Analysis of "Appraisal Rights" in a Dell Buyout

Shareholder rights to appraised "fair value" of "going concern"
Decisions to reserve rights and choose alternatives
Support of shareholder interests

A project is being organized for Forum participants interested in considering "appraisal rights" as an alternative to the offered price in a proposed Dell buyout.

Shareholder rights to appraised "fair value" of "going concern"

As stated in the preliminary drafts of Dell's proxy statement, shareholders will be "entitled to have the 'fair value' (as defined pursuant to Section 262 of the DGCL) of your shares of Common Stock determined by the Court of Chancery of the State of Delaware and to receive payment based on that valuation instead of receiving the merger consideration."[1] An analysis of this choice requires both

(a) an understanding of Delaware legal standards for an appraisal based on a long-term investor interest in the business enterprise as a "going concern," rather than on current market or bidding prices;[2] and

(b) access to information needed for analyzing the "going concern" to determine whether its value can be reasonably expected to exceed the proposed transaction payment.

While offer prices resulting from competitively bid sales to companies seeking benefits of a business combination may often exceed the values that would be appraised for an independent going concern, it is less common for management buyouts or "going private" restructurings to be priced at more than what professional investors and bankers consider to be the intrinsic value of a company. Situations such as the Dell buyout proposal therefore justify careful analysis.

Decisions to reserve rights and choose alternatives

The process for reserving and securing appraisal rights combines very sensible decision-making steps and, unfortunately, some challenging administrative requirements that were defined

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[1] See page 136 (PDF page 144) of the May 20, 2013 Dell Inc. SEC Schedule 14A Proxy soliciting materials - revised preliminary material (287 pages, 1,290 KB, in PDF format).

[2] The legal foundation of appraisal rights is the Delaware law's view of the stockholder interest as an investment in a corporate business enterprise, and not as a security for secondary market trading. In this context, a stockholder faced with a compulsory sale is protected by a right to compensation for the fair value of that interest. For the court's strict reliance on independent appraisal of a company's value as a "going concern" without reference to bid prices, see *Golden Telecom, Inc. v. Global GT LP and Global GT LTD*, 11 A.3d 214 (Delaware Supreme Court, December 29, 2010) (11 pages, 43 KB, in PDF format); for more detailed legal views of valuation standards, see 2009, Lawrence A. Hamermesh of Widener University and Michael Wachter of University of Pennsylvania: "Rationalizing Appraisal Standards in Compulsory Buyouts" (49 pages, 316 KB, in PDF format) and the related 2005, Hamermesh and Wachter: "The Fair Value of Cornfields in Delaware Appraisal Laws" (48 pages, 442 KB, in PDF format).

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before the development of modern securities regulations and financial services. These are the basic phases and deadlines:

1. ***Reserve rights before the vote* –** To reserve rights to appraisal, formal demand for appraisal must be presented prior to the date of the shareholder meeting held for voting on the proposed transaction, and the shareholder also cannot vote for approval of the proposed transaction. This step does not commit the shareholder to proceeding with appraisal rights, since the process allows shareholders a period to consider alternatives as indicated below, but the shareholder will not have the option to select appraisal if the rights are not properly secured at this stage.
2. ***Choose between offer price and appraisal within 60 days of "effective date"* –** A shareholder who has reserved rights to appraisal can withdraw the demand and accept the approved proposal's offered payment at any time until 60 days after the date on which the buyout transaction becomes effective. (The effective date can be a few days after an approving vote, or in some cases months later.) This option will not be available, though, if the shareholder has already taken the action below to become an active petitioner or party in the appraisal action.
3. ***Decide whether to be an active or passive participant within 120 days of the "effective date"* –** Shareholders who have secured appraisal rights have until 120 days after the effective date to decide whether to take an active part in the court process for appraisal, including the selection of legal and valuation advisors, or to simply wait as passive participants for a determination of appraised value and cost allocations.
4. ***Settlement opportunities* –** Settlement offers can be presented at any time. Typically negotiated by legal counsel for shareholders who are active parties in the court appraisal process, settlements are most commonly established several months after the process starts when both sides have been able to consider the testimony of valuation experts.

As indicated, this very practical series of choices involves some fairly burdensome administrative processes. Starting with the first step's notice of demand, for example, the formal paper needs to come from the registered owner of the stock. For most investors who are beneficial owners rather than directly registered owners, this will require instructing the shareholder's broker or custodian to direct the registered owner, usually Depository Trust, to present the formal notice. This is a common practice and the requirements should be readily understood by the lawyers and administrative managers involved, but it is important to assure correct and timely execution. The Delaware court requires strict compliance with Section 262's provisions to qualify for appraisal rights.

Support of shareholder interests

The purpose of this new Forum project is to identify and support the needs of Dell shareholders who want to consider appraisal rights. Requirements of investor information access that are being addressed generally in the main Dell Valuation project will be more specifically focused in relation to the nature and timing of appraisal rights decisions. To support administrative requirements as well as the appraisal process, we plan to invite the advice of respected experts and explore possible cooperative arrangements for more effective management of shareholder interests.

Inquiries about participation in this project will be welcomed, and I will of course appreciate your suggestions of issues to be addressed.

GL – May 23, 2013

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