IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE APPRAISAL OF DELL INC.	Consolidated C.A. No. 9322-VCL

REBUTTAL REPORT OF

PROFESSOR GUHAN SUBRAMANIAN

JULY 24, 2015

Rebuttal Report of Professor Guhan Subramanian

July 24, 2015

I. BACKGROUND

A. QUALIFICATIONS

1. I serve as the H. Douglas Weaver Professor of Business Law at the Harvard Business School (HBS) and the Joseph Flom Professor of Law and Business at the Harvard Law School (HLS). I am the first person in the history of Harvard University to hold tenured appointments at both HBS and HLS. I have taught at HBS and/or HLS continuously since 1999. I serve as the faculty chair for the JD/MBA program at Harvard University and the Vice-Chair for Research at the Harvard Program on Negotiation. I hold degrees in Economics, Law, and Business from Harvard University.

2. My academic research and publications focus on issues of negotiations, corporate law, and corporate dealmaking. I am a co-author of *Commentaries and Cases on the Law of Business Organization* (4th ed. 2012, with Bill Allen & Reinier Kraakman), a leading textbook on corporate law. The book is used at many top law schools in the United States, including Harvard, Yale, and Stanford law schools. I am also the author of *Dealmaking: The New Strategy of Negotiauctions* (2011), a practitioner-oriented book that examines and provides guidance for managing auction-like deal processes.

3. My articles have been published in the *Harvard Law Review*, the *Yale Law Journal*, the *Stanford Law Review*, the *Harvard Business Review*, and the *Journal of Law & Economics*, among other places. Scholars in the field have selected ten of my academic articles as being among the "top ten" articles published in corporate and securities law in their respective years, among the 400+ articles that are published each year. The recently-published two-volume treatise *Law & Economics of Mergers & Acquisitions*, which includes thirty-three "seminal"

articles over the past forty-five years, contains four of my articles, more than from any other scholar.[1]

4. Delaware courts have cited and endorsed this research in deciding important policy questions of corporate law. For example, in the past few years my research has been cited in *Air Products v. Airgas*[2] (accepting my empirical evidence that "effective" staggered boards are a potent defense, and that achieving 85% in a hostile tender offer is not realistically attainable); *In re Compellent Technologies, Inc. Shareholder Litigation*[3] (using my empirical work on deal jumping to estimate the likelihood of a higher bid); and *In re Cornerstone Therapeutics Inc. Stockholder Litigation* (citing my work on the effect of independent directors in minority buyouts).[4]

5. Two of my prior articles are particularly relevant for the current matter. *A Buy-Side Model of M&A Lockups: Theory & Evidence* (with John Coates), published in the *Stanford Law Review* in 2000, presents the first systematic empirical evidence on deal protection devices in M&A deals. *Go-Shops vs. No-Shops in Private Equity Deals: Evidence & Implications*, published in *The Business Lawyer* in 2008, presents the first systematic empirical evidence on the structure and influence of go-shop provisions in private equity (PE) buyouts. Both of these articles have been cited favorably by the Delaware courts;[5] both of these articles were selected by academics as among the "top ten" articles in their respective years, out of more than 400 articles published in each of these years; and both of these articles were selected as among the "seminal" articles from the past forty-five years in the treatise noted above.

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1 Steven M. Davidoff & Claire A. Hill EDS., The Law & Economics of Mergers & Acquisitions (2013).
2 16 A.3d 48 (Del. Ch. 2011).
3 2011 WL 6382523 (Del. Ch. Dec. 9, 2011).
4 No. 564, 2014 (Del. May 14, 2015).
5 *See, e.g.*, *In re Del Monte Foods Co. Shareholders Litigation*, 25 A.3d 813, 844 n.6 (Del. Ch. 2011).

6. Through the *Go-Shops* project, I personally examined the deal process in all private equity buyouts announced between January 2006 and August 2007 (n=141), including 48 deals that involved go-shop processes. This article is cited by both valuation experts retained in this matter.[6]

7. Two other articles of mine are also relevant for the current matter, in that they examine the procedural protections for minority shareholders in buyouts by controlling shareholders (a.k.a. freeze-outs). *Post-*Siliconix *Freezeouts: Theory & Evidence*, published in the *Journal of Legal Studies* in 2007, presents the first systematic empirical evidence on the procedural protections and substantive outcomes of freeze-out transactions. *Fixing Freezeouts*, published in the *Yale Law Journal* in 2006, provides doctrinal and transactional practice implications of these findings. Both of these articles have been cited favorably by the Delaware courts in their reformulation of freeze-out doctrine over the past five years.[7] Both of these articles were selected as "top ten articles" in corporate and securities law in their respective years, out of more than 400 articles published in each of these years.

8. Through these two projects, I personally examined the deal process in all freeze-out transactions of Delaware targets announced between June 2001 and June 2005 (n=76). This examination included a detailed review of the controlling shareholder's negotiations with the special committee, as well as the incidence and structuring of majority-of-the-minority conditions.

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[6] *See* Expert Report of Glenn Hubbard at ¶ 116 n. 147 (June 5, 2015) ("Hubbard Report"); Expert Report of Bradford Cornell (June 5, 2015) at ¶¶ 137-138.

[7] *See, e.g., In re CNX Gas Corp. Shareholders Litigation*, 2010 WL 2291842, Case No. 5377-VCL at *7 n.4 and *10 n.5 (Del. Ch. May 25, 2010); *In re CNX Gas Corp.*, 2010 WL 2705147, Case No. 5377-VCL at *11-*12 (Del. Ch. July 5, 2010); *In re MFW Shareholders Litigation*, 67 A.3d 496 (Del. Ch. May 29, 2013) (citations to both articles throughout opinion); *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 654 (Del. 2014).

9. In November 2013, I delivered the annual Pileggi Lecture to the Delaware judiciary, members of the Delaware bar, and law students in Wilmington, Delaware. According to the *Delaware Journal of Corporate Law*, "[t]he lecturer is always a leading voice in the field of corporation law."[8]

10. At HLS, I teach the basic course on Corporate Law to 125-140 students each year. As Harvard JD/MBA program chair, I also teach the JD/MBA seminar every other year to fifteen to twenty JD/MBA students. At HBS, I teach in numerous executive education programs, such as the *Advanced Management Program*, *Strategic Negotiations*, and *Changing the Game*.

11. I teach twice a year in an HBS executive education program called *Making Corporate Boards More Effective*. Participants in this program are required to be directors of one or more publicly-traded companies. I also lecture on corporate law topics twice a year to the Corporate Directors Group, a national association of public-company directors. Through MCB and CDG I have taught and discussed the duties of directors, including duties in sale-of-control situations, with hundreds of public-company directors.

12. In most years I teach a joint course between HLS and HBS entitled *Deals*, which focuses on complex business transactions. For each deal that we study in this class, a student team presents their analysis, and then a practitioner guest who was centrally involved comments on the student team presentation. Several of the deals we have studied in this course involve deal protection and market search processes. For example, in 2007 we studied the 2006 MBO of HCA, which involved a go-shop process. In 2012 we studied the 2008 MBO of Getty Images, which also involved a go-shop. Throughout the course, we study topics such as: the implications of asymmetric information, moral hazard, and adverse selection for deal design; managerial

[8] Francis G. Pileggi Distinguished Lecture in Law, Del. J. of Corp. L., http://djcl.org/Pileggi_Lecture/pileggi.html.

incentives and agency costs of management; and effective "deal process design," which includes the use of auction and auction-like mechanisms.

13. I am regularly retained as an advisor or expert witness in complex corporate transactions. I also advise individuals, boards of directors, and management teams on issues of dealmaking and corporate governance. Over the past fifteen years I have been involved as an advisor or expert witness in deals or situations worth over $150 billion in aggregate value. I am a director of LKQ Corporation (NASDAQ: LKQ), a Fortune 500 company in the automotive sector. LKQ has approximately $6.0 billion in annual revenues, 25,000 employees, and $8.5 billion in market capitalization. The company has its headquarters in Chicago and is incorporated in Delaware. At LKQ, I am a member of the Audit Committee and the Nominating/Governance Committee.

14. My Curriculum Vitae, which includes a complete listing of my academic publications and expert witness testimony over the past four years, is attached as **Appendix A**.

B. STATEMENT OF ASSIGNMENT

15. I have been asked by counsel for Petitioners to answer the following questions:

a. What are the institutional details and practical realities that influence the effectiveness of a go-shop MBO process as a tool for price discovery in the M&A marketplace?

b. How often, and under what circumstances, does a third-party bidder make a formal overbid in a go-shop MBO process?

c. Is it correct, as Professor Hubbard claims, that the "restrictions and safeguards [in the Dell MBO process] are consistent with a process that aligns the incentives of all parties to achieve a fair price for non-continuing stockholders and also allows bidders other than those initially involved to participate on an equal basis"?[9]

[9] Hubbard Report, *supra* note 6, at ¶ 113.

16. I have been compensated for my work on this matter at my standard rate of $1,400 per hour. My compensation is not affected by the opinions that I express or by the outcome of this case. A research assistant at Subramanian Advisory Services, LLC, working under my direction and supervision, has helped me in the preparation of this report, but all of the work reflected in this report is my own.

C. SUMMARY OF RELEVANT FACTS

17. The following facts, to my knowledge, are uncontested by the parties. Unless otherwise specified, all facts come from the "Background of the Merger" section of the Dell Proxy Statement, as filed on May 31, 2013 and updated on August 14, 2013.

18. In June 2012, a representative of Southeastern Asset Management ("Southeastern"), which owned 8.4% of the shares of Dell Inc., contacted Michael S. Dell to suggest the possibility of a going-private transaction in which Southeastern would roll over a portion of its shares. Mr. Dell responded that he would "think about the idea." On August 10th and 14th Mr. Dell held meetings with Silver Lake Partners ("Silver Lake") and on August 11th and 13th he held meetings with Kohlberg Kravis Roberts[10] ("KKR") to also discuss a possible going-private transaction. On August 14th, Mr. Dell told Mr. Mandl, Dell's lead independent director, that he was "interested in exploring the possibility" of taking the company private.

19. On August 17, 2012, the Dell board held a telephonic meeting to discuss a possible going-private transaction. On August 20th, the board established a Special Committee of four independent directors, chaired by Mr. Mandl, which would have exclusive authority to consider any going-private proposal from Mr. Dell or others. The Special Committee was

[10] Although the Proxy Statement describes this bidder only as "Sponsor A," numerous public accounts report that Sponsor A was KKR. *See, e.g.*, Michael J. De La Merced, *Timeline: How Michael Dell's Takeover Bid Got Hatched*, N. Y. Times Dealbook (Mar. 29, 2013). I use this assumption for clarity of exposition but my conclusions do not depend on this fact.

authorized to make a recommendation to the board, and the board resolved not to recommend any going-private transaction or alternative transaction to the shareholders without the prior favorable recommendation by the Special Committee.

20. Over the next few weeks the Special Committee retained Debevoise as its legal advisor and JPMorgan as its financial advisor. Debevoise prepared confidentiality agreements for each of Mr. Dell, Silver Lake, and KKR. By early September, with these confidentiality agreements in place, the company provided access to an online data room for each of Mr. Dell, Silver Lake, and KKR.

21. Mr. Dell's confidentiality agreement "required [him] to work in good faith with other potential sponsors if requested to do so by the Special Committee and to refrain from taking any actions that would prevent him from doing so." In addition to working with other sponsors as part of the going-private transaction, Mr. Dell was required to "explore in good faith the possibility of working with any such potential counterparty or financing source if requested by the company," although the ultimate decision "after such good faith exploration shall be within [Mr. Dell's] discretion."[11]

22. In August/September 2012, the Dell Special Committee, along with JPMorgan and Debevoise, held meetings with Silver Lake and KKR to discuss the transaction process. I find no evidence in the Background to the Merger description that the Special Committee or its representatives held discussions with any other potential buyers during this period. In particular,

[11] Letter from Dell SVP and General Counsel Lawrence Tu to Michael Dell (Aug. 31, 2012) at 2 (EVERCORE00044734).

apparently upon instruction from legal counsel, Mr. Dell did not have further communication with Southeastern after their initial conversations in June/July 2012.[12]

23. On October 16th, JPMorgan sent a letter to Silver Lake and KKR, requesting proposals no later than October 23rd. Silver Lake submitted a proposal with a purchase price of $11.22 to $12.16 per share. The proposal envisioned that Mr. Dell would roll over all his shares, and Silver Lake indicated that its interest "was solely in pursuing a transaction in partnership with Mr. Dell." KKR proposed a purchase price of $12 to $13 per share, with Mr. Dell and Southeastern rolling over their shares, and contemplated an additional $500 million cash investment by Mr. Dell.

