to deviate from deal price, the Court's frequent references to the absence of specific record evidence to support more common or structural defects in transaction processes are most appropriately viewed as a proxy for this concern. For example, the most cogent reading of *Dell's* repudiation of the "private equity carve out" as a structural defect in sale processes involving only financial buyers isn't a categorical rejection of the proposition that private equity hurdle rates are generally substantially above public market costs of equity capital, but, as the *Dell* Court suggests, is only disfavored *in its generality* because it is practically untenable for the Delaware Courts to review valuation *de novo* in every sale process of a target in which the only solicited parties are private equity firms.[31]

Finally, it requires no logical leap to infer that the *Dell* Court's sophistry on ECMH inspired the Vice Chancellor's reductionist reasoning for his USP Relevance holding. As the Vice Chancellor, himself, discussed at length in *Aruba II*, his decision not to read *Dell*'s endorsement of ECMH in an"instrumental" manner (i.e., the moderate view of ECMH discussed above) was discretionary and driven in large part by the *Dell* Court's own reductionist approach. The Court states

> Both *Dell* and *DFC* follow the same broad structure. First, the opinions discussed the efficient capital markets hypothesis. Second, they discussed the sale processes and held that the processes provided sufficiently reliable evidence of fair value

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of pre-signing leaks, the number of Silver Lake bid raises over a protracted period and the extent of parties contracted and actual engagement during the go-shop period undermined petitioners' claims that the process was not robust due to the failure to affirmatively canvas buyers pre-signing and "[n]othing in the record suggest that increased competition would have produced a better result"); *id.* at 52 (noting the considerable and substantive engagement by Blackstone, TPG, HP and Icahn during Dell's go-shop period the court explained that "[t]he record does not show that structural issues inhibited the effectiveness of the go-shop").

[31] *See id.* at 28 ("We found in *DFC* that the notion of a 'private equity carve out' stood on especially shaky footing where other objective indicia suggested the deal price was a fair price.").

> that it constituted an abuse of discretion for the trial judge not to have given that indicator greater weight. Third, for completeness, they worked through challenges to the discounted cash flow analyses. Finally, they remanded the cases so that the trial court could consider giving greater weight to the deal price. Because of this high-level structure, it is possible to read the decisions as discussing the efficient capital markets hypothesis only instrumentally in support of a deal-price-less synergies metric. I personally considered that possibility, but after multiple readings of Dell and DFC, several factors convinced me that something more was at work.
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> . . . Most significantly, the Delaware Supreme Court specifically identified the failure to give weight to the market price as a standalone source of error because the market price itself provided evidence of fair value: "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." This language appeared to me to recognize explicitly that when the market for a company's shares has attributes associated with the premises underlying a traditional view of the efficient capital markets hypothesis, and the company lacks a controlling stockholder, then the stock market price is "likely a possible proxy for fair value.32

III. THE DISCORDANT TREATMENT OF USP RELEVANCE AND DELL COMPLIANCE HOLDINGS IN ARUBA III

Aruba III is a strange decision in many respects but, among its most informative peculiarities is how differently it treats *Aruba I's* two principle holdings. The reasoning underlying both the *USP Relevance* and *Dell Compliance* holdings were similarly reductionist and paralleled the high court's reductionism in discussing the relevance of ECMH in *Dell*. Both holdings were similarly reviewed under the same "abuse of discretion" standard. Moreover, both holdings are susceptible to being read in a manner with substantial long-term implications for Delaware appraisal litigation. The *USP Relevance* holding, absent reversal, would likely have functionally ended the viability of appraisal rights in the acquisitions of almost all public companies. The *Dell Compliance*

[32] *Aruba II*, 2018 LEXIS 160, at *21, *29 (citations omitted).

holding provides a counterintuitive result of an extremely flawed sale process that was nevertheless found to generate a transaction price with dominant evidentiary value.

