DEAL PROCESS DESIGN IN MANAGEMENT BUYOUTS

Guhan Subramanian

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Guhan Subramanian[*]

Management buyouts (MBOs) are an economically and legally significant class of transaction: not only do they account for more than $10 billion in deal volume per year, on average, but they also play an important role in defining the relationship between inside and outside shareholders in every public company. Delaware courts and lawyers in transactional practice rely heavily on "market-check" processes to ensure that exiting shareholders receive fair value in MBOs. This Article identifies four factors that create an unlevel playing field in that market check: information asymmetries, valuable management, management financial incentives to discourage overbids, and the "ticking-clock" problem. This taxonomy of four factors allows special committees and their advisors to assess the degree to which the playing field is level in an MBO, and (by extension) the extent to which a market canvass can provide a meaningful check on the buyout price. This Article then identifies more potent deal process tools that special committees can use to level the playing field: for example, contractual commitments from management that allow the board to run the process; pre-signing rather than post-signing market checks; information rights rather than match rights; ex ante inducement fees; and approval from a majority of the disinterested shares. This Article also identifies ways that the Delaware courts can encourage the use of these more potent devices when appropriate: through the threat of entire fairness review, the application of Revlon *duties, and the weight given to the deal price in appraisal proceedings. The result would be improved deal process design in MBOs and improved capital formation in the economy overall.*

INTRODUCTION

Management buyouts (MBOs) lie at the intersection of two classes of transactions that corporate law treats with special care: first, MBOs are conflict transactions, because senior managers have a fiduciary duty to maximize value for the sell-side shareholders but also have buy-side interests; and second, MBOs are fundamental transactions (and therefore oftentimes economically significant) because they involve the sale of the company.[1] Without appropriate protections for the non-

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[1] Throughout this Article I use the term "MBO" or "management buyout" as established in the academic and practitioner literature on the subject. *See, e.g.*, Louis Lowenstein, *Management Buyouts*, 85 COLUM. L. REV. 730, 732 (1985) ("While in practice an MBO has other characteristics, for present purposes the essential ones are that a single operating company is involved and the management of the public company is on both sides of the table, acting on behalf of the

continuing shareholders, MBOs are vulnerable to potential abuse: among other things, management can initiate its transaction opportunistically, offering a lowball price at a time when the market price is below long-run intrinsic value, and then engineer a sale or take the company public again just a few years later at multiples of the buyout price.

The "market-check" process is generally viewed as an important protection to ensure that exiting shareholders receive fair value. In particular, a post-signing "go-shop" is disproportionately the tool of choice for special committees seeking to satisfy their duties to non-continuing shareholders. If management and its favored private equity (PE) partner offer too little, goes the logic, another buyer will step in to pay fair value. Delaware courts have been receptive to such arguments, holding that, in general, a reasonable market-canvass process satisfies the sell-side board's *Revlon* duties.

This Article demonstrates why such reliance by special committees, their advisors, and the Delaware courts is unwarranted. Specifically, this Article identifies four factors that create an unlevel playing field between the inside bidder (that is, management and its favored partner) and potential third-party bidders. *First*, there are invariably information asymmetries between management and third parties, which fuel "winner's curse" concerns for any outside bidder that might win. *Second*, incumbent management is often important for the ongoing success of the enterprise, thereby converting a common-value auction into a private-value auction, in which third-party bidders cannot reliably free-ride on the public bids of the insiders. *Third*, in some MBOs the "valuable-management" problem cannot be defused simply by allowing third parties to partner with management as well, because management has financial incentives to discourage overbids. And *fourth*, all three of these problems are exacerbated when the market check is conducted post-signing, through a go-shop process, because third parties will face a ticking clock. This Article provides examples of each of these four factors, compiled from a systematic review of all significant and contestable MBOs over the past decade. For certain factors, I use this database to quantify the magnitude of their effect.

This taxonomy of four factors allows practitioners and courts to assess the degree to which the playing field is level in an MBO, and (by extension) the extent to which a market canvass can provide a meaningful check on the buyout price. The approach also allows practitioners and courts to identify interactions among factors. The linch-

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shareholders to determine whether a sale is in their interest and to seek the best possible price, all the while acting in their own proprietary interest as purchasers.").

pin, this Article shows, is valuable management: when that factor is not present, the information-asymmetry problem, the problem of management's incentives, and the ticking-clock problem all recede as well. This Article is also the first to identify a key factor in MBOs: whether the management team is a net buyer or net seller in the transaction. Consistent with practitioner intuition but unobserved by academic commentators to date, this Article provides empirical evidence suggesting that management pays lower prices in MBOs when it is a net buyer in the transaction. The implication is that courts and practitioners should be particularly insistent on procedural protections in MBOs where management is a net buyer.

For practitioners, this Article identifies the conditions under which an MBO market-check process can take place on a level playing field. But the converse is equally important: when these conditions are not present, boards and their advisors need to push for protections for noncontinuing shareholders that go beyond the ubiquitous special committee approval. For example: special committees should not allow a post-signing go-shop process to replace pre-signing hard bargaining with management. Match rights, which have become commonplace in MBOs and going-privates more generally over the past ten years, should be resisted in favor of information rights or no informational obligations whatsoever to the inside bidder. Ex ante rather than ex post inducement fees should also be part of the negotiation toolkit, and the magnitude of these fees should reflect not just out-of-pocket costs but also compensation for opportunity costs and reputational loss for unsuccessful third-party bidders. Cooperation agreements with management are also critical, on three dimensions: to help with the sale process, to leave management open to work with other bidders, and to agree to support any higher offer. And approval should be required from a majority of the disinterested shares, rather than just a majority of the outstanding shares. While all of these more potent deal technologies have appeared sporadically over the past decade, they need to be deployed more consistently by special committees, especially when all four of the factors noted above are present.