24. Mr. Dell met with representatives of Silver Lake on November 16th and representatives of KKR on November 17th. Mr. Dell "encouraged the representatives of each of Silver Lake and [KKR] to submit revised bids that were as strong as possible," and that "they should assume that he would be prepared to participate at the highest price they were willing to pay."

25. On December 3rd, KKR notified Mr. Dell that it would not be submitting an updated proposal and was withdrawing from the process. On December 4th, Silver Lake submitted an updated proposal of $12.70 per share. On December 7th, Mr. Mandl contacted

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[12] Southeastern Asset Management Proxy Statement at 1, *available at* http://www.sec.gov/Archives/edgar/data/807985/000113379613000127/k347143_prec14a.htm (June 6, 2013) ("[O]n July 13, 2012, SAM sent Mr. Dell a spreadsheet exploring the potential sale of the Dell Financial Services business and/or issuance of debt to fund a significant share repurchase. While brief follow-up conversations occurred over the late summer and fall of 2012, SAM's attempts to get further detail, including requests through counsel for a confidentiality agreement, were not successful."); Dell Inc. Form DEFM14A (filed May 31, 2013) at 29 ("Mr. Dell also stated that, while he had spoken in June and July with Southeastern about the potential for a going private transaction, he had not spoken with Southeastern about the possibility of such a transaction since that time.") (hereinafter Dell Proxy Statement); Deposition of Michael Dell (May 15, 2015) at 471-473 (stating that he did not speak to Southeastern after June/July on the advice of counsel).

Texas Pacific Group[13] (TPG), identified by JPMorgan as "the sponsor next most likely to make a credible proposal." TPG entered into a confidentiality agreement and also gained access to the on-line data room. TPG then held "numerous due diligence discussions with the Company's management and representatives, including Mr. Dell." On December 23rd, TPG informed JPMorgan that it would not be submitting a proposal and was withdrawing from the process.

26. On January 10th, 2013, the Special Committee retained Evercore as an additional financial advisor, with specific responsibility for running the anticipated "go-shop" process. Evercore's retention agreement specified a monthly fee of $400,000, a flat fee of $1.5 million for Evercore's fairness opinion, and a "Superior Transaction Fee," equal to 0.75% of the difference between the value of the Initial Transaction and the value of any Superior Transaction that Evercore might identify during the go-shop period, with a $30 million cap on Evercore's total fee.[14]

27. On January 15th, the Special Committee held a meeting with its advisors to "discuss[] the possibility of approaching other financial sponsors or strategic buyers to solicit additional bids." Evercore "expressed the view that it would not be beneficial to contact additional parties at the current stage of the process." The Special Committee decided to not reach out to other potential buyers.

28. During January/February 2013, the Special Committee and its representatives negotiated exclusively with Mr. Dell and Silver Lake, ultimately reaching a deal on February 4th at $13.65 per share ("the Dell/Silver Lake Offer"). The Dell/Silver Lake Offer planned for Mr. Dell to roll over his entire 16% equity stake into the new company; in addition he would

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[13] Although the Proxy Statement describes this bidder only as "Sponsor B," numerous public accounts report that Sponsor B was Texas Pacific Group. *See, e.g.*, De La Merced, *supra* note 10. I use this assumption for clarity of exposition but my conclusions do not depend on this fact.

[14] Evercore Retention Agreement at 2 (Jan. 10, 2013). (EVERCORE00127574)

contribute $750 million of new equity.[15] As a result Mr. Dell would own 75% of the post-MBO company.[16] The Special Committee unanimously recommended the deal to the full board, which in turn approved the deal on February 4th.

29. The merger agreement included a "go-shop" period, during which the Special Committee and its representatives could solicit higher offers.[17] The go-shop period began on February 5, 2013, when the Dell/Silver Lake Offer was announced, and continued for 45 calendar days, to March 23, 2013 (the "Go-Shop Period"). The Special Committee could continue negotiating after the Go-Shop Period expired with any "Excluded Party," defined as a party identified during the Go-Shop Period that "is or could reasonably be expected to result in a Superior Proposal."[18]

30. The merger agreement also specified that Dell/Silver Lake would have a one-time match right against any Superior Proposal. This match right required the Special Committee to negotiate with Dell/Silver Lake "in good faith" for four business days "to make such adjustments in the terms and conditions of this Agreement" that would make the competing offer no longer a Superior Proposal.[19]

31. Evercore conducted the go-shop process, making contact with 71 total parties and identifying eleven that "expressed interest in evaluating a possible transaction." Blackstone was one of the eleven parties that expressed interest. After executing a confidentiality agreement on February 22nd, "Blackstone was granted access to an electronic data room later that day and subsequently conducted due diligence, including through discussions with members of the

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[15] *See* SilverLake Slide #9 -- Sources & Uses (undated) (SLP_DELLAP00116678).
[16] *See id*.
[17] Agreement and Plan of Merger by and among Denali Holding Inc. et. al and Dell, Inc (Feb. 5, 2013) at § 5.3 (hereinafter Merger Agreement).
[18] *Id.* at § 5.3.
[19] *Id.* at § 5.3(f)(ii).

Company's management (including with Mr. Dell)." Blackstone indicated to representatives of Evercore that Blackstone intended to form a consortium to pursue a possible transaction, eventually joining with "Sponsor B," Francisco Partners III. LP ("Francisco"), "Strategic Party E," and Insight Venture Management, LLC ("Insight").

32. On March 22nd, Blackstone, Francisco, and Insight ("the Blackstone Consortium") submitted a non-binding proposal to the Special Committee that offered Dell shareholders a choice of at least $14.25 per share cash or rolling over their shares, subject to an unspecified cap (the "Blackstone Proposal"). Blackstone also informed the Special Committee that "it was not willing to proceed with its evaluation of the transaction contemplated by the Blackstone Proposal" unless Dell agreed to reimburse Blackstone for its out-of-pocket expenses. Also on March 22nd, Icahn Enterprises ("Icahn") submitted a non-binding proposal to the Special Committee that offered Dell shareholders a choice of $15.00 cash (with a cap of $15.6 billion on the total amount of cash that would be paid out) or rolling over their shares (the "Icahn Proposal").

33. On March 24th, the day after the Go-Shop Period had expired, the Special Committee designated both the Blackstone Consortium and Icahn as "Excluded Parties," on the view that either or both could reasonably be expected to result in a Superior Proposal. On March 25th, the Special Committee agreed to Blackstone's request for expense reimbursement, up to a cap of $25 million.

34. On April 18th, Blackstone informed the Special Committee that it would be withdrawing from the process. On May 9th, Icahn and Southeastern made a new non-binding proposal to the Special Committee, offering $12 in cash or Dell stock to shareholders, in addition to retaining their current shares (the "Icahn/Southeastern Proposal"). On May 13th, the Special

Committee asked for "additional clarifications and additional information" regarding the Icahn/Southeastern Proposal. After deeming Icahn/Southeastern non-responsive, the Special Committee endorsed the Dell/Silver Lake Offer. Dell mailed the definitive proxy statement to shareholders on or around May 31st and began soliciting proxies to approve the Dell/Silver Lake Offer.

D. SUMMARY OF CONCLUSIONS

35. Based on my experience, academic publications, and my review of the facts of this matter, I have reached the following conclusions:

a. Four features of go-shop MBO processes create an unlevel playing field for third-party bidders: information asymmetries; the "ticking clock" problem; valuable management; and managerial incentives to discourage third-party bids. As a result of these institutional details and practical realities, courts and practitioners should be skeptical of go-shop MBO processes as an effective tool for price discovery in the M&A marketplace.

b. A systematic review of all go-shop processes in MBOs between 2006 and the first half of 2015 reveals only two instances where a third-party bidder made a formal overbid. Both of these instances appear to be cases where the "valuable management" impediment to an overbid was small or non-existent, which in turn mitigates the information asymmetry problem and the "ticking clock" problem.

c. The Dell transaction had all four of the features that create an unlevel playing field for third-party bidders. Professor Hubbard is therefore not correct that the go-shop MBO process "aligns the incentives of all parties to achieve a fair price" and other bidders could "participate on an equal basis" with the inside bidders. By extension, it is my opinion that the lack of formal third-party bids in the Dell MBO go-shop process should not be considered as evidence in favor of the fairness of the Dell/Silver Lake Offer.

36. I explain these conclusions in the remainder of this Report. I reserve the right to revise and supplement this report based on additional materials that I might review, including materials that have not yet been made available for review. A list of documents that I relied upon in preparing my report is provided in **Appendix B**.

II. INSTITUTIONAL DETAILS AND PRACTICAL REALITIES OF GO-SHOP MBO PROCESSES

37. At first glance, an auction mechanism should yield effective price discovery in the M&A marketplace. I describe this conventional wisdom in my *Dealmaking* book: "Just hold an auction, interested parties will show up, and the price will be bid up or down (depending on whether you are a buyer or seller) to your advantage."[20] However, certain institutional details and practical realities make a go-shop MBO process less effective as a tool for price discovery. They are: information asymmetries; the "ticking clock" problem; valuable management; and management's financial incentives to discourage an overbid. These factors are not included in standard economic models of auctions,[21] yet they are important for understanding how go-shop MBO processes actually work. I discuss each of these four factors in turn.

A. INFORMATION ASYMMETRIES

38. Any MBO process presents an information asymmetry problem, because management knows more about the company than any third-party bidder. The result of the information asymmetry is the winner's curse problem: if the third-party bidder wins the auction, it knows that it has paid more than the "smart money" (i.e., management), in which case it has almost certainly overpaid;[22] and if the third-party bids and loses, it has spent time and money with nothing to show for its efforts. As one commentator put it: "Just as Person B would not

[20] Guhan Subramanian, Dealmaking: The New Strategy of Negotiauctions 34 (2011).

[21] *See also* Paul Klemperer, Auctions: Theory & Practice 104 (2004) ("Most of the extensive auction literature . . . . is of second-order importance for *practical* auction design.") (emphasis in original); Subramanian, *supra* note 20, at 118 (describing *post mortem* academic/practitioner conference at New York University on Cable & Wireless American auction, which "contributed to my growing sense that auction theory has little to say about how most real auctions actually work").

[22] Absent synergies or other private value, which I discuss in Part II.C below.

want to bid against Person A for the contents of Person A's wallet, no financial buyer would want to bid against a financial buyer working with management."[23]

39. In my *Dealmaking* book, I provide an assessment of the winner's curse problem:

> [B]idders should look forward and reason back as follows: "When I am the high bidder (the only scenario that matters), what do I know that I don't know now?" The answer is that everyone else . . . guessed lower [on intrinsic value] than I did. "Would I feel comfortable making this bid, knowing this fact?" The answer could be yes. Some bidders have expertise that gives them an "edge" over others; that is, they are able to assess value better than anyone else can. . . . [But without an edge,] winner's curse concerns apply in full force.[24]

40. In the context of MBOs, not only do outside bidders not have an "edge," they are typically at a disadvantage relative to the inside bidder due to information asymmetries.

41. In my research on freeze-out transactions, I observe that the controlling shareholder (who is often overlapping with management) can maximize the effect of the information asymmetry by executing the freeze-out at a time "when it perceives that the market price of the target stock is lower than its intrinsic value."[25] A controlling shareholder (or management) can even use information asymmetries to manipulate the market price, which sets the baseline for the buyout price:

> Consider the case of a one-time positive NPV project, for which the only question is whether to implement the project before or after the freezeout. If the project is not completely transparent to the marketplace, a controller might rationally delay this investment until after the freezeout, in order to reap the full benefit rather than sharing the benefit with the minority. This value diversion would be difficult to detect, and, even if detected, would likely be protected by the business

[23] J. Russel Denton, Note, *Stacked Deck: Go-Shops and Auction Theory*, 60 Stan. L. Rev. 1529, 1546 (2008).

[24] Subramanian, *supra* note 20, at 87-88.

[25] Guhan Subramanian, *Fixing Freezeouts*, 115 Yale L. J. 1, 33 (2006). I explain further: "Although insider trading restrictions prevent the most egregious forms of this kind of opportunism, the controller may be able to take advantage of smaller pieces of nonpublic information, which individually do not meet the test for materiality, but collectively give the controller greater insight than the public minority shareholders about the intrinsic value of the company." *Id.*

judgment rule, particularly if there were some plausible basis for the delay (e.g., reduced risk due to the delay).[26]

42. In my opinion, this information asymmetry problem between management and potential third-party bidders creates an unlevel playing field in a go-shop MBO process. Without an edge, third-parties will be rationally deterred from bidding, in order to avoid the winner's curse.