However, save for a portion of the opinion devoted to the treatment of secondary topics,[33] virtually the entire remainder of *Aruba III* discusses a point-by-point criticism of the Vice Chancellor's reductionist reasoning to support the *USP Relevance* holding.[34] The reasoning generally identifies and rejects (as reductionist over-reading) the host of predicate principles that the Vice Chancellor deduced in *Aruba I and Aruba II* as implied by the high court's own reductionist reasoning in *Dell*.[35] In fact, one could imagine these twelve pages of *Aruba III* being reduced to a single sentence that simply referenced the Vice Chancellor's careful analysis in *Aruba II* rejecting an instrumentalist view of market price,[36] and noted that the high court actually meant the opposite. Were the legal standard for appraisal FV more prescriptively developed, such that the relevance of market prices were a legal issue rather than a factual one, the Court could even avoid the uncomfortable optics of reversal on an AOD basis. Regrettably, this is not how the law has developed.

Conversely, the Supreme Court's discussion of the Vice Chancellor's *Dell Compliance* holding is highly conspicuous in its brevity. In fact, the decision contains no section devoted to reviewing this holding, and its only substantive discussion of Aruba's sale process is comprised of a

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[33] These include recounting the procedural history of the Chancery Court decisions and the due process concerns they raised, its repudiation of agency cost avoidance as a "deductible synergy" in the subject transaction and rationalizing a "deal price minus synergies" calculation form an inhospitable record to obviate the need for lower court adjudication on remand. *Aruba III*, 2019 LEXIS 197, at *3-7, *21-23, *9-12, *24-26.
[34] *Aruba III*, LEXIS 197 at *12-24.
[35] *Id.* at *4-15 (on the continued importance of competition); *id.* at *15-16 (on the longstanding instrumental relevance of market measures in appraisal decisions); *id.* at *16 (the differential capacity of deal price to reflect the value of non-public information; *id.* at *17-18 (the distinction between semi-strong informational efficiency and fundamental value efficiency; *id.* at *19-21 (the importance of value-altering information released post-announcement but prior to closing); i*d.* at *14 ("The trial judge's broader reading of *Dell* and *DFC* is arguable, but the trial judge's sense that those decisions somehow compelled him to make the decision he did was not supported by any reasonable reading of this decisions or grounded in any direct citation to them.").
[36] *Aruba II*, LEXIS 160 at *21-29.

single paragraph in which the Chief Justice notes the absence of competitive bidding to illustrate the proposition that such absence does not categorically evidence "lack of competition",[37] and another paragraph in which the Chief Justice discussed the post-announcement rally in Aruba's stock on strong quarterly results, for the proposition that HP had unique access to material non-public information.[38]

Neither of these passing references to the deal process remotely evidences any view by the Delaware Supreme Court on the propriety of the Aruba process, beyond the headline inference that it was not so poor that to credit its outcome with evidentiary value was beyond the bounds of the Vice Chancellor's discretion. Having said that, given substantial ambiguity on the *Dell Compliance* standard and its increased importance following repudiation of the *USP Relevance* holding, it is worth trying to infer, however tentatively, some guidance from what appears to be a conscious decision to avoid the issue. At the outset, it is worth acknowledging that this avoidance might simply have been due to a recognition that the ECMH *dicta* in *Dell* had led the Chancery Court astray in *Aruba I*, which reflected a renewed emphasis on constraining such discussion in appraisal cases going forward. However, this generalized concern is difficult to square with the Chief Justice's relatively expansive discussion contextualizing ECMH in the Court's historical jurisprudence elsewhere in the decision on the *USP Relevance* holding with such discussion not genuinely necessary to support its grounds for reversal on that issue.[39] As such, the high court's reticence appears limited to the topic of whether the *Aruba I* sale process was Dell Compliant.

Had the Court viewed the deal process, under a *de novo* standard of review, as compliant on the record before it – whether because it viewed the process defects identified by the Vice Chancellor as insufficient in magnitude to undermine reliability or, more likely, because it viewed their impact on the resulting deal price as insubstantial – one would think that discussion of this issue would be unambiguously helpful to the development of the legal standard. If the *Dell Compliance* holding in *Aruba III* is, as many a defense bar client memo has asserted, that the Delaware Courts will generally defer to deal price in any public company case that does not involve a controlling shareholder – even when the process is as rotten as Aruba's – because they hate appraisal in the public

[37] *Aruba III*, LEXIS 197 at *15.
[38] *Id.* at *20.
[39] *Id.* at *18-19.

company context, it would be an odd choice to bury this view under an abuse of discretion standard of review without further discussion. Such a holding would let prospective petitioners know the fruitlessness of such claims, or would allow them to factor in a different burden of proof (effectively, a rebuttable but specific deal price presumption) into the decision to bring actions, with all the associated benefits to judicial economy.