As a doctrinal matter, Delaware courts should clarify standards of review to encourage approval from a majority of disinterested shares in addition to special committee approval. This clarification would better replicate the negotiation process in arm's-length deals. It would also align the Delaware doctrine of MBOs with the Delaware Supreme Court's recent pronouncements on the procedural requirements required in freezeout transactions, another important class of conflict transaction and a close cousin of MBOs. In a line of cases beginning with *Weinberger v. UOP, Inc.*[2] in 1983 and culminating in *Kahn v. M&F Worldwide Corp.*[3] in 2014, the Delaware Supreme Court has bolstered protections for minority shareholders in freezeout transactions, yet during this same timeframe the doctrine of MBOs has remained static. This Article proposes specific adjustments to the doctrine of MBOs that would bring their procedural protections in line with freezeout doctrine and in line with the modern realities of MBOs. In addition, this Article demonstrates why courts should not presume that plain-vanilla market-check processes satisfy the sell-side board's *Revlon* duties, particularly in MBOs where the market canvass is executed through a post-signing go-shop. Instead, Delaware courts should look for more potent deal process tools in order to conclude that the market check operated on a truly level playing field. Finally, this Article demonstrates why courts should presume that the deal price provides the best indication of "fair value" in appraisal proceedings if — but only if — it is the result of an arm's-length negotiation, subject to a meaningful market check.

As a policy matter, the findings and conclusions from this Article are relevant not only for the $100+ billion in MBO transactions announced over the past decade, but also for overall capital formation. The "law and finance" literature suggests a connection between minority shareholder protections and the development of capital markets.[4] Put simply, minority shareholders will be more willing to invest at the front end if they are confident that they will be treated fairly at the back end. The more potent deal-structuring tools proposed in this Article better protect minority shareholders at the back-end exit, which facilitates minority investment and capital formation in the economy overall. The positive social welfare effect of doctrinal reforms in MBOs would be far greater than those of the Delaware courts' reforms in freezeout transactions, for the simple reason that such MBO reforms would affect every public company.

The remainder of this Article proceeds as follows: Part II offers the 2013 MBO of Dell Inc. by its founder and CEO Michael Dell as a motivating case study. Part III generalizes from this case study to describe the four practical realities that create an unlevel playing field in MBOs. In view of these real-world dynamics, Part IV describes what boards, special committees, and their advisors should do to level the

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[2] 457 A.2d 701 (Del. 1983).

[3] 88 A.3d 635 (Del. 2014).

[4] *See, e.g.*, Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998).

playing field. Part V provides implications for the Delaware courts. Part VI concludes.

I. A MOTIVATING CASE STUDY: THE DELL MBO

In this Part, I offer a case study of the Dell MBO, which began in June 2012 and concluded in May 2016.[5] While this deal was larger and higher-profile than most MBOs, many of the dynamics exhibited in Dell are general to all MBOs. In particular, the Dell deal exhibited four features that I discuss in more general terms in Part III. The narrative description here is meant to provide some texture and color to the general phenomena described in that Part.

A. Background

In one of the greatest business success stories of all time, Michael Dell, as a freshman at the University of Texas at Austin, founded Dell Inc. in 1984 to build personal computers.[6] In 1988 the company went public with a market capitalization of $85 million, and in 1992 the company entered the ranks of the Fortune 500.[7] The company grew rapidly during the boom years of the PC market in the 1990s and moved nimbly to adapt its strategy as the market shrank in the early 2000s.[8] In March 2004, coming off 25% growth in net income the year before, Michael Dell stepped down as CEO, leaving the company "clearly . . . on solid footing" in the hands of his longtime second-in-command Kevin Rollins.[9] But the company failed to stay abreast of new market trends, including notebook computers, and the company acquired a bad reputation for customer service.[10] In 2006, Dell lost its position as the largest manufacturer of PCs to Hewlett-Packard.[11] In January 2007, Michael Dell returned as CEO.[12]

Dell saw that massive changes were needed to secure the company's future. The PC, on which Dell had built its original success, was being crowded out by notebooks and soon by tablets and smartphones.

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[5] This case study is adapted from an unpublished Harvard Business School case study co-authored by Charlotte Krontiris and me.

[6] MICHAEL DELL & CATHERINE FREDMAN, DIRECT FROM DELL, at ix (2006).

[7] *Our History*, DELL, http://www.dell.com/learn/us/en/uscorp1/our-history [https://perma.cc/T63S-WUR6].

[8] *See* Gary McWilliams, *Dell's Founder to Step Down as CEO*, WALL STREET J. (Mar. 5, 2004, 12:01 AM), http://www.wsj.com/articles/SB107841738906546569 [https://perma.cc/R2G5-GHB7].

[9] *Id.*

[10] Tom Krazit, *Michael Dell Back as CEO; Rollins Resigns*, CNET (Dec. 7, 2007, 12:24 PM), http://www.cnet.com/news/michael-dell-back-as-ceo-rollins-resigns [https://perma.cc/AHQ7-XFU3].