B. THE "TICKING CLOCK" PROBLEM

43. The information asymmetry problem described above exists in any MBO process. However, the information asymmetry is amplified in go-shop MBOs, compared to standard MBOs, because of the "ticking clock" problem. Go-shop periods are generally between 30 and 60 days. In the Go-Shop Sample (described in Part III.B below), for example, the mean (median) number of days to find a third-party bidder was 38 days (40 days). As difficult as it would be to overcome the information asymmetry with an indefinite clock, it becomes virtually impossible with a window this short. And of course, the combination of the information asymmetry and ticking clock problem becomes a larger impediment to a third-party bidder when the company is larger.

44. The ticking clock problem is exacerbated by the fact that potential bidders during the go-shop process only get management's partial attention. During the tight timeframe of the go-shop window, management will need to divide its time among the bidders that sign confidentiality agreements. (And this assumes that management is a willing participant with third-party bidders – an assumption I examine in Part II.D.)

45. In the absence of a ticking clock, third-party bidders seem to be more willing to make an overbid into an MBO process. I describe the research on this point in my *Go-Shops*

[26] *Id.* at 34.

article: "Prior studies report robust competition during the pre-signing phase in public-company MBOs. . . . [P]ost-signing competition with a management group may be more difficult than pre-signing competition because of the presence of a breakup fee, a match right, or the 'ticking clock' for conducting due diligence and making an offer."[27]

C. VALUABLE MANAGEMENT

46. Valuable management presents another impediment to a third-party bid, if management is not available (either explicitly or implicitly) to partner with other bidders. In effect, valuable management converts a "common value auction" (in which all bidders are trying to estimate the same thing, namely, the value of the company) to a "private value auction" (in which the inside bidder has a private, idiosyncratic source of value in the form of valuable management).

47. The private value created by valuable management changes third-party bidding strategy in an important way. In a common value auction, bidders' signals are "affiliated,"[28] which means that outside bidders can free ride on the "smart money" of inside bidders. For example, several years after the iconic auction of Revlon in 1985, Steve Fraidin (then a lawyer at Fried Frank representing Ted Forstmann in the deal) explained:

> At one point there was a negotiation between the parties to try to settle the situation, and my client [Forstmann] tells Perelman, "We have a big advantage – we have confidential information, you don't have any. We know what to bid and you do not." Perelman, who is a smart man, said, "Actually, I have even better information than you have because I know what you're bidding. And once I know what you're bidding and I know how smart you are and I know that you

[27] Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence & Implications*, 63 Bus. Law. 729, 750-751 (2008) (citations omitted).

[28] *See* Paul Milgrom & Robert Weber, *A Theory of Auctions and Competitive Bidding*, 50 Econometrica 1089 (1982) (identifying implications of affiliated signals for deal process design).

> have all the confidential information, I know I can bid a nickel more and still have a good deal." And he was absolutely right.[29]

48. Because Revlon was an auction between two financial buyers (Forstmann Little and Ron Perelman), the contest was primarily a common value situation. This meant that bidders' signals were affiliated, and Perelman could effectively free ride on the bids from Forstmann Little (ultimately winning the auction with this strategy).

49. In contrast, when management is a critical ingredient for the ongoing success of the company, a go-shop MBO is more akin to a private-value auction. In this scenario, the inside bidder has private value due to the fact that the company without management is worth less. A strategy of free riding on the insider's bids risks paying for the value added by management without actually realizing that value once the deal closes.

50. Information asymmetries and valuable management are two distinct causes of third-party bidder deterrence – one can exist without the other. Consider information asymmetry but non-valuable management: management knows better than outsiders what the company is worth, but management does not add private value itself. Or consider the opposite, valuable management but no information asymmetry: everyone knows what the company is worth, including the fact that the company is worth more with management. Either of these situations on its own creates an unlevel playing field between the inside bidder and third-party bidders.

51. Of course, the combination of information asymmetries and valuable management is even more of a deterrent than either on its own: management knows better than outsiders what the company is worth, and some of that value is added by management (and management knows better than outsiders how much). In this scenario there is a large wedge between the insider bidders and third-party bidders.

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[29] *Quoted in* Guhan Subramanian, *The Drivers of Market Efficiency in* Revlon *Transactions*, 28 J. Corp. L. 691, 700 (2000).

52. To be clear, the purpose of this analysis is not to criticize valuable management (which of course is a good thing); it is simply to point out the implications of this feature for the effectiveness of a go-shop MBO process. Management does not have an obligation to work with third-party bidders, but when management chooses to not do so (either implicitly or explicitly), and when management is valuable, a go-shop MBO process can no longer provide evidence in favor of "fair value."

53. Finally, it is important to note that when management is not valuable, the other three sources of bidder deterrence in go-shop MBOs largely go away. Without private value added by management, third-party bidders (like Perelman at Revlon) can free ride on the inside bids. This extinguishes the information asymmetry problem, because the inside bid contains a strong signal of value; and it extinguishes the "ticking clock" problem, because there is no need for time-consuming due diligence as soon as the inside bid is revealed. Therefore, third-party bids in go-shop MBO processes are most likely when the private value added by management is small or non-existent.

D. Management Financial Incentives to Discourage Overbids

54. A natural way for a third-party bidder to mitigate the private value problem described in the prior Part is to partner with management. In theory at least, partnering with the CEO gives a third-party bidder the same access to the private value generated by the CEO, and therefore puts the third-party bidder on a level playing field with the incumbent buyout team. However, this theoretical ability to achieve a level playing field can be compromised by the management team's own financial incentives.

55. A CEO can be both a buyer and a seller in an MBO. As the price goes up, he gets more money for his shares as a seller, but he also pays more for the shares as a buyer. The CEO's overall financial incentive will depend on whether he is a net buyer or net seller of the

company's stock in the transaction. For example, one study finds that directors and officers cashed out \$52 million of stock, on average, in a sample of MBOs from 2003-2009.[30] If the D&Os contributed less than \$52 million of equity capital on the buy-side, management in these deals would have a financial incentive to push the price up, in order to receive more for their stock.[31] To take another example, a CEO who rolls over his entire stake and then contributes additional equity capital on the buy-side is a net buyer of shares in the transaction. This CEO would have an incentive to keep the price down because he is a net buyer.

56. This analysis has implications for the CEO's receptivity to engage with potential third-party bidders. If the CEO is a net buyer in the transaction, the CEO will have personal financial incentives to discourage overbids, which push the price up. A well-advised CEO would of course make representations of being willing to work with third-party bidders, but these representations will have limited credibility in this scenario. To the extent that the CEO is essential for the ongoing value of the enterprise, no buyout group would want to partner with a reluctant CEO.

57. For this reason a prospective third-party bidder is caught in a Catch-22: without partnering with the CEO, the third-party does not realize the private value that comes from such partnership, but partnering with a reluctant CEO may destroy the very private value that the third-party is seeking to achieve in the first place. Third-parties can no longer comfortably free ride on the inside bids. Recognizing this problem, they will rationally be deterred from bidding. The magnitude of the deterrence will depend on the magnitude of the private value that the CEO

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[30] Matthew Cain & Steven Davidoff, *Form Over Substance? The Value of Corporate Process and Management Buy-outs*, manuscript at Table 1 (working paper August 2010).

[31] A complicating factor is that pushing the price up would reduce returns for management's buyout partner (who is contributing equity capital), which could strain future relationships and/or create higher hurdles for management's performance post-MBO.

and management bring to the table, as well as the magnitude of the CEO's financial incentive on the buy-side of the transaction.

III. EMPIRICAL EVIDENCE ON DEAL-JUMPING IN GO-SHOP MBOS

A. FINDINGS FROM 2008 *GO-SHOPS* STUDY

58. In 2008, I published the first systematic empirical analysis of go-shop provisions (the "2008 Go-Shops Study").[32] In that paper, I examined all private equity buyouts of U.S. targets greater than $50 million in value, announced between January 2006 and August 2007 (n=141). Among these 141 deals, 93 (66%) involved a standard no-shop clause and the remaining 48 (34%) involved a go-shop process. Among the go-shop sub-sample, I found that that there were two kinds of go-shops: (1) a "pure" go-shop, which I define as a deal "in which the target negotiated exclusively with a single bidder, then conducted a market canvass during a post-announcement 'go-shop' period;"[33] and (2) an "add-on" go-shop, which I define as a deal "in which the target conducted a market canvass pre-announcement but also engaged in a post-announcement market canvass pursuant to a go-shop clause."[34]

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[32] Subramanian, *supra* note 27. *See also* Jin Q Jeon & Cheolwoo Lee, *Effective Post-Signing Market Check or Window Dressing? The Role of Go-Shop Provisions in M&A Transactions*, 41 J. Bus. Fin. & Acctng. 210, 213 (2014) ("Subramanian (2008) is the first study that empirically examines the go-shop provision in takeover agreements.").

[33] Subramanian, *supra* note 27, at 745 (Table 2).

[34] *Id.*

59. In both kinds of go-shops, I found (contrary to the conventional wisdom at the time[35]), that go-shop provisions generally yielded a meaningful market check. For example, in the context of "pure" go-shops, I found that the sell-side bankers contacted 39.6 potential buyers during the go-shop phase, on average, and 3.2 of these signed confidentiality agreements. With add-on go-shops, I found that the sell-side bankers contacted 15.9 potential buyers, on average, and 2.7 of these signed confidentiality agreements. I further found that "[a]fter examining this non-public information, the go-shop successfully generates another offer 5% of the time in an add-on go-shop and 17% of the time in a pure go-shop, consistent with the intuition that the go-shop should yield a higher-value buyer more often when there has been no pre-signing shopping."[36]

60. I then examined the deals in my sample where the go-shop process successfully identified another bidder (n=6). I observed that:

> [N]one of the successful go-shops involved management buyouts, or, conversely, all of the successful go-shops involved targets that did not have management involvement in the initial buyout group. This finding cannot be explained by higher premiums in go-shop MBOs: in unreported analyses I find no meaningful difference in premiums received or returns to target shareholders between go-shop MBOs and go-shop non-MBOs.[37]

61. I summarized my empirical findings as follows:

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[35] *See, e.g.*, Andrew Ross Sorkin, *Looking for More Money, After Reaching a Deal*, New York Times (Mar. 26, 2006) ("The question, though, is why a company wouldn't hold an open auction to begin with? . . . [M]ore often than not, it would seem that an open auction is the best way to go. . . . [T]he biggest problem with a go-shop provision is that by default, other potential bidders start at a huge disadvantage."); Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops – the Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 Brooklyn L. Rev. 525 (2008); Tom Taulli, *ACS Buyout: A Second Bite at the Apple?*, BloggingBuyouts (June 12, 2007) ("[I]t's usually the case that a 'go shop' doesn't amount to much anyway."), *available at* http://www.bloggingbuyouts.com/2007/06/12/acs-buyout-a-second-bite-at-the-apple. *See generally* M. Lipton, T.N. Mervis & P.K. Rowe, *Private Equity and the Board of Directors*, Wachtell, Lipton, Rosen & Katz memorandum to clients, at 4 (noting that "some skepticism has been expressed about the effectiveness of go-shops given a perception that private equity buyers may be reluctant to compete against signed-up deals").

[36] Subramanian, *supra* note 27, at 747.

[37] *Id.* at 750.

> While the data suggests a positive overall assessment of go-shops from the perspective of target shareholders, there is cause for concern in the subset of go-shops in which current management is part of the buyout group. The fact that no higher bidder has emerged in an MBO go-shop to date (after nearly two years of experience with go-shops, in a frenzied deal environment) suggests that third parties may be wary of entering a bidding contest, or that bankers might not conduct as thorough and energetic search, when management has already picked its preferred buyout partner. A management team with difficult-to-acquire firm-specific skills and knowledge can use its inherent advantage to buy the company from the public shareholders at a lower price by effectively committing to its favored buyout group and making clear its unwillingness to work with any other buyout group that might emerge during the go-shop process.[38]

62. Subsequent academic commentators have confirmed my empirical finding that go-shop MBOs do not get jumped. In a sample of 63 go-shop processes, for example, Denton (2008) found that none of the eleven jumped deals in his sample were MBOs.[39] In a sample of 62 go-shop processes, Morton & Houtman (2008) also found that none of the four jumped deals in their sample were MBOs.[40]

63. I concluded from my empirical findings that there is "a potential 'dark side' to go-shop provisions in the context of MBOs," and recommended that "target boards of directors and

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38 *Id.* at 756-757.