Conversely, had the Court viewed the deal process (again, under a *de novo* standard) as non-compliant but within the Vice Chancellor's discretion to find otherwise, discussion on this issue would still have substantially aided the Chancery Court in future adjudications to understand the scope of its discretion and, at a higher policy level, the Court's view of appraisal's place in the Delaware corporate law framework.

Accordingly, the most logical inference to be gleaned by this reticence is simply that the Delaware Supreme Court avoided discussion of the *Dell Compliance* standard in *Aruba III* because **it did not want to provide the Chancery Court with substantive guidance on this standard**. Why might this be the case? One cogent rationale for so abstaining might be that, particularly in light of *Dell* and *DFC's* heavy focus on <u>atypical</u> process defects whose impact is <u>well evidenced in the specific case record</u> – the Court is less concerned about the volume of appraisal cases going forward as well as the potential for genuinely "run of the mill" processes to be subjected to the perceived risk of *de novo* judicial valuation. To be clear, the subset of M&A transactions yielding appraisal petitions has never evidenced the arbitrariness with which the defense bar claims and studies of these cohorts have generally found that they align with other circumstantial indicia of undervaluation.[40] With that said, assuming the general restraint on *de novo* judicial valuation mandates in *Dell* and *DFC* was motivated, in some part, by this concern over indiscriminate petitions, it seems amply addressed by the well-

[40] *See* Matthew Schoenfeld, *The High Cost of Fewer Appraisal Claims in 2017: Premia Down, Agency Costs Up* (August 29, 2017), https://ssrn.com/abstract=3028381 (discussing the decline in appraisal petitions filed since the *Dell* and *DFC* decisions and the contemporaneous decline in announced merger premia).

telegraphed guidance to the Chancery Court to award (below) deal price in all cases without such unique process fact patterns.[41]

Absent this concern, the need for clear *ex ante* standards for *Dell Compliance* appears both unnecessary and counterproductive if the appraisal remedy is to serve the productive function advocated by many scholars of providing the Chancery Court with a lighter-touch and lower hurdle venue to police fiduciary duties, particularly in light of the demise of post-closing BOFD litigation.[42] As the history of fiduciary law well illustrates, the heavy investment of Corporate America into ex ante deal lawyering renders such policing a never-ending arms race in which the *ex post* guidelines for fiduciary guardrails developed by the Chancery Court in litigation outcomes are frustrated by the next generation of transactional practice technology. The facts of Aruba's sales process serve as a useful illustration: None of the numerous process defects and conflicts identified by the Vice Chancellor would have supported a breach of fiduciary duty, and yet one remains, after reading his copious findings-of-fact that the one constituency whose interests had no champion in the sale of Aruba were its shareholders. Moreover, for most of the process issues identified – the involvement of conflicted bankers currying favor with the buyer, the incompetent negotiating by a CEO against his future employer, the collusive effort to front-run a positive earnings release – there is no bright-line rule for *Dell Compliance* that could possibly be identified ex ant*e* that would both cover them and not simply yield future deal conventions obviating those rules. In this vein, telegraphing prescriptive legal standards for *Dell Compliance* undermines the Chancery Court's ability to evaluate transaction price relevance on a practical, rather than formulaic, basis. Having cautioned for atypicality and record support in *Dell* and *DFC* for the defects required to undermine *Dell Compliance* in order to limit the availability public-company appraisal to cases that warrant it, the Delaware Supreme Court's silence in *Aruba III* suggests an intention, ironic as it may be, to return discretion to the Chancery Court.

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[41] This is particularly true given the Chancery Court's recent willingness to credit (i.e., deduct) claimed synergies substantially more "speculative" than those any market buyer would value, such as the claimed cost reductions of a financial sponsor with no strategically-relevant portfolio companies, and to impute a substantial portion of them into the deal price in the absence of a factual record that they were negotiated into the deal.
[42] Guhan Subramanian, *Appraisal after Dell*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 26–27 (Steven D. Solomon & Randall S. Thomas ed. 2019). https://ssrn.com/abstract=3095164.