[11] *Id.*

[12] *Id.*

To survive these changes, Dell would need to become a vendor not of a single piece of technology, but of "end-to-end enterprise solutions."[13] Under Dell's direction, the company launched an aggressive mergers and acquisitions (M&A) campaign — over a six-year period it completed twenty-two acquisitions,[14] including six in 2012 alone.[15] "It is difficult to overstate the magnitude of the changes that have occurred at Dell in the past several years," a Gartner analyst concluded, "from expanding into indirect channels, making greater use of contract manufacturers, becoming highly acquisitive, and moving into new technology areas such as services and software."[16] But by 2012, the transition was still not over the hump. Despite all the recent acquisitions, Dell's "enterprise solutions" strategy still had geographical and technical holes. The company's smartphone and tablet ventures had failed, and the company was still depending on PC sales for nearly half its revenue.[17] And even that core PC business was ailing: Dell continued to lose market share, from 11.7% of all PC shipments in 2011 to 10.7% in 2012.[18] Michael Dell told the board that the short term would be "very challenging" and that the transformation strategy would require "sacrific[ing] short term results."[19]

B. First Moves

On June 15, 2012, while meeting with colleagues in Lagos, Nigeria,[20] Michael Dell received an unexpected call from Staley Cates, President and Chief Investment Officer at Southeastern Asset Management.[21] Southeastern held 8.4% of Dell, making it the largest out-

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[13] Matthew Eastwood & Crawford Del Prete, *Dell Agrees to Be Taken Private by Michael Dell and Silver Lake Partners*, IDC (Feb. 6, 2013), http://www.idc.com/downloads/lcUS23935413.pdf [https://perma.cc/2JCH-RMLY].

[14] *Id.*

[15] Adrian O'Connell, *Dell's Leveraged Buyout Necessitates Scenario Planning for Customers*, GARTNER (Feb. 15, 2013), https://www.gartner.com/doc/2339419/dells-leveraged-buyout-necessitates-scenario [https://perma.cc/HGN4-D3UX].

[16] *Id.*

[17] Press Release, Gartner, Gartner Says Declining Worldwide PC Shipments in Fourth Quarter of 2012 Signal Structural Shift of PC Market (Jan. 14, 2013), http://www.gartner.com/newsroom/id/2301715 [https://perma.cc/NF4K-NF7P].

[18] Connie Guglielmo, *Dell Sales, Profit Miss Estimates on Dip in PC Demand, Global Tech Spending*, FORBES (Nov. 15, 2012, 4:25 PM), http://www.forbes.com/sites/connieguglielmo/2012/11/15/dell-sales-profit-miss-estimates-on-dip-in-pc-demand-global-tech-spending [https://perma.cc/UPK6-8PRV].

[19] *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *5 (Del. Ch. May 31, 2016) (alteration in original).

[20] *See Michael Dell Makes Surprise Visit to Africa*, PC TECH MAG. (July 10, 2012), http://pctechmag.com/2012/07/michael-dell-makes-surprise-visit-to-africa [https://perma.cc/6USA-KZ3Y].

[21] *See Appraisal of Dell*, 2016 WL 3186538, at *2; Dell Inc., Definitive Proxy Statement (Schedule 14A), at 20 (May 31, 2013).

side shareholder, and Cates wanted to know whether Dell ever thought about taking the company private.[22] Cates thought it might be a good idea, provided that Southeastern be permitted to "roll over" its shares into the private company. He sent Dell a spreadsheet outlining the transaction.[23]

Dell was indeed interested. In recent years, the company had slipped from first to third place in the personal computer market, which itself had been losing ground to tablets and other handheld devices. Unhappy with his company's slumping stock performance, and personally owning 16% of the shares, Dell began to believe that taking the company private was its best hope for transformation, free from the pressure of generating short-term earnings for public investors. Over the next few weeks, Dell went back and forth with Southeastern, discussing how such a deal might be worked out.[24]

One month later, Dell attended the *Fortune* Brainstorm Tech conference in Aspen, Colorado.[25] Also in attendance was Egon Durban, a 39-year-old managing director of private equity powerhouse Silver Lake Partners.[26] At the conference, Dell met with Durban and agreed to meet again in August to discuss a possible deal.[27] When they reconnected on August 10 and 14, Durban told Dell that Silver Lake was interested in an MBO of Dell.[28] In between the meetings with Silver Lake, Dell called George Roberts at Kohlberg Kravis Roberts (KKR), another PE firm.[29] Dell and Roberts were longtime friends — in fact, they met face-to-face at their nearby vacation homes in Hawaii.[30] (Durban also owned a residence in the same area.) KKR also responded to Dell's proposal with interest.[31]

On August 14, after four days of discussions with Silver Lake and KKR, Dell informed Alex Mandl, Dell's lead independent director, that

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[22] Se. Asset Mgmt., Inc., Preliminary Proxy Statement (Schedule 14A), at 7, 28 (June 6, 2013).

[23] Dell Inc., *supra* note 21, at 20.

[24] *Id.*

[25] Dan Primack, *Dell: We've Got 99 Problems but the Bid Ain't One*, FORTUNE (Mar. 29, 2013, 8:21 PM), http://fortune.com/2013/03/29/dell-weve-got-99-problems-but-the-bid-aint-one [https://perma.cc/LB4N-ZCYC].

[26] *Id.*; Shira Ovide & Anupreeta Das, *The Hidden Deal Maker Behind the Dell Buyout*, WALL STREET J. (Feb. 13, 2013, 7:30 PM), http://www.wsj.com/articles/SB10001424127887324445904578284011243534432 [https://perma.cc/J445-BGPF].

[27] Dell Inc., *supra* note 21, at 20.