39 Denton, *supra* note 23, at 1550-1553.

40 Mark A. Morton & Roxanne L. Houtman, *Go-Shops: Market Check Magic or Mirage?*, Potter Anderson & Corroon LLP Client Memorandum 10 (Feb. 2008). In an extension of my work, Antoniades, Calomiris & Hitscherich (2015) use a two-stage instrumental variable approach rather than my matched-sample approach to control for potential endogeneity problems in the decision whether to include a go-shop clause. They conclude from their analysis that "go-shop decisions, on average, do not have a positive effect on initial offers, and very likely have a negative one." Adonis Antoniades, Charles W. Calomiris & Donna M. Hitscherich, *No Free Shop: Why Target Companies in MBOs and Private Equity Transactions Sometimes Choose Not to Buy 'Go-Shop' Options* (working paper May 2015), manuscript at 24. The authors do not find statistically significant results for MBO go-shops in any of their multivariate models. *See id.* at 41-45 (Tables 4-8). This may be due at least in part to relatively weak or legally meaningless instruments in their first-stage model, such as the number of officers and directors of the target, the number of law firms advising the target, the legal advisors' rank in M&A league tables, and the volatility of the target's stock price. *See id.* at 42 (Table 5, Column 1), 49-55. The authors also do not distinguish between "add-on" go-shops and "pure" go-shops, which I found in my sample to be very different kinds of go-shop processes.

Delaware courts should pay close attention to the precise structure of go-shops in the MBO context."[41] Specifically, I recommended that:

> a. "[C]ourts should look for simple information rights (i.e., keeping the initial bidder informed about higher bids that emerge), rather than the increasingly commonplace match right, in pure go-shop MBOs. . . . Particularly in the case of a pure go-shop MBO, the Delaware courts should reverse course to consider a match right as a strong negative factor in the standard *Revlon* analysis";[42]
>
> b. "Even better, sell-side boards should push for a provision in the merger agreement that explicitly prevents the MBO group from participating in any post-signing auction [citing Kerzner International as an example of this go-shop structure]. . . . [T]his go-shop structuring would induce the MBO group to put full value on the table in its initial bid";[43]
>
> c. "If the MBO group already holds a significant stake in the target, sell-side boards should push for a contractual commitment by management to sell in to any higher offer that emerges during the go-shop period. The corollary to this point is that sell-side boards should not allow the MBO group to lock up its shares with its buyout partner because locked up inside shares would naturally deter third parties";[44] and
>
> d. "Delaware courts should look favorably on inducement fees that are specified as part of the initial merger agreement. For example, a target board might extract a concession from the MBO group to reimburse out-of-pocket expenses for any third-party buyer who makes a bona fide superior proposal that is at least 5% higher than the deal price, even if the third party does not win in the end. This deal term would be a radical innovation because in every case that I am aware of an inducement fee is negotiated ex post, i.e., after a bidder appears. An ex ante inducement fee nevertheless should be part of the target board's negotiation toolkit, particularly in the go-shop MBO context, because of the strong (and correct) perception of a non-level playing field between the MBO group and potential third-party bidders."[45]

64. The converse of these policy recommendations is equally important: in the absence of these kind of structural solutions that would work to mitigate the unlevel playing field

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[41] Subramanian, *supra* note 27, at 760.
[42] *Id.* at 758.
[43] *Id.*
[44] *Id.* at 759.
[45] *Id.* at 758-759.

inherent in go-shop MBOs, courts and practitioners should be skeptical that a go-shop MBO process yields effective price discovery in the M&A marketplace.

65. The closest instance that I found in the 2008 Go-Shops Study to an actual third-party bid in a go-shop MBO process was the February 2006 buyout of Kerzner International, by its founder and CEO Sol Kerzner. One feature of the merger agreement that might have contributed to the presence of a third-party bidder was a prohibition on Kerzner's management from participating in any post-signing auction. Although Delaware courts generally disfavor hands-tying agreements, I observed that this feature "would induce the MBO group to put full value on the table in its initial bid."[46] The subsequent negotiation with the prospective third-party bidder is described in my *Dealmaking* book:

> Under the terms of the merger agreement, the board then had forty-five days to negotiate with other potential buyers to see if anyone could beat [Sol] Kerzner's price of $76.00 per share – known on Wall Street as a "go shop" clause. On April 11, twenty-two days into the go-shop period, an unknown bidder (identified in Kerzner's public filings only as "Party A") expressed significant interest in acquiring the company. But the bidder was concerned that Sol Kerzner and his management team had a significant inside track on what the company was worth.
>
> Party A's solution was a setup move: the Kerzner board would have to pay to get Party A to play. Specifically, Party A demanded (1) reimbursement of its expenses in the event that it made a firm offer at $78.00 per share or better; and (2) approximately $100 million more in the event that its bid was the highest outside bid and the Kerzner board did not sign a deal with Party A within ten days of its bid being made. The Kerzner board explained Party A's setup move: "Due to its concerns that the investor group [led by Mr. Kerzner] had a natural advantage over other bidders from its pre-existing knowledge of the company and established relationships with governmental authorities and joint venture partners, it would require an inducement to complete . . . due diligence and to submit a proposal to acquire the company."
>
> The Kerzner board nevertheless rejected Party A's setup move, and Party A walked away. One might say that the setup move in this case lost Party A the deal, but Party A correctly understood that Sol Kerzner and his team had a big advantage over any outside bidder. If Party A bid and won, it would know that the insiders didn't think the company was worth that much. And if Party A bid

[46] *Id.* at 758.

> and lost, it would have nothing to show for the time and effort it had invested. Under these conditions, Party A needed significant inducements in order to play. So rather than the setup move losing the deal, the better interpretation is that the setup move avoided a situation that Party A couldn't possibly win.[47]

B. New Empirical Evidence on Go-Shops MBOs

66. In order to update the findings from the 2008 Go-Shops Study, I constructed a new sample of go-shop deals. I searched the MergerMetrics database for all going-private transactions announced between January 2006 and June 2015 that included a go-shop clause.[48] Following the methodology from my 2008 study, I eliminated all transactions less than $50 million in value, as well as transactions where a single shareholder or voting group held more than 35% of the shares, in order to focus on economically meaningful transactions that were contestable.[49] Excluding the Dell MBO, which otherwise would have been included, the sample includes 126 transactions (the "Go-Shop Sample").

67. Within the Go-Shop Sample, MergerMetrics identifies a "Deal Jumping Situation" or "Withdrawn Due to Competing Bid" in 14 transactions. Among these 14 deals, management buy-side participation in the initial deal (as identified by 13E-3 filings) existed in two deals: the Silicon Storage Technology (SST) buyout in November 2009, and the Quest Software buyout in March 2012. Both of these deals were announced after the end of the sample period in my original *Go-Shops* article. I examined both of these deals to determine the extent and nature of the management involvement, as well as the overall context of the deal.

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[47] Subramanian, *supra* note 20, at 145-146.

[48] I have used MergerMetrics in my academic and other work, and find it to be a generally reliable data source. However, I have not double-checked the MergerMetrics codings against SEC filings or other primary sources. In the 2008 Go-Shops Study I hand-coded the sample based on SEC filings. I did not have access to MergerMetrics at that time.

[49] *See also* Guhan Subramanian, *Post-Siliconix Freeze-outs: Theory & Evidence,* 36 J. Leg. Stud. 1, 8 (2007) (also using a 35% cut-off for identifying controlled companies). As a partial cross-check on MergerMetrics, I searched the Thomson Platinum M&A Database for go-shop MBO transactions. This search revealed no additional transactions that met the search criteria beyond those already identified by MergerMetrics.

68. In the SST MBO, CEO Bing Yeh and COO Yaw Wen Hu partnered with Prophet Equity to offer $2.10 per share for the company, or $210 million in total value, on November 13, 2009. Mr. Yeh held 11.3% of the shares and Mr. Hu held 1.3% of the shares at the time of the deal, and both were expected to roll over their stakes into the new company. Analysts commented on the low price (amounting to a 13% premium over the announcement-day share price),[50] and the stock closed that same day at 7% above the offer price. One SST director (Bryant Riley) voted against the proposed MBO and then resigned from the board. The deal included a 45-day go-shop period to look for a higher bidder.

69. On February 3rd, Microchip Technology offered $2.85 per share. After a bidding contest with Cerberus, another third-party bidder, Microchip, eventually closed the deal at $3.05 per share in April 2010 – representing a 45% premium over the initial MBO offer of $2.10. Bing Yeh left SSI at the closing,[51] suggesting that Microchip did not view him as being essential for the ongoing enterprise.

70. In the Quest Software MBO, CEO Vincent Smith partnered with Insight Venture Partners to offer $23 per share for the company, or roughly $2 billion in total value, on March 9, 2012. Mr. Smith owned approximately 34% of the company, which gave him a substantial leg-up in the 60-day go-shop process. Dell nevertheless made a Superior Proposal at $25.50 per share. If Mr. Smith did not support the Dell proposal, the deal included a novel, three-part structure to level the playing field: (1) an option for Dell to acquire 19.9% of the Quest shares;

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[50] *See, e.g.*, Brenon Daly, *A Management Buy-Under at Silicon Storage Technology?*, *available at* https://blogs.the451group.com/techdeals/semiconductors/a-management-buy-under-at-silicon-storage-technology/.

[51] *See* Letter from Bing Yeh to Valued Customers and Partners (May 24, 2010) (announcing his departure from SST to start Greenliant Systems), *available at* http://www.greenliant.com/dotAsset/43008.pdf. Mr. Hu also left SST shortly after the deal closed. *See* Inotera Announces Change in Executive Management Team: Dr. Yaw Wen Hu appointed as Senior Vice President, (August 30, 2010), *available at* http://www.inotera.com/English/Press_Center/Press_Releases/2010-08-30+Inotera+News+Release.htm.

(2) a breakup fee of 2.0% of the transaction value if shareholders voted down the deal (i.e., a "naked no vote" termination fee); and (3) a 3.5% breakup fee if the Dell offer were subsequently trumped.[52] After a prolonged bidding contest, Dell won with an offer of $28.00 per share. The deal closed in July 2012, and Smith (like Yeh) left the company shortly thereafter.[53]

71. In my opinion, the novel inducements in the Quest go-shop process were an effort to level the playing field between a third-party and an inside bidder who held a near-control stake in the company. It highlights the degree of effort that the board felt was required to induce a third-party bidder to participate in a go-shop MBO process.

72. In both SST and Quest, I infer that management was not essential to the ongoing enterprise from the fact that Mr. Yeh and Mr. Smith both left shortly after the deal closed. This common feature has important implications for bidder deterrence: as described in Part II.C, when the private value of management is small or non-existent, third-party bidders can effectively free ride off inside bids, which mitigates the information asymmetry problem, the ticking clock problem, and the management financial incentives problem. In my opinion, it is not surprising that the only two overbids in go-shop MBO processes are situations where (by inference) the private value problem is small. This is precisely what the theory developed in Part II would predict.

73. In summary, the updated empirical evidence indicates that the only two go-shop MBOs that have been jumped are both situations where the CEO was not essential to the ongoing enterprise. This is not to say that go-shop MBO processes cannot yield third-party bids when top

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[52] *See* Quest Software Announces Receipt of Superior Proposal, Quest Software Press Release (June 14, 2012), *available at* http://www.sec.gov/Archives/edgar/data/1088033/000119312512270339/d367221dex991.htm.

[53] Chris Casacchia, *Dell Confirms Quest Software CEO's Departure*, Orange County Business Journal (Dec. 14, 2012), *available at* http://www.ocbj.com/news/2012/dec/14/dell-confirms-quest-software-ceos-departure.

management is essential; just that the impediments to a third-party bid in a go-shop MBO process place a significant wedge between third-party bidders and inside bidders. Specifically, a third-party bidder would have to overcome the combined cost of information asymmetries, the ticking clock problem, valuable management, and management's financial incentives in order to justify making a bid. In go-shop MBOs where private-value elements are significant, no third-party bidder has done so.

C. CASE STUDY: GO-SHOP IN HCA MBO

74. The MBO of HCA, which is one of the deals I examined in the 2008 Go-Shops Study, shares many similarities with the Dell MBO: it was approximately the same size as Dell; the CEO and founder (Dr. Thomas Frist Jr.) was considered essential to the ongoing enterprise; there was no meaningful pre-signing competition; and the deal was subject to a 50-day go-shop period. Dr. Frist and his management team held their first meeting with PE firms on April 5, 2006, and informed the board about the MBO possibility on May 8th. The board established a Special Committee of independent directors, which negotiated with management on the deal price and other terms. In July 2006, the PE firms (Bain Capital, KKR, and Merrill Lynch Private Equity) negotiated their contractual arrangements with management. Dr. Frist and his family planned to raise their stake from 6.8% to 18.5% as part of the deal, by rolling over their existing stake and injecting up to $180 million of additional equity into the deal.[54] Just as in Dell, the HCA Proxy Statement described management's willingness to work with other buyers:

> During these negotiations, the sponsors indicated that it was critical to their willingness to proceed with the proposed transaction that certain members of the Senior Management Group . . . reach preliminary agreement with the sponsors regarding their participation in the transaction. . . . As instructed by the special committee, the management discussions were conditioned on management's

[54] HCA Inc. DEFM14A (Oct. 17, 2006) at 47 (noting that "Bain, KKR, and Merrill Lynch Global Private Equity "intend to assign up to $180 million of their equity commitments to the Frist Entities") (hereinafter HCA Proxy Statement).

> agreement that it would not commit to be exclusive to the sponsors, and accordingly would be available to enter into similar discussions and arrangements with any subsequent bidder for the Company.[55]

75. Despite management's stated willingness to work with others, commentators predicted a fruitless go-shop process. *USA Today*'s commentary was representative:

> HCA can consider higher bids in the next 50 days, but analysts say it is unlikely that another suitor will come forward. "It will be tough for a third-party to move in, given how large the transaction is and the fact that a lot of the large players are in this deal," says Kemp Dolliver, at Cowen & Co. Another obstacle to a competing bid: HCA founder Dr. Thomas F. Frist Jr., is part of the buyout consortium.[56]

76. Beginning on July 24th, Credit Suisse and Morgan Stanley contacted 23 parties as part of the go-shop process.[57] On July 26th, the *Wall Street Journal* reported that Blackstone was interested in submitting a bid for HCA.[58] But the go-shop period expired on September 12th without any bids, and the deal closed in November 2006.

77. In my opinion, all four factors that I identify in Part II were present in the HCA go-shop process: information asymmetries between management and potential third-party bidders; a "ticking clock" problem, exacerbated by the sheer size of HCA; private value from the fact that Dr. Frist and his team were essential to the ongoing enterprise; and financial incentives to discourage overbids, due to the fact that Dr. Frist was a net buyer in the MBO. In my opinion, the outcome of the go-shop process can be explained at least in part by the significantly unlevel playing field caused by these four factors.

78. In their presentation of the HCA buyout in my *Deals* class in 2007, the student team summarized their analysis with the following slide:

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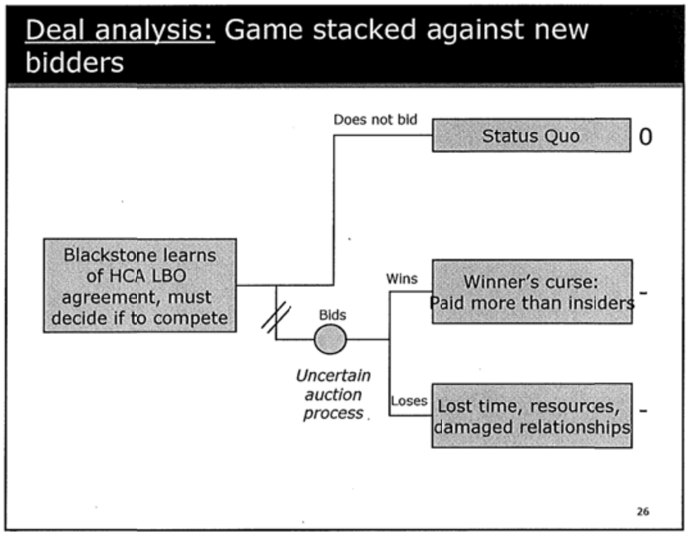
[55] *Id.* at 26.
[56] *HCA agrees to be bought out for $20.8 billion*, USA Today (July 25, 2006)
[57] HCA Proxy Statement, *supra note* 54, at 27.
[58] Henny Sender & Randall Smith, *Blackstone May Enter Bid for HCA*, Wall St. J. (July 26, 2006).



79. I consider this to be an excellent summary of the practical realities of the HCA go-shop.

80. In March 2011, less than five years later, HCA went public. The Frist family and the PE investors more than tripled their money,[59] notwithstanding the intervening financial crisis.

IV. APPLICATION TO DELL MBO

81. I now assess the Dell MBO go-shop process against each of the four factors identified in the prior Part, to determine the degree to which the Dell MBO go-shop process may have created an unlevel playing field between Dell/Silver Lake and potential third-party buyers.

A. INFORMATION ASYMMETRIES

82. Michael Dell is one of the creators of the personal computer industry. He is the founder of Dell, and the CEO for nearly thirty years before the MBO offer in 2013.[60] That he would have an informational advantage about the future of the personal computer industry and Dell is self-evident. In my opinion, any winning bidder against Mr. Dell would face a serious

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[59] Clare Baldwin & Alina Selyukh, *HCA raises $3.79 billion in largest U.S. PE-backed IPO*, Reuters (March 9, 2011).

[60] As noted below, Michael Dell did not serve as Dell's CEO between 2004 and 2007. With the exception of this limited time period, Michael Dell served as the Company's CEO continuously from its 1980 founding until the closing of the Dell MBO.

risk of succumbing to the winner's curse problem. Third-party bidders, foreseeing this, would rationally be deterred from participating in the go-shop process, absent significant synergies or other private sources of value that would outweigh Mr. Dell's informational advantage.

83. I now discuss two aspects of the Dell transaction that could potentially amplify the information asymmetry in the Dell MBO: differential access to management and potential opportunistic timing.

1. <u>Differential Access to Management</u>

84. It appears from the Dell Proxy Statement that bidders were given access to the same electronic data room once they signed a confidentiality agreement. While a single data room can mitigate information asymmetry problems between the inside buyer and potential buyers during the go-shop process, it does not eliminate the problem. The reason is that Silver Lake and KKR had a substantial "head start" over Blackstone, Southeastern, Icahn, and all other buyers. Specifically, Silver Lake and KKR had access to the data room in early September 2012, while the go-shop bidders did not have access to the data room until February 2013. For example, by the time that the Go-Shop Period expired on March 23rd, Blackstone had had access to the data room for one month, compared to nearly seven months for Silver Lake.

85. In addition, certain third-parties did not seem to have equal access to Mr. Dell and other senior managers. While the Proxy Statement reports that each of Silver Lake, KKR, Blackstone, and TPG had numerous conversations with Dell senior managers including Mr. Dell, there is no mention of access to management for the ten other parties that "expressed interest in evaluating a possible transaction."[61] The problem may be exacerbated by the fact that there was

[61] See Dell Proxy Statement, *supra* note 12, at 43-49,

no Cooperation Agreement with Mr. Dell,[62] which would require him, in general, to cooperate with the Special Committee during the sale process. The absence of an explicit Cooperation Agreement can fuel information asymmetry concerns among prospective bidders. As described in Part II.B, even when management is acting in good faith, it would be difficult if not impossible for them to be able to give the same kind of access to potential go-shop bidders during the 45-day Go-Shop Period as during the relatively leisurely seven months before the initial transaction was announced. This differential access fuels the information asymmetry problem and winner's curse concerns. A hypothetical winning bidder would logically assume that Mr. Dell provided certain "color" to Silver Lake on data room items, which caused Silver Lake to drop out of the bidding.

86. Not only did prospective go-shop bidders generally get differential access, it appears that Southeastern was given no access at all. Mr. Dell was instructed by counsel to not talk to Southeastern as part of the sale process, even though Southeastern was the first PE firm to suggest a going-private transaction.[63] Clearly, not having access to Mr. Dell would exacerbate the information asymmetry and the winner's curse problem, to the point of making the go-shop process an unwinnable game. Management's unwillingness to talk to Southeastern also suggests management preferences among bidders, which then calls into question Mr. Dell's true willingness to work with anyone. I return to this point in Part IV.C below.

[62] *Compare* Letter from Dell SVP and General Counsel Lawrence Tu to Michael Dell (Aug. 31, 2012) at 3 (EVERCORE00044734) (requiring Mr. Dell to represent only that his "evaluation of a possible transaction . . . will not interfere with the performance of [his] duties as Chief Executive Officer of the Company") with J. Crew Group Inc. DEFM14A (Jan. 25, 2011) at 91 (noting Cooperation Agreement with Mr. Drexler, which includes: "[1] participation in meetings, presentations, due diligence sessions and other sessions with persons interested in making a takeover proposal; [2] assistance in the preparation of solicitation materials, offering documents and similar documents to be used in connection with such efforts; and [3] cooperation and assistance in obtaining any consents, waivers, approvals and authorizations for and in connection with any takeover proposal").

[63] *See* Michael Dell Deposition, *supra* note 12, at 471-472.

2. **Possibility of Opportunistic Timing**

87. As noted in Part II.A, an inside bidder can maximize the effect of information asymmetries by opportunistically timing its bid and/or delaying positive-NPV projects. I do not express an opinion on whether such factors are present here. However, I will observe that Mr. Dell published an op-ed in the *Wall Street Journal* just one year after the MBO, in which he stated:

> Privatization has unleashed the passion of our team members who have the freedom to focus first on innovating for customers in a way that was not always possible when striving to meet the quarterly demands of Wall Street. . . . In the past year we have made investments of several hundred million dollars in areas with significant time horizons, such as cloud and analytics. . .[64]

88. Mr. Dell makes these points to contrast the short-term focus of public companies with the long-term focus of private companies. Nevertheless, his description of "unleash[ing] the passion of our team members" and making significant long-term investments is consistent with my description in Part II.A of a controlling shareholder rationally delaying positive-NPV projects "in order to reap the full benefit rather than sharing the benefit with the minority."

B. THE "TICKING CLOCK" PROBLEM

89. The Dell go-shop gave the Dell Special Committee 45 calendar days from the initial deal announcement date to identify a potential higher bidder.[65] This 45-day window is approximately average among the deals in the Go-Shop Sample. However, the median Transaction Value in the Go-Shop Sample is $766 million – more than 25 times smaller than the Dell transaction. In fact, Dell is larger than all but two deals in the Go-Shop Sample – only TXU and First Data are larger, and HCA is approximately the same size. All three of these other deals had 50-day go-shop windows – not significantly longer, but at least a little more breathing room.

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[64] Michael Dell, *Going Private Is Paying Off for Dell*, Wall St. J. (Nov 24. 2014), *available at* http://www.wsj.com/articles/michael-dell-going-private-is-paying-off-for-dell-1416872851.

[65] Merger Agreement at § 5.3.

90. While 45 days is a tight timeframe in general, it is extremely tight for a transaction as large as Dell. Transaction size matters for the viability of a go-shop process, in two ways. First, it influences the feasibility of a proposal within the 45-day go-shop window. And second, it influences the feasibility of assembling a consortium bid, which is often essential in a deal of this size. I discuss each of these factors in turn.

1. <u>Viability of 45-Day Window</u>

91. Larger companies generally take longer to understand, all else equal. There are only a few bidders capable of conducting adequate due diligence on a company the size of Dell within 45 days. And if there is some risk of not getting to Excluded Party status by the end of the 45 days, some bidders will rationally be deterred from starting in the first place.

92. Contemporaneous evidence from Blackstone's due diligence process indicates how tight the 45-day window was. On April 1, 2013, six days after the go-shop period had expired, Chinh Chu, a Senior Managing Director at Blackstone, e-mailed Michael Dell to identify seven "nuances and details [that] need to be explored in greater detail," including: "strategy for the PC business in light of eroding industry fundamentals" and "downside case for the PC business in the event that tablets continue to gain significant share, pricing erosion accelerates, Chrome is successful, and the transition to virtual desktop accelerates, which may further reduce ASPs."[66] A news report three days later cited sources saying "that "[Blackstone's] due diligence process is still in the early stages, and that Blackstone is just starting to put together a business plan."[67]

93. In my opinion, Blackstone could move faster in its due diligence process than virtually any other potential buyer in the M&A marketplace – not only because of Blackstone's

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[66] *See* E-mail from Chinh Chu, Senior Managing Director of Blackstone, to Michael Dell (April 1, 2013)
[67] Nadia Damouni & Poornima Gupta, *DealTalk – Blackstone Heading to Texas to Firm Up Dell Strategy,* Reuters (April 4, 2013).

general M&A capabilities, but also in this particular instance because David Johnson, a Blackstone Senior Managing Director and deal team leader, was formerly head of strategy at Dell. That Blackstone was still "in the early stages" of its due diligence process and was "just starting to put together a business plan" nine days after the go-shop period had expired illustrates how difficult it would be for other third-party bidders to get to Excluded Party status within the 45-day window that the Dell go-shop provided. Third-parties, foreseeing all this, would rationally be deterred from starting in the first place.

2. <u>Feasibility of Consortium Bid</u>

94. There is a second, and distinct, reason that size matters. Among the small set of potential bidders who would be capable of making a bid for Dell, most of them would likely want to at least consider a consortium bid – either due to diversification requirements of the PE fund, financing constraints, or just to share the risk of such a massive investment. To see the point, consider that among the ten going-privates larger than $15 billion (excluding Dell), seven involved consortium bidders.[68] Even Blackstone, one of the largest PE firms in the world as ranked by assets under management, told Evercore at the outset that it "intended to form a consortium to pursue a possible transaction,"[69] and over the next few weeks Blackstone assembled several bidders to join its consortium.[70]

95. Of course, arranging a consortium bid takes time. The internal negotiation among the consortium members regarding financing, governance, and exit rights can take weeks or even

[68] The seven are: HCA (KKR, Bain Capital, Merrill Lynch Global Private Equity); Freescale (Permira, TPG, Carlyle, Blackstone); Harrah's Entertainment (TPG, Apollo); Clear Channel Communications (Thomas H. Lee, Bain Capital); TXU (Lehman Brothers, Citigroup, Morgan Stanley, TPG, Goldman Sachs, KKR); ALLTEL (TPG, Goldman Sachs); and H.J. Heinz (3G Capital, Berkshire Hathaway). The three going-privates larger than $15 billion that did not involve a consortium buyer are: Hilton Hotels (Blackstone); First Data Corp. (KKR); and Equity Office Properties (Blackstone).

[69] Dell Proxy Statement, *supra* note 12, at 43.

[70] *Id.* at 45-46.

months, putting aside the time it would take for due diligence on the actual target company. As an illustration of this point, while 22% of the original bids in the Go-Shop Sample were consortium bids, not a single jump bid in the Go-Shops Sample came in the form of a consortium bid.[71] This (non)finding highlights the enormous difficulty of arranging a consortium bid when a 45-day go-shop clock is ticking.

3. <u>Implications of "Pure" Go-Shop</u>

96. The Dell go-shop process is closer to what I call a "pure" go-shop rather than an "add-on" go-shop. In the 2008 Go-Shops Study, I found that the Special Committee contacted 15.9 buyers on average during the pre-signing phase of an add-on go-shop process, compared to only 1 buyer (by definition) contacted pre-signing during a "pure" go-shop process.[72] In the Dell MBO, the Special Committee contacted only three bidders (Silver Lake, KKR, and TPG) pre-signing, and two out of these three were bidders that had been identified for the Special Committee by Mr. Dell. At several instances during the pre-signing phase, the Special Committee considered but rejected the possibility of contacting other bidders, including any strategic bidders. And once KKR and TPG had dropped out, Silver Lake was left with no pre-signing competition. I therefore classify the Dell MBO as closer to the "pure" go-shop end of the spectrum.

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[71] The closest to a consortium jump bid in the Go-Shops Sample occurred when Microsoft successfully jumped Quadrangle's agreement to buy media services company Greenfield Online. In October 2007, ZM Capital and Microsoft began negotiations with Greenfield to jointly acquire the company. Nine months later, in June 2008, Greenfield unexpectedly announced its sale to Quadrangle. Microsoft made a solo overbid into the go-shop process, and then sold the survey business to ZM. According to press reports, "Greenfield wanted a simple transaction, with only one buyer, so Microsoft took the lead, agreeing to sell ZM Capital the surveys business in the aftermath." Erin Griffith, *Kind of a Big Deal: The Go-Shop That Went Somewhere*, PE Hub (Sept. 12, 2008), *available at* https://www.pehub.com/2008/09/kind-of-a-big-deal-2/.

[72] Subramanian, *supra* note 27, at 745 (Table 2).

97. This is important for two reasons. First, as noted in Part II.B, the academic literature indicates that most competition that might exist for an MBO takes place pre-signing, i.e., before the go-shop clock starts to tick. Because the Dell Special Committee did not invite any significant pre-signing competition (and by the end had no pre-signing competition), this critical phase of the MBO process, where the majority of competing offers are generated, was largely by-passed. Second, the lack of pre-signing competition meant that potential third-party bidders such as Blackstone had to go from a standing position to being an Excluded Party (i.e., "0 to 60") entirely in the 45-day window. No one had a "running start" going into the go-shop process by virtue of having been aware of the Dell MBO during the pre-signing phase.

98. Steven Davidoff ("The Deal Professor") summarized the point in a *New York Times Dealbook* article that was critical of the Dell go-shop process:

> The conventional wisdom is that go-shops are a hollow ritual. The feel-good perception that the company is being actively shopped covers up the fact that the initial bidder has a perhaps unbeatable head start. Once a deal is announced, others don't have time to catch up, nor do they want to get in a bidding contest. A go-shop becomes just a cover-up for a pre-chosen deal.[73]

99. I concur in this assessment.

C. VALUABLE MANAGEMENT

100. Michael Dell brings private value to the deal: Dell is worth more with him than without him. As a result third-party bidders cannot simply "bid a nickel more" because they don't necessarily have Michael Dell.

101. To the extent that this claim needs any support, one can examine the natural experiment of Mr. Dell leaving and then re-joining Dell in 2004 and 2007 respectively. In both instances, the announcements were surprises to the marketplace, making them relatively clean

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[73] Steven Davidoff, *A Flawed Bidding Process Leaves Dell at a Loss*, N.Y. Times Dealbook (April 23, 2013).

for event study analysis.[74] When Mr. Dell announced that he would be giving up the CEO role on March 4, 2004, the stock lost 1.4% of its value, or approximately $1.2 billion in total value.[75] This market reaction was despite the fact that Mr. Dell retained the Chairman role, and despite the fact that he was turning over the CEO role to his longtime second-in-command, Kevin Rollins. When Mr. Dell's return as CEO was announced on January 31, 2007, the stock price increased by 4.7%, or approximately $2.5 billion in total value.[76] In each instance, the market assessed the value of Mr. Dell against the next best alternative for the top job. In my opinion, this is strong evidence that Mr. Dell brings significant private value to Dell Inc.

102. A contemporaneous anecdote provides some of the underlying explanation for these stock market reactions. On April 4, 2013, Reuters reported that Mr. Dell "would be Blackstone's preferred choice running the new company," but that Blackstone also had "extensive discussions" with Michael Capellas, former CEO of Compaq, who was the "leading external candidate for the Dell CEO job."[77] Within hours Mr. Dell sent a sharply-worded e-mail to Blackstone's Chu, stating in part:

> This evening I was having dinner with a potential customer worth over $600 million in revenue to our company. They were reacting quite negatively to the story and others like it. The customer was suggesting ways to contractually protect themselves from the risks associated with . . . the kinds of changes

[74] For an example of event study analysis, *see, e.g.*, Bo Becker, Daniel Bergstresser & Guhan Subramanian, *Does Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge*, 56 J. Law & Econ. 127 (2013). The analysis in the text is not a full-blown event study analysis, in that it does not take into account risk-adjusted market movements. However, there were no significant market movements on either of the event-study dates. I am therefore confident that the results are at least directionally correct and sufficient to support the basic point that Michael Dell is an extremely valuable CEO.

[75] Calculated as: $33.13 closing share price on March 4th - $32.68 opening share price on March 5th, multiplied by 2,556 million shares outstanding.

[76] Calculated as: $25.36 opening price on February 1st - $24.22 closing price on January 31st, multiplied by 2,223 million shares outstanding.

[77] Damouni & Gupta, *supra* note 67.

> suggested in press speculation. I am disappointed by the real damage[] stories like this and others are inflicting on our business.[78]

103. Put simply, customers wanted Michael Dell. That $600 million of business would be put at risk by the possibility of him leaving the company illustrates the obvious point that he was extremely valuable. In my opinion, there are only a handful of CEOs who are as inextricably associated with the companies that they lead as Michael Dell. In the technology sector, Steve Jobs, Larry Ellison, and Mark Zuckerberg are some obvious comparable examples that come to mind. For any of these companies, the "valuable management" problem is severe, and would lead to an unlevel playing field between the inside bidder and potential third-parties. Consider, for example, what structural devices would be needed to have some hope of a meaningful go-shop process in the MBO of Apple (when Steve Jobs was still alive), Oracle, or Facebook. In general, valuable management converts a common value situation into a private value situation, fuels information asymmetry and "ticking clock" problems, and creates an unlevel playing field between the inside bidder and potential third-party bidders.

104. Testimony from Egon Durban at Silver Lake confirms that Mr. Dell was an essential part of the deal for them.[79] News sources also reported that Mr. Dell was Blackstone's "preferred choice" to run the company.[80] I now turn to the question of whether Blackstone or other third-parties could have mitigated or eliminated the "valuable management" problem by partnering with Mr. Dell.

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78 E-mail from Michael Dell to Chinh Chu (March 27, 2013).

79 Deposition of Egon Durban at 44:16-46:12 (May 20, 2015) (in explaining why Dell was considered a good candidate for an LBO, Mr. Durban references, among other factors, that "[t]here was a shareholder who owned a significant block, who happened to be the founder and entrepreneur, Michael Dell, who we had gotten to know over the years . . . He's an iconic figure in the technology industry. . . . [B]acking the team is really important to use. And, again, Michael was a powerful founder and entrepreneur of his own business.").

80 *See* Damouni & Gupta, *supra* note 67.

D. MANAGEMENT FINANCIAL INCENTIVES TO DISCOURAGE OVERBIDS

105. Mr. Dell agreed to potentially work with a third-party buyer. In a letter to Mr. Dell dated August 31, 2012, Dell SVP and General Counsel Lawrence Tu confirmed their understanding on this point:

> You agree to explore in good faith the possibility of working with any such potential [third-party] counterparty or financing source if requested by the Company; it being understood that your decision as to whether to work with any counterparty or financing source after such good faith exploration shall be within your discretion.[81]

106. However, I find no evidence of any contractual commitment for Mr. Dell to work with other potential bidders, even if doing so would have maximized the value received by the non-continuing Dell shareholders.[82] In the absence of such an agreement, potential third-party bidders would necessarily take Mr. Dell's contractual obligation to explore an employment agreement "in good faith" with a certain grain of salt. The reason is that Mr. Dell had financial incentives to discourage an overbid, notwithstanding his fiduciary duty to maximize value in the sale process. I explain this conclusion in the remainder of this Part.

1. Michael Dell as Net Buyer of Shares

107. The Dell/Silver Lake Offer planned for Mr. Dell to roll over his entire 16% equity stake into the new company; in addition he would contribute $750 million of new equity.[83]

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81 Letter from Dell SVP and General Counsel Lawrence Tu to Michael Dell (Aug. 31, 2012) at 2 (EVERCORE00044734). *But see* Josh Kosman & Mark Decambre, *Schwarzman Shut Out of Dell Bidding*, N.Y. Post (Jan. 25, 2013) ("Silver Lake insists on being the lone PE firm to team with Michael Dell, so Blackstone or another firm would have to come up with a way to fill the $3.6 billion equity hole he would leave.").

82 For an example of such an agreement, *see, e.g.*, Cooperation Agreement between Laureate Education, Inc. and Douglas L. Becker (Jan. 28, 2007) at § 1.2 (requiring Mr. Becker to "continue to perform his managerial functions consistent in all material respects with past practice" or "provide such consulting services to the Company as the Acquiring Party may reasonably request" for up to 6 months on a full-time basis and an additional 6 months on a part-time basis, if requested by the Acquiring Party in an Alternative Transaction Agreement).

83 *See* SilverLake Slide #9 -- Sources & Uses (undated) (SLP_DELLAP00116678).

Therefore, Mr. Dell would be a net buyer of shares, which means he would have a financial incentive to push the deal price down rather than up.

108. Any third-party overbid that was similarly structured to include Mr. Dell as a net buyer would cost Mr. Dell more money, relative to the Dell/Silver Lake Offer. And of course, if Dell/Silver Lake chose to increase their offer to match the competition, this would cost Mr. Dell even more money. For example, if a Dell/Silver Lake increase were funded entirely by equity (perhaps because the Silver Lake offer already used maximum feasible leverage), then Mr. Dell's $750 million equity contribution would increase in proportion to the overall increase in the offer price. A third-party bidder would understand that any overbid structured similarly to the Dell/Silver Lake Offer (i.e., with Mr. Dell as a net buyer of shares) could only cost Mr. Dell more. Foreseeing all of this, third-party bidders considering an overbid would understand that Mr. Dell would be a reluctant partner in their bid.

2. <u>Equity Ownership Under Blackstone Proposal</u>

109. Of course, a third-party could structure its bid to make Mr. Dell a net seller rather than a net buyer. In this scenario, Part II.D explains how Mr. Dell's financial incentives would be aligned with other Dell shareholders, in that he would prefer a higher deal price rather than a lower one. However, Mr. Dell's reaction to the Blackstone Proposal suggests that he wanted a larger equity stake in the post-MBO company, not a smaller one.

110. The Blackstone Proposal gave Dell shareholders the option of $14.25 per share cash or keeping their stake in Dell.[84] At the time the Blackstone Proposal represented 4% more than the $13.65 Dell/Silver Lake Offer. Blackstone touted the "[s]hareholder friendly structure"

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[84] Letter from Blackstone Management Partners LLC to the Special Committee of the Board of Directors of Dell Inc. (March 22, 2013) at 2. (DELLE00432111)

of its offer, and described its proposal as providing "a more compelling value proposition to Dell and its shareholders than currently provided under the Merger Agreement."[85]

111. By letting Dell shareholders continue holding their shares, however, the Blackstone proposal would have likely meant a smaller equity stake for Mr. Dell. Mr. Dell was focused on this aspect of the Blackstone Proposal. In an e-mail to Blackstone's Mr. Chu on March 27th, Mr. Dell requested "a more detailed proposal around the capital structure you would contemplate, particularly the equity ownership."[86] Mr. Chu e-mailed Mr. Dell back the next day acknowledging Mr. Dell's "reservations" regarding Blackstone's proposed structure.[87] The Dell Proxy Statement is cryptic about what happened next: "Over the next few weeks, Mr. Dell had occasional additional contacts with the representatives of Blackstone . . . but did not receive any proposals from Blackstone with respect to capital structure, equity ownership or governance."[88]

112. In my opinion, the straightforward analysis of Mr. Dell's financial incentives and the experience with the Blackstone proposal exemplify the Catch-22 described in Part II.D: a third-party bidder that did not partner with Michael Dell would lose the enormous private value that he would bring to the deal; but a third-party bidder that partnered with a reluctant Michael Dell would potentially destroy (or at least reduce) that very same private value. The only way to break the Catch-22 would be to give Mr. Dell free shares in the post-MBO company – but this of course would reduce the PE firm's returns from the deal.

[85] *Id.* at 2-3.
[86] E-mail from Michael Dell to Chinh Chu (March 27, 2013).
[87] E-mail from Chinh Chu to Michael Dell (March 28, 2013). *See also* Dell Proxy Statement, *supra* note 12, at 40 (May 31, 2013) ("Representatives of Wachtell Lipton [Mr. Dell's counsel] and Simpson Thacher [Silver Lake's counsel] subsequently confirmed to representative of Debevoise [the Special Committee's counsel] that Mr. Dell and Silver Lake were not willing to modify their previous proposal in order to provide that the public stockholders would have an opportunity to retain an interest in the Company.").
[88] Dell Proxy Statement, *supra* note 12, at 48.

E. POTENTIAL MITIGATING FACTORS

113. The Dell Special Committee made some efforts to tilt things back in favor of third-parties. For example, it negotiated a one-time match right for Dell/Silver Lake, rather than indefinite match rights;[89] it retained Evercore to conduct the go-shop process, with a significant contingent fee if Evercore found a higher-value bidder;[90] and it agreed to reimburse Blackstone for up to $25 million in out-of-pocket expenses.[91] However, it is my opinion that these devices were not sufficient to create a level playing field between the inside bidder and potential third-parties; in fact some aspects potentially made the problem worse. I explain why in the remainder of this Part.

1. <u>One-time Match Right</u>

114. A one-time match-right is potentially better than an indefinite match right because it gives a third-party bidder a potential "path to success." However, in my opinion it is still a substantial impediment to a third-party bid because: (1) even a one-time match right eliminates the possibility of a jump bid with a "short fuse," which is an important tool that would otherwise be available to a third-party bidder; (2) the potential path to success would involve an initial bid to defuse the match right and then a subsequent bid with a short fuse – which requires two meaningful price bumps rather than just one; and (3) I see nothing in the Dell merger agreement

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89 Merger Agreement § 5.3(f).
90 Evercore Retention Agreement, *supra* note 14, at 2.
91 Dell Proxy Statement, *supra* note 12, at 48.

that would prevent Michael Dell/Silver Lake from insisting on another match right as part of its negotiation to match the competing offer.[92]

115. On this last point, a one-time match right will not be any different from an indefinite match right if the first bidder insists on subsequent match rights each time it matches the third-party offer. Even this possibility will deter third-party bids. From the Dell/Silver Lake perspective, a one-time match right may provide the same deterrent effect as indefinite match rights, with of course the optical benefit of appearing to be only a one-time right to match. The alleged benefit of a one-time match right never gets tested because, in certain scenarios, it is the substantive equivalent of an indefinite match right.

116. It is also worth noting that match rights are a relatively new phenomenon in transactional practice. In the Go-Shops Sample, match rights of any kind appeared in 69% of transactions as late as 2006; match rights only became ubiquitous by 2009. In view of their relatively recent appearance in the M&A marketplace, it might be more appropriate to compare a one-time match right in the Dell/Silver Lake Offer to the baseline of no match right at all.

2. Evercore Contingent Fee

117. On December 28, 2012, the Special Committee held a telephonic meeting in which it concluded that it should retain a second financial advisor: "In light of the importance of the go-shop process . . . the Special Committee determined that it would be advantageous to engage an additional independent financial advisor that had specific financial incentives to obtain

[92] *See* Merger Agreement at § 5.3(f)(ii) ("[A]fter providing such notice and prior to taking such actions, the Company shall have, and shall have caused its Representatives to, negotiate with the Parent Parties in good faith (to the extent the Parent Parties desire to negotiate) during such four (4) Business Day period to make such adjustments in the terms and conditions of this Agreement and the Financing as would permit the Company, the Special Committee or the Company Board not to take such actions."). I see nothing in the Merger Agreement that would prevent "such adjustments in the terms and conditions" from including another match right.

a higher purchase price for the Company in a go-shop process."[93] Mr. Mandl was authorized to interview prospective firms, and Evercore was retained two weeks later, on January 10, 2013.

118. Once the Go-Shop Period began on February 5th, Evercore contacted 67 parties (19 strategic buyers, 18 financial sponsors, and 30 other parties) to solicit interest in a transaction, and was contacted by 4 more.[94] Among the 71 parties in total, eleven "expressed interest in evaluating a potential transaction,"[95] though it is not clear from the Dell Proxy Statement how many of these eleven signed confidentiality agreements. These numbers compare favorably to the statistics from the 2008 Go-Shops Study, in which I found that the sell-side investment bankers contacted 39.6 buyers in a "pure" go-shop process, on average, of which 3.2 buyers signed confidentiality agreements.[96]

119. In my opinion, there is no evidence suggesting that Evercore conducted anything other than a robust go-shop process. This may be due to Evercore's compensation arrangement, which provided significant financial incentives for Evercore to find a higher bidder. The Dell/Silver Lake Offer was worth approximately $21 billion, so a standard 10% overbid from a third-party would be worth approximately $23.1 billion.[97] Under its compensation arrangement, Evercore would receive 0.75% of the $2.1 billion increase, or $15 million. If Dell/Silver Lake then exercised its match right with (say) another 5% bump, the Evercore contingent fee would go

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[93] Dell Proxy Statement, *supra* note 12, at 35.
[94] *Id.* at 43.
[95] *Id.*
[96] Subramanian, *supra* note 27, at 745 (Table 2).
[97] In my database of all post-signing bidding contests against U.S. targets between 1995 and 2010 (n=70), I find that the average increase from the first negotiated deal to the final deal price is 27.7%. In the much smaller sample of jump-bids in the 2008 Go-Shops Study (n=6), the average price bump is 6.6%. Subramanian, *supra* note 27, at 749 (Table 3). In the two deals that are most relevant – Silicon Storage Technology and Quest Softwware – the final bids were 45% and 22% higher, respectively, relative to the initial signed deals with the management team. *See supra* Part III.B.

even higher, capped only by the $30 million overall limit on Evercore's compensation.[98] These numbers swamp the $400,000 monthly fee and the $1.5 million flat fee for Evercore's fairness opinion. There is no doubt that Evercore had "high-powered incentives" to find a third-party bidder during the Go-Shop Period.

120. However, the converse of this point is far more important: because Evercore would not receive a contingent fee for any third-party bid made before the Go-Shop Period,[99] Evercore had financial incentives to limit the pre-signing competition in order to minimize the baseline price for calculating its contingent fee and to maximize the available field once the Go-Shop Period began. That is, during the critical pre-signing window between January 10, 2013 (when Evercore was retained) and February 5, 2013 (when the Dell/Silver Lake deal was announced), Evercore had financial interests that were directly opposed to its client, the Dell Special Committee.

121. The Special Committee held an in-person meeting on January 15, 2013, just after Evercore was retained. According to the Dell Proxy Statement:

> The Special Committee and its advisors . . . discussed the possibility of approaching other financial sponsors or strategic buyers to solicit additional bids, and the potential benefits and risks of doing so. Evercore discussed the overall process the Special Committee had pursued to date and expressed the view that it would not be beneficial to contact additional parties at the current stage of the process.[100]

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[98] *See* Evercore Retention Agreement at 2 (calculating "Superior Transaction Fee" as 0.75% of the difference between a "Superior Transaction" and the "Initial Transaction," where a "Superior Transaction" is the result of "a process pursuant to a 'go-shop' provision contained in a prior definitive agreement for a[n] [Initial] Transaction").

[99] *See id.* at 2 (calculating a 0.75% "Superior Transaction Fee" for the increase offered by a "Superior Transaction," where a Superior Transaction is "a Transaction which the Special Committee or the Board of Directors determines to be superior to the Initial Transaction . . . *after conducting a process pursuant to a 'go-shop' provision contained in a prior definitive agreement for a Transaction*.") (emphasis added)

[100] Dell Proxy Statement, *supra* note 12, at 37.

122. Curiously, there is no indication in the Proxy Statement that the Special Committee's original banker, JPMorgan, expressed a view on whether the Special Committee should contact other potential buyers, even though JPMorgan was present at the January 15th meeting.[101]

123. The one obvious party that could have been contacted pre-signing was Blackstone. Not only does Blackstone have the same or more firepower as Silver Lake, KKR, and TPG, all of whom were contacted pre-signing, but a Blackstone Senior Managing Director, Dave Johnson, was formerly Dell's head of strategy.[102] One potential explanation for this omission is Evercore's financial incentive. Another potential explanation is prior strained relationships among Dell management. According to one press report, "Johnson and Michael Dell have not seen eye-to-eye over a strategy that would take Dell forward."[103]

124. As a public-company director myself, I am loathe to second-guess the decision of a Special Committee acting in the heat of the battle. However, I am genuinely puzzled by the decision to not contact Blackstone pre-signing, particularly in view of Blackstone's managerial connection to Dell. Whatever the root cause for this decision, it is clear from the terms of Evercore's compensation arrangement that Evercore had a financial interest to recommend against contacting third-parties pre-signing. In particular, by keeping Blackstone out of the pre-signing phase, Evercore would reap the financial benefit of any Blackstone offer made during the Go-Shop Period.

125. As a result of not being contacted pre-signing, Blackstone was forced to play catch-up during the Go-Shop Period against a formidable inside-bidder. But by this time,

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[101] Dell Proxy Statement, *supra* note 12, at 36 (noting that representatives of Debevoise, BCG, Evercore, and JPMorgan were present for the in-person meeting).

[102] *See also* Kosman & Decambre, *supra* note 81 (noting that "Blackstone might have had an edge" because Johnson had just joined Blackstone).

[103] Damouni & Gupta, *supra* note 67.

Blackstone was on an unlevel playing field. In a March 30th e-mail, a Senior Managing Director at Evercore reminded certain Dell employees: "[W]e all have to be mindful that Blackstone is looking to accomplish in 4-6 weeks what [S]ilverlake had 6 months to do, with the full support and insight of the CEO and founder behind them."[104] In particular, the information asymmetries, the "ticking clock" problem, the private value problem, and managerial incentives to discourage overbids would have operated full-force during the Go-Shop Period to drive down Blackstone's (and other bidders') willingness and ability to bid.

3. <u>Blackstone Inducement Fee</u>

126. Blackstone negotiated for and received an inducement fee that would reimburse Blackstone for its out-of-pocket expenses up to $25 million.[105] In theory, this too could be a mitigating device to help level the playing field in a go-shop MBO process; but for two reasons I find this inducement fee to be a modest inducement at best, and mostly symbolic.

127. First, the magnitude of the fee is trivial in a deal as large as Dell – even the full $25 million amounts to just 0.12% of the deal value. In my observation of PE firms, out-of-pocket expenses are far less important than opportunity costs (of being in a deal) and reputational costs (of being in a deal and losing). A meaningful breakup fee, consisting of 3-5% of deal value, is typically used to compensate bidders for these more significant costs.[106]

128. Second, the inducement fee had the feature of keeping an existing bidder in the mix, rather than inducing a new bidder to participate. In order to truly induce new bidders, an inducement fee should be offered *ex ante* to all potential third-party bidders, rather than *ex post* to an individual bidder. As I describe in my *Go-Shops* article:

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[104] E-mail from Naveen Nataraj to certain Dell employees (March 30, 2013) (DELLE00331432).
[105] Dell Proxy Statement, *supra* note 12, at 48.
[106] *See* John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory & Evidence*, 53 Stan. L. Rev. 307 (2000) (presenting typical motivations for breakup fees and empirical evidence on their magnitude).

> [A] target board might extract a concession from the MBO group to reimburse out-of-pocket expenses for any third-party buyer who makes a bona fide superior proposal that is at least 5% higher than the deal price, even if the third party does not win in the end. . . . An ex ante inducement fee . . . should be part of the target board's negotiation toolkit, particularly in the go-shop MBO context, because of the strong (and correct) perception of a non-level playing field between the MBO group and potential third-party bidders.[107]

129. The general point is that more potent tools were available to the Special Committee in its effort to level the playing field between Blackstone and Silver Lake. For example, the Special Committee could have offered a stock option to Blackstone and/or a breakup fee, as in the Quest go-shop MBO (described in Part III.B). Although these structural devices would have been unusual, the Dell Special Committee was certainly aware of their potential use since Dell was the beneficiary of such tools in the Quest situation itself.

4. <u>Summary</u>

130. The Dell Special Committee made some efforts to tilt things back in favor of third-parties, but in my view more potent tools were needed in order to create a plausibly level playing field between the inside bidder and potential third-parties. For example, instead of a one-time match right, the Special Committee could have insisted on simple information rights, or even no information rights at all (as in the Kerzner International MBO). This deal structure would have kept open the possibility of an offer with a "short fuse," which would have been one of the few paths to success for a potential third-party bidder in the Dell go-shop process.

131. Instead of retaining Evercore on January 10th, when Evercore could influence the decision to contact Blackstone pre-signing, the Special Committee could have retained Evercore only when the Go-Shop Period started. Not only would this have saved Dell some money and avoided the possibility of conflicted advice during the critical pre-signing phase, but it also

[107] Subramanian, *supra* note 27, at 758-759.

would have been more appropriate since Evercore's core assignment was to run the go-shop process.

132. Or, as I recommend in my *Go-Shops* article, the Dell Special Committee could have negotiated for *ex ante* inducement fees, e.g., to reimburse out-of-pocket expenses for any third-party bidder who made a bona fide superior proposal that was at least 5% higher than the deal price. A blanket *ex ante* inducement fee (rather than negotiating individual inducement fees *ex post*) would have reduced the perceived cost and risk for third-party bidders.

133. In summary, there were more potent structural solutions available to the Dell Special Committee. In the absence of such solutions, it is my opinion that the potential mitigating factors did not create a level playing field during the Dell go-shop MBO process.

V. CONCLUSION

134. In his expert report filed in this matter, Professor Hubbard claims that the "restrictions and safeguards [in the Dell MBO process] are consistent with a process that aligns the incentives of all parties to achieve a fair price for non-continuing stockholders and also allows bidders other than those initially involved to participate on an equal basis."[108] In my opinion, this statement is incorrect. The Dell MBO did not "align[] the incentives to achieve a fair price" because Michael Dell had financial incentives to discourage third-party bidders. Other bidders could not "participate on an equal basis" because all four of the impediments to a third-party bid were present: information asymmetries, the ticking clock problem, valuable management, and management's incentives to discourage third-party bids.

135. In view of these four factors, it is my opinion that more potent devices to level the playing field would have been appropriate. In the absence of such devices, it is simply incorrect to conclude that other bidders could "participate on an equal basis" in the go-shop process.

[108] Hubbard Report, *supra* note 6, at ¶ 113.

136. By extension, I conclude that the Dell go-shop MBO process was not an effective market check for ensuring that fair value was paid to the non-continuing shareholders. "Fair value" cannot be inferred from the highest price paid in an auction where the playing field is severely tilted toward an inside bidder. In a context such as the Dell MBO, fair value must instead be determined by the discounted future cash flows or some other valuation method.

Dated: July 24, 2015

Guhan Subramanian

APPENDIX A: SUBRAMANIAN CV

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Academic Positions Held

H. Douglas Weaver Professor of Business Law, Harvard Business School, 2007-Present

Joseph Flom Professor of Law and Business, Harvard Law School, 2004-Present

Faculty Chair, JD/MBA Program, Harvard University, 2004-Present

Vice Chair for Research, Program on Negotiation, Harvard Law School, 2013-Present

H. Douglas Weaver Visiting Professor of Business Law, Harvard Business School, 2006-07

Joseph Flom Assistant Professor of Law and Business, Harvard Law School, 2002-2004

Assistant Professor of Business Administration, Harvard Business School, 2001-2002

Lecturer in Business Administration, Harvard Business School, 1999-2001

Education

J.D., *magna cum laude*, Harvard Law School, 1998. Moot court competition winner. Editor, Harvard Law Review.

M.B.A., Harvard Business School, 1998.

A.B., *magna cum laude* (Economics), Harvard University, 1992. Phi Beta Kappa. Elected undergraduate student government president.

Books

Negotiauctions: New Dealmaking Strategies for a Competitive Marketplace (2010).

Cases and Commentaries on the Law of Business Organization (4th ed. 2012) (with William T. Allen & Reinier Kraakman).

Cases and Commentaries on the Law of Business Organization (3rd ed. 2009) (with William T. Allen & Reinier Kraakman).

Cases and Commentaries on the Law of Business Organization (2nd ed. 2007) (with William T. Allen & Reinier Kraakman).

Published Papers

Freezeouts: Doctrine & Perspectives, M&A HANDBOOK (Claire Hill & Steven Davidoff Solomon, eds.) (forthcoming 2016) (with Fernan Restrepo).

The Effect of Delaware Doctrine on Freezeout Structure and Outcomes: Evidence on the Unified Approach, 5 *Harvard Business Law Review* 205 (2015) (with Fernan Restrepo).

Corporate Governance 2.0, *Harvard Business Review* (March 2015).

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A New Era for Raiders, *Harvard Business Review* (Nov. 2010).

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The Emerging Problem of Embedded Defenses: Lessons from Air Line Pilots Ass'n Intl. v. UAL Corp., *Harvard Law Review* 120, no. 5 (March 2007).

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Takeover Defenses and Bargaining Power, *Journal of Applied Corporate Finance* 17, no.4 (Fall 2005).

The Disappearing Delaware Effect, *Journal of Law, Economics & Organization* 20, no.1 (April 2004). Selected by academics as one of the "top ten" articles in corporate/securities law for 2004, out of 439 articles published in that year.

Bargaining in the Shadow of Takeover Defenses, *Yale Law Journal* 113, no.3 (Dec. 2003). Selected by academics as one of the "top ten" articles in corporate/securities law for 2004, out of 439 articles published in that year.

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The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy, *Stanford Law Review* 54, no.9 (June 2002) (with L. Bebchuk & J. Coates). Selected by academics as one of the "top ten" articles in corporate/securities law for 2002, out of 350 articles published in that year.

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A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill, *Delaware Journal of Corporate Law* 23, no.2 (1998).

Note, Using Capital Cash Flows to Value Dissenters' Shares in Appraisal Proceedings, *Harvard Law Review* 111, no.7 (May 1998).

Working Papers

The Effect of Takeover Defenses, Discussion Paper, Harvard Law School Olin Center for Law, Economics & Business (November 2007) (with L. Bebchuk & J. Coates).

Courses Taught

Corporations, Harvard Law School (2002-present)

Advanced Negotiation: Deals, Harvard Law School/Harvard Business School (2004-present)

Law & Business Seminar, Harvard Law School/Harvard Business School (2002-present)

Negotiation Workshop, Harvard Law School (2002-2004)

Analytic Methods for Lawyers (Accounting & Finance module), Harvard Law School (2002-2005)

First-Year Negotiations, Harvard Business School (1999-2002)

Law and the Global Manager, Harvard Business School (2001-2002)

Harvard Business School Executive Education: Making Corporate Boards More Effective, Changing the Game, Strategic Negotiations, Program for Management Development, Advanced Management Program

Harvard Law School Executive Education: Program of Instruction for Lawyers, Program on Negotiation for Senior Executives, Dealing with Difficult People, Designing Complex Deals.

Kennedy School of Government Executive Education: Senior Leaders in Government (Negotiations module).

Other Activities

Director, Audit Committee Member, and Nominating/Governance Committee Member, LKQ Corp (NASDAQ: LKQ).

Non-Resident Tutor in Law & Business, Dunster House.

Member, American Law & Economics Association.

Member, New York State Bar Association.

Member, Entry-Level Appointments Committee (2005-06), Committee on Curriculum Innovation (2002-04), Committee on Physical Planning (2003-2005), Harvard Law School.

Course head, first-year required course on Negotiations, Harvard Business School (2001-2002; 2008-2009)

Prior Expert Testimony

Morguard Corporation v. H.M.Q.; Court File No.: 2009-1561(IT)G (report & trial testimony). Retained by the Canadian government to explain to the Canadian tax court how a breakup fee worked, and how both bidders and targets conceptualized it.

William Hale Hubbell v. G.J. Ratcliffe et al., Docket No. X04, HHD-CV-08-4038824-S (report & deposition). Retained by Day Pitney on behalf of the Hubbell board to assess its actions in response to a request from a large shareholder to initiate a sale process.

Brown v. AuthenTec, Inc. et al., Case No. 05-2012-CA-57589 (Fla. 2012) (report & deposition). Retained by counsel for shareholder plaintiffs to provide an assessment of whether the asset lockup in the Apple-AuthenTec deal was a typical deal protection device.

Martin Marietta Materials, Inc. v. Vulcan Materials Co., C.A. No. 7102-CS (Del. Ch. 2012) (reports & deposition). Retained by Wachtell, Lipton, Rosen & Katz on behalf of Vulcan to describe the role of confidentiality agreements in merger negotiations, and to provide implications as to whether a standstill should be implied as part of a CA.

MBIA Insurance Corp. v. Countrywide Financial et. al., Index No. 602825/2008 (NY 2012) (report & deposition). Retained by O'Melveny & Myers on behalf of BankofAmerica to provide policy rationale for de facto merger doctrine and apply it to the facts of BofA's acquisition of Countrywide.

Commonwealth REIT et al. v. Corvex Management, LP, AAA No. 11-512-Y-276-13 (multiple reports & trial testimony). Retained by Gibson, Dunn & Crutcher on behalf of Corvex Management to assess the defensive measures taken by the Commonwealth board.

In re Interstate General Media Holdings, LLC, C.A. No. 9221-VCP (reports, deposition & trial testimony). Retained by Seitz Moritz on behalf of Intertrust to compare the likely outcome of the deal processes proposed for the sale of the Philadelphia Inquirer.

Landmen Partners Inc. v. The Blackstone Group, LP, 08-CV-3601 (HB) (multiple reports & depositions). Retained by Simpson Thacher on behalf of Blackstone to assess the reasonableness of portfolio company disclosures in Blackstone's S-1 registration statement.

Kottayil v. Insys Therapeutics, Inc., No. CV2009-02883 (report, deposition & trial testimony). Retained by Greenberg Traurig on behalf of minority shareholder to assess procedural protections in freezeout transaction.

Anderson News, LLC et al. v. American Media, Inc. et al., 09 CIV. 227 (PAC) (reports & deposition). Retained by Kasowitz, Benson, Torres & Friedman to assess the negotiation tactics used in Anderson News' proposed surcharge to its distributors.

Allergan Inc. v. Valeant Inc., Case No.: 8:14-cv-01214-DOC-(ANx) (reports & deposition). Retained by Kirkland & Ellis to compare Allergan's bylaws to other companies and provide policy implications.

Global Gaming Philippines LLC and GGAM Netherlands B.V. v. Bloomberry Resorts & Hotels Inc. and Sureste Properties Inc (report & trial testimony). Retained by Paul Hastings to determine whether the Management Services Agreement and Equity Option Agreement were one agreement or separate agreements.

In re Newman (report & trial testimony). Retained by the Law Offices of Becky Beaver to provide empirical evidence on the viability of the academic job market in the New England region.

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Data

MergerMetrics Database

Thomson Platinum M&A Database