[28] *Id.*

[29] David Carey et al., *Michael Dell Said to Weigh Blackstone LBO with CEO Role*, BLOOMBERG (Apr. 1, 2013, 4:52 PM), http://www.bloomberg.com/news/articles/2013-03-31/michael-dell-said-to-consider-blackstone-lbo-with-ceo-guarantee [https://perma.cc/2B27-ZMGT].

[30] Shira Ovide & David Benoit, *Dell Shareholders Approve Buyout,* WALL STREET J. (Sept. 12, 2013, 4:11 PM), http://www.wsj.com/articles/SB10001424127887324549004579070934251475824 [https://perma.cc/X3VC-ZD75].

[31] Carey et al., *supra* note 29.

he was exploring the possibility of an MBO.[32] At that point, Dell told Mandl that he had not committed to the idea or to a partner, but assured Mandl that he would choose the buyer that offered the best value for Dell's other shareholders.[33]

Three days later, Mandl gathered the board on a teleconference.[34] Dell briefly joined the call, disclosing his discussions with Southeastern, Silver Lake, and KKR, and emphasizing his desire to proceed only with the support of the board.[35] The board created a special committee, consisting of four independent directors and chaired by Mandl, which would have exclusive authority to consider any proposal from Michael Dell or others.[36] Mandl told Dell that the board was open to a deal, and Dell in turn told Silver Lake and KKR.[37] He did not inform Southeastern.[38]

Four days later, the company released its quarterly earnings: revenue was $300 million below projections from July, and $800 million below projections from June.[39] Dell's stock price dropped 5% on the announcement, giving Michael Dell and his team a potential window of opportunity.[40]

C. *Initial Offers*

As the Dell board began organizing itself for a potential transaction, Silver Lake and KKR prepared their proposals. The board's Special Committee retained J.P. Morgan (JPM) and Debevoise & Plimpton (Debevoise) to advise on the deal, while Michael Dell retained Wachtell, Lipton, Rosen & Katz.[41] On October 23, 2012, both Silver Lake and KKR submitted preliminary proposals. Silver Lake offered to pay $11.22 to $12.16 a share, conditioned upon Michael Dell rolling over his 16% stake in the company and making a further equity injection.[42] KKR offered $12 to $13 a share, assuming both Dell and Southeastern would roll over their shares, and requesting an additional

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32 Dell Inc., *supra* note 21, at 20.
33 *Id.*
34 *Id.*
35 *Id.*
36 *Id.* at 21.
37 *Id.*
38 *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *3 (Del. Ch. May 31, 2016).
39 Dell Inc., *supra* note 21, at 21.
40 *See Dell, Inc. Historical Closing Stock Prices*, DELL, http://i.dell.com/sites/doccontent/corporate/secure/en/Documents/dell-closing-costs.pdf [https://perma.cc/C8ZP-6872].
41 Dell Inc., *supra* note 21, at 20–21.
42 Michael J. de la Merced, *Timeline: How Michael Dell's Takeover Bid Got Hatched*, N.Y. TIMES: DEALBOOK (Mar. 29, 2013, 4:20 PM), http://dealbook.nytimes.com/2013/03/29/how-michael-dells-takeover-bid-got-hatched [https://perma.cc/TT5N-K4ZH].

$500 million equity injection from Michael Dell.[43] That day, Dell's share price closed at $9.35.[44]

The Special Committee rejected both offers and retained the Boston Consulting Group (BCG) to help evaluate its strategic alternatives, including its future prospects as a public company.[45] But the board's negotiating position was rapidly deteriorating. On November 15, the company released its third quarter financial results, once again underperforming both management's and analysts' expectations.[46] Dell stock fell 7.3%, to $8.86 per share.[47]

The next day, Michael Dell and company representatives met with Silver Lake and KKR. According to the proxy statement:

> Mr. Dell encouraged the representatives of each of Silver Lake and [KKR] to submit revised bids that were as strong as possible. With respect to price, Mr. Dell told the representatives of each of Silver Lake and [KKR] that they should assume that he would be prepared to participate at the highest price they were willing to pay.[48]

On December 4, Silver Lake responded with an updated price of $12.70 per share,[49] while KKR dropped out of the process, explaining that the PC market was too uncertain and Dell's recent numbers did not inspire confidence.[50] Not pleased with the prospect of having only Silver Lake to negotiate with, the Special Committee reached out to Texas Pacific Group (TPG), on the recommendation from JPM that TPG was the next most likely firm to be interested.[51] But TPG also dropped out, days before its first proposal was due, citing similar concerns as did KKR.[52] Meanwhile, BCG made its report to the Dell board: as a public company, Dell would likely continue to struggle to implement strategic initiatives.[53]

On January 10, 2013, the Special Committee retained Evercore as an additional financial advisor, with specific responsibility for running the anticipated go-shop process.[54] 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 any initial agreement and

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43 *Id.*
44 Carey et al., *supra* note 29.
45 Dell Inc., *supra* note 21, at 28.
46 *Id.*
47 *Id.* at 29.
48 *Id.*
49 *Id.* at 30.
50 *Id.*
51 *Id.* at 31.
52 *Id.* at 34.
53 *Id.* at 35.
54 *Id.* at 69.

the value of a Superior Transaction that Evercore might identify during the go-shop period, with a $30 million cap on Evercore's total fee.[55]

News of a potential Dell MBO leaked on January 12, 2013.[56] Business analyst commentary in response to a rumored deal price of $14 per share was generally unfavorable.[57] *Barron's* wrote: "At $14, Dell . . . would be roughly the 20th-least-expensive stock in the S&P 500, excluding financials. It is unprecedented for a large company to go private at such a paltry price-earnings ratio (P/E), and Dell's board might have a hard time backing such a sale."[58] Others observed that the market-check and shareholder-vote constraints would not be meaningful impediments to a deal, in view of Michael Dell's 16% stake and his importance for the ongoing success of the company.[59]

On January 15, the Special Committee held an in-person meeting with its advisors to discuss the potential solicitation of additional bids from other PE firms or strategic buyers.[60] In particular, Blackstone was an obvious candidate: not only did it have the same or greater firepower as KKR, TPG, and Silver Lake, but it also had deep expertise with Dell because David Johnson, Dell's head of M&A, had just weeks earlier joined Blackstone as a managing director.[61] However, Evercore argued against contacting any other parties, at least "at the current stage of the process," explaining that Blackstone could always be contacted during the go-shop process.[62] The Special Committee accepted this advice, leaving Silver Lake as the only bidder in the mix.[63]

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55 *Id.* at 80.

56 *See* Serena Saitto & Jeffrey McCracken, *Dell Said to Be in Buyout Talks with Private-Equity Firms*, BLOOMBERG (Jan. 14, 2013, 9:43 PM), http://www.bloomberg.com/news/articles/2013-01-14/dell-is-said-be-in-buyout-discussions-with-private-equity-firms [https://perma.cc/8WSR-HCV5].

57 Andrew Bary, *How to Give Dell's Shareholders a Fair Deal*, BARRON'S (Jan. 19, 2013), http://www.barrons.com/articles/SB50001424052748704843204578245642513078234 [https://perma.cc/YZQ9-FPJ5].

58 *Id.*

59 *See, e.g.*, Dennis K. Berman, *The Riddle: Who Is Michael Dell Working For?*, WALL STREET J. (Jan. 16, 2013, 9:38 PM), http://www.wsj.com/articles/SB10001424127887323783704578246172646417646 [https://perma.cc/KF3P-XEUW] ("[W]ithout Mr. Dell's stake, it would be nearly impossible to assemble the $22 billion to $25 billion needed to buy the company. It's also unlikely that another buyout shop or industry player would make a competing bid without Mr. Dell's consent.").

60 Dell Inc., *supra* note 21, at 37.

61 Ian Sherr & Shira Ovide, *From Dell Insider to Suitor*, WALL STREET J. (Mar. 25, 2013, 11:10 PM), http://www.wsj.com/articles/SB10001424127887323466204578382863873897912 [https://perma.cc/3NAM-98AX].

62 Dell Inc., *supra* note 21, at 37.

63 *See id.*

On January 16, Silver Lake upped its bid to $12.90 per share.[64] The Special Committee was still not satisfied with the offer, and Mandl told Dell that he "was pessimistic that an agreement would be reached."[65] A few days later, however, Mandl reached out to Dell: the Special Committee would accept $13.75 per share.[66] Silver Lake floated $13.25 per share, but Mandl flatly refused: the $13.75 proposal "was not intended to be the start of a price negotiation."[67] When Durban at Silver Lake threatened to walk away from the deal, Mandl "told him to go ahead."[68]

Instead, Silver Lake and the Dell Special Committee began a marathon three-day negotiation session. Silver Lake offered $13.50 per share, which was rejected.[69] Silver Lake then went back to Michael Dell: they would raise their offer if he would roll over his shares at a lower value than the offer price.[70] Dell agreed, and Silver Lake returned to the Special Committee with its "best and final" offer: $13.60 per share.[71] The Special Committee refused.

Within days, Silver Lake recanted its "best and final" declaration and offered to raise the price to $13.75 per share on the condition that Dell suspend payment of its quarterly dividends until the deal closed, or $13.60 per share with dividends continuing.[72] When the Special Committee again refused, Silver Lake offered another adjustment: it would pay $13.65 per share, dividends continuing.[73] The Special Committee now agreed, and the board quickly followed suit.[74] Finally, the parties had a deal.

The deal was announced on February 5, 2013.[75] Michael Dell would roll over his existing 16% stake in the company, valued at approximately $3.4 billion, and would contribute an additional $750 million of equity, in exchange for 74.9% of the post-MBO entity.[76] Silver Lake would contribute $1.4 billion in exchange for the remaining 25.1% of shares.[77] Lenders would contribute $18.1 billion of financing,

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64 *Id.*
65 *Id.*
66 *Id.*
67 *Id.* at 38.
68 *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *11 (Del. Ch. May 31, 2016).
69 Dell Inc., *supra* note 21, at 38.
70 *Id.*
71 *Id.*
72 *Id.* at 40.
73 *Id.* at 41.
74 *Id.* at 42.
75 *Id.* at 43.
76 *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *43 (Del. Ch. May 31, 2016); Guhan Subramanian, *In re* Appraisal of Dell Inc. Trial Testimony Demonstratives 8 (Oct. 7, 2015) (on file with the Harvard Law School Library).
77 *Appraisal of Dell*, 2016 WL 3186538, at *12; Dell Inc., *supra* note 21, at 2.

including a $2 billion loan from Microsoft.[78] Dell planned to stay on as chairman and CEO of his namesake company.

The deal included a go-shop period, during which Evercore would solicit higher offers. The go-shop period began on February 5, when the deal was announced, and continued for 45 calendar days, to March 23.[79] 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 whose acquisition proposal "is or could reasonably be expected to result in a Superior Proposal."[80] 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 [the] Agreement" that would make the competing offer no longer a Superior Proposal.[81]

To ensure a meaningful go-shop process, Michael Dell agreed to:

> explore in good faith the possibility of working with any Persons or groups of Persons regarding an Acquisition Proposal . . . including by reviewing and responding to proposals and taking part in meetings and negotiations with respect thereto; it being understood that [Michael Dell's] decision as to whether to work with any Person or group of Persons after such good faith exploration shall be within [his] discretion.[82]

However, the *New York Post* reported that "Silver Lake insist[ed] 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."[83]

In addition to the go-shop process, the Dell–Silver Lake deal required approval from a majority of Dell shareholders, excluding Dell's own 16% stake.[84] The exclusion of Michael Dell's shares effectively raised the hurdle for shareholder approval: rather than approval from 42% of the disinterested shares (=(51-16)/(100-16)), 51% of the disinterested shares had to affirmatively approve the deal.

D. Reactions to the Deal

The $13.65 deal price fell short of the $14.00 rumored price that commentators had viewed skeptically less than a month earlier. Ana-

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78 Dell Inc., *supra* note 21, at 102; Subramanian, *supra* note 76, at 9.

79 *Appraisal of Dell*, 2016 WL 3186538, at *13–14.

80 Dell Inc., Current Report (Form 8-K) Ex. 2.1, at 47 (Feb. 6, 2013).

81 *Id.* at 46.

82 Dell Inc., Current Report (Form 8-K) Ex. 10.1, at 4 (Feb. 6, 2013).

83 Josh Kosman, *Schwarzman Shut Out of Dell Bidding*, N.Y. POST (Jan. 25, 2013, 5:00 AM), http://nypost.com/2013/01/25/schwarzman-shut-out-of-dell-bidding [https://perma.cc/56LP-GW4A].

84 Dell Inc., *supra* note 21, at 2.

lyst reaction was correspondingly lukewarm, with some suggesting that the price could "be 'perceived as cheap.'"[85] In the blogosphere, the announcement was met with generally negative commentary, and sometimes outright cynicism. "The same management that [is responsible for Dell's underperformance] now wants to buy the company at a lower price that they, in a sense, caused," remarked an NYU finance professor.[86] "That looks to me like rewarding management for a job badly done."[87]

More concerning for the bidding consortium, however, was the response from shareholders. Soon after the deal was announced, the two largest Dell shareholders other than Michael Dell himself — Southeastern and mutual fund giant T. Rowe Price — voiced strong opposition, arguing that Dell stock was worth as much as $25 a share.[88] In a letter to the Dell board, Southeastern called the deal "an opportunistically-timed bid to take the Company private at valuations far below Dell's inherent value."[89] Southeastern further announced that it would "avail itself of all options at its disposal to oppose the proposed transaction"[90] — and, matching speech to action, promptly hired a proxy solicitor.[91]

Meanwhile, Evercore was busy executing the go-shop process, contacting sixty-seven parties about bidding for Dell.[92] Four more parties reached out unsolicited.[93] By March 23, when the go-shop period ended, only two real alternatives had emerged: Blackstone and billionaire activist shareholder Carl Icahn.[94]

Blackstone submitted a nonbinding proposal offering at least $14.25 per share, with an option for shareholders to roll over their

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[85] David Benoit, *Dell Buyout: Price Disappoints Says Deutsche Bank Analyst*, WALL STREET J. (Feb. 5, 2013, 2:46 PM), http://blogs.wsj.com/deals/2013/02/05/dell-buyout-price-disappoints-says-deutsche-bank-analyst [https://perma.cc/SV5S-DYA6].

[86] Aswath Damodaran, *Michael Dell's Conflicted Buyout*, MUSINGS ON MARKETS (Feb. 12, 2013, 7:12 AM), http://aswathdamodaran.blogspot.com/2013/02/michael-dells-conflicted-buyout.html [https://perma.cc/B2RN-MT4N].

[87] *Id.*

[88] Liz Hoffman, *Dell Showcasing PC Woes to Justify $24B Bargain: Investor*, LAW360 (Mar. 5, 2013, 1:35 PM), https://www.law360.com/texas/articles/420810/dell-showcasing-pc-woes-to-justify-24b-bargain-investor [https://perma.cc/LBE4-V6KE].

[89] *Southeastern Asset Management Opposes Current Transaction for Dell*, PR NEWSWIRE (Feb. 8, 2013, 3:33 PM), http://www.prnewswire.com/news-releases/southeastern-asset-management-opposes-current-transaction-for-dell-190423511.html [https://perma.cc/Q6NB-ZJM8].

[90] *Id.*

[91] Telis Demos, David Benoit & Ben Worthen, *T. Rowe Price Opposes Dell Buyout*, WALL STREET J. (Feb. 12, 2013, 7:24 PM), http://www.wsj.com/articles/SB10001424127887324880504578300090035992424 [https://perma.cc/DG3U-GZMB].

[92] Dell Inc., *supra* note 21, at 43.

[93] *Id.*

[94] *Id.* at 47.

shares subject to an unspecified cap.[95] Partners in the proposed deal would include Francisco Partners, a tech-focused private equity firm based in San Francisco, and Insight Venture Partners, a private equity and venture capital firm based in New York.[96] The *Wall Street Journal* reported that GE Capital would also be part of the deal, as Blackstone proposed to sell it Dell's financial services branch for up to $5 billion.[97] Blackstone also successfully negotiated with the Special Committee to be reimbursed for up to $25 million in bid-related expenses.[98]

The other proposal came from Icahn Enterprises. Icahn put forth a deal in which shareholders could either roll over their shares or sell for $15.00 per share for roughly 58% of the company.[99] The deal would be financed by Icahn Enterprises and Dell's cash on hand, as well as new debt.[100] Southeastern and T. Rowe Price both pledged to roll over their shares, along with Icahn.[101] The Special Committee offered to reimburse Icahn's bid-related expenses, as with Blackstone, if Icahn would agree not to engage in a proxy fight.[102] Icahn refused.[103]

On March 25, after the go-shop period had expired, the Special Committee designated both Blackstone and Icahn Enterprises as Excluded Parties, on the conclusion that both "could reasonably be expected to result in superior proposals."[104] However, the Special Committee's press release noted that as "[t]here can be no assurance that either proposal will ultimately lead to a superior proposal[,] . . . the Special Committee has not changed its recommendation with respect

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[95] *Id.* at 46.

[96] Carey et al., *supra* note 29.

[97] Sharon Terlep, Ian Sherr & Kate Linebaugh, *Sale of Dell Financial Arm Could Be Worth About $5 Billion*, WALL STREET J. (Mar. 23, 2013, 11:36 PM), http://blogs.wsj.com/deals/2013/03/23/sale-of-dell-financial-arm-could-be-worth-about-5-billion [https://perma.cc/BS5K-J9JX].

[98] Andrew Ross Sorkin, *A $25 Million Question over a Bid for Dell*, N.Y. TIMES: DEALBOOK (Apr. 1, 2013, 9:26 PM), http://dealbook.nytimes.com/2013/04/01/a-25-million-charade-over-a-bid-for-dell [https://perma.cc/VA4E-BXSK].

[99] Dell Inc., *supra* note 21, at 47.

[100] *Id.*

[101] *Id.*

[102] *Dell Inc., Silver Lake Partners, Carl C. Icahn and Blackstone: Chronology of Events Surrounding Take-Private, Topping Bid and Potential Proxy Fight*, UNSOLICITED VIEWS (Morrison & Foerster, LLP, S.F.), Sept. 2013, at 3 (2013), http://media.mofo.com/files/Uploads/Images/UV-Dell-Icahn.pdf [https://perma.cc/QHD3-NND9] [hereinafter Morrison & Foerster Chronology].

[103] David Benoit, *Icahn Still Considering Dell Proxy Fight*, WALL STREET J. (Apr. 16, 2013, 2:08 PM), http://blogs.wsj.com/moneybeat/2013/04/16/icahn-still-considering-dell-proxy-fight [https://perma.cc/2ZW7-9AAX].

[104] *Dell Special Committee Receives Two Alternative Acquisition Proposals in "Go-Shop" Process*, BUS. WIRE (Mar. 25, 2013, 7:00 AM), http://www.businesswire.com/news/home/20130325005524/en/Dell-Special-Committee-Receives-Alternative-Acquisition-Proposals [https://perma.cc/HP3S-TDMZ].

to, and continues to support, the company's pending sale" to Dell and Silver Lake.[105] In closing, the press release reminded the public of all the careful work that had gone into the Dell–Silver Lake deal: "Silver Lake Partners raised its bid six times by a total of approximately $4 billion, or over 20%, during the course of negotiations."[106] However appealing Blackstone and Icahn Enterprises might have seemed, the board still backed its original agreement.

Less than a month later, the deal landscape changed once more when Blackstone withdrew from the bidding process. *Dealbook* reported that "[f]rom the beginning, there had been dissension within Blackstone about whether it should pursue an offer" because the firm was "worried that they would be used as a stalking horse" for the Dell–Silver Lake bid.[107] In a letter to the Special Committee, Blackstone further claimed that it had been spooked by an examination of Dell's books, which showed the business was worse off than the firm had thought. As Blackstone wrote:

> While we still believe that Dell is a leading global company with strong market positions, a number of significant adverse issues have surfaced since we submitted our letter proposal to you on March 22nd, including: (1) an unprecedented 14 percent market decline in PC volume in the first quarter of 2013, its steepest drop in history, and inconsistent with Management's projections for modest industry growth; and (2) the rapidly eroding financial profile of Dell.[108]

Dell shares fell almost 4% in response, to just below the Dell–Silver Lake offer price.[109] Meanwhile, Icahn had not been idle. On May 9, Icahn Enterprises announced that it was collaborating with Southeastern to offer a new alternative to the Dell–Silver Lake deal: shareholders could retain their shares, or sell for $12 per share to a fund financed by Dell's cash on hand and $5 billion in new debt.[110] In their letter to the Dell board announcing this proposal, Icahn and Southeastern let loose: "We want this board to hear from both Icahn and Southeastern loud and clear that it is insulting to shareholders' intelligence for the Board to tell them that this Board only has the best in-

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[105] *Id.*

[106] *Id.*

[107] Andrew Ross Sorkin & Jeffrey Cane, *Blackstone Drops Out of the Bidding for Dell*, N.Y. TIMES: DEALBOOK (Apr. 18, 2013, 11:31 AM), http://dealbook.nytimes.com/2013/04/18/blackstone-seen-abandoning-bid-for-dell [https://perma.cc/MG4Z-82AC].

[108] Letter from Chinh Chu, Boulder Acquisition Corp., to Alex Mandl, Presiding Dir., Special Comm. of the Bd. of Dell Inc. (Apr. 18, 2013), *reprinted in* Sorkin & Cane, *supra* note 107.

[109] Peter Burrows, *Blackstone Withdraws Dell Bid Relieving Pressure to Raise Price*, BLOOMBERG (Apr. 20, 2013, 12:01 AM), http://www.bloomberg.com/news/articles/2013-04-19/blackstone-said-to-pull-out-of-dell-bid-on-plummeting-pc-sales [https://perma.cc/9ZUD-9FVP].

[110] Se. Asset Management, Inc., Soliciting Material Pursuant to § 240.14a12 (Schedule 14A), at 1 (May 10, 2013).

terests of shareholders at heart . . . ."[111] The phrases "very wrong-headed,"[112] "this almost absurd bargain,"[113] "an opportunistic buy-out,"[114] "this is a no brainer,"[115] and — in all capital letters — "IT IS NOT TOO LATE TO DO THE RIGHT THING"[116] all appeared in the letter. More alarming was the accompanying threat: if the Dell board did not allow shareholders to vote for the Icahn-Southeastern proposal alongside the Dell–Silver Lake proposal, Icahn and Southeastern would nominate twelve new directors at the next annual meeting.[117]

Through May and June 2013, battle lines were drawn. On June 18, one month before the shareholder vote, Icahn upped the ante. In an open letter, he proposed that Dell self-tender for 1.1 billion shares at a price of $14 per share.[118] Once again, the deal would be financed by Dell's cash on hand and new debt.[119] While the board had heretofore refrained from definitively rejecting Icahn-Southeastern proposals, it now spoke out in no uncertain terms: "Mr. Icahn's concept is not, in its present state, a transaction that the Special Committee could endorse and execute — there is neither financing, nor any commitment from any party to participate, nor any remedy for the company and its shareholders if the transaction is not consummated."[120]

On July 1, however, Icahn published another open letter (a favorite mode of communication) announcing that he had secured lender commitments for the proposed self-tender offer.[121] While the Special Committee announced that it would "be pleased to review any additional information, including financing commitments" regarding Icahn's proposal,[122] it doubled down on its support for the Dell–Silver Lake transaction, warning about "substantial downside risk" should the shareholders reject the deal.[123] Icahn and Southeastern fired back with a barrage of open letters: condemning the board's "scare tactics";[124] calling upon shareholders to perfect their appraisal rights; and

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[111] *Id.* at 2.
[112] *Id.*
[113] *Id.* at 3.
[114] *Id.* at 4.
[115] *Id.* at 5.
[116] *Id.* at 7.
[117] *Id.* at 2, 6.
[118] Morrison & Foerster Chronology, *supra* note 102, at 5–6.
[119] Carl C. Icahn, General Statement of Acquisition of Beneficial Ownership (Schedule 13D) Ex. 1.1 (June 18, 2013).
[120] *Carl Icahn's Ongoing Battle with Michael Dell*, FORBES (June 28, 2013, 8:59 AM), http://onforb.es/14BVpVl [https://perma.cc/BX5D-V8JD].
[121] Carl C. Icahn, Definitive Additional Materials (Schedule 14A) Ex. 1 (July 1, 2013).
[122] Dell Inc., Definitive Additional Materials (Schedule 14A) (July 1, 2013).
[123] Morrison & Foerster Chronology, *supra* note 102, at 6.
[124] Carl C. Icahn, Definitive Additional Materials (Schedule 14A) Ex. 1 (July 15, 2013).

finally refining the terms of the July 1 self-tender proposal to include, in addition to the $14 per share price, one transferrable warrant for every four shares.[125] Icahn and Southeastern placed the value of this deal at $15.50 to $18 per share.[126]

E. The End Game

In late June 2013, as Icahn's self-tender proposal gained traction, the Special Committee began to lean on Michael Dell to raise his price.[127] While Dell apparently "listened" to the board's request, he demurred.[128] A few days later, the word was out: Michael Dell was holding fast at his price and did not intend to raise it. The *Wall Street Journal* reported that "Michael Dell doesn't plan to raise his $13.65 a share bid," "the offer won't get any better for investors," and "there was mutual agreement [between Dell and Silver Lake that] they would stand firm on price."[129]

Despite Dell's rebuff, the board continued to urge shareholders to vote in favor of the deal, warning that Dell stock could fall as low as $5.85 a share based on disappointing first-quarter earnings.[130] But by July 17, things were looking down. The deal required approval from a majority of the disinterested shares outstanding,[131] which meant that abstentions would effectively count as "no" votes.[132] People close to the deal estimated that 30% of shares would be actively voted against the deal (including Icahn and Southeastern's combined 12.7% of shares), leaving an uncomfortably narrow margin for Dell and Silver Lake to succeed.[133] A further 27% of shares were not voted, many for

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[125] Benjamin Pimentel, *Icahn, Southeastern Pitch New Dell Proposal*, MARKETWATCH (July 12, 2013, 10:06 AM), http://www.marketwatch.com/story/icahn-southeastern-pitch-new-dell-proposal-2013-07-12 [https://perma.cc/JPZ9-UZRM].

[126] *Id.*

[127] Michael J. de la Merced, *Michael Dell Is Said to Be Encouraged by Board to Raise Offer*, N.Y. TIMES: DEALBOOK (July 2, 2013, 10:21 PM), http://dealbook.nytimes.com/2013/07/02/michael-dell-is-said-to-be-encouraged-by-board-to-raise-offer [https://perma.cc/XT5P-CFBK].

[128] *Id.*

[129] David Benoit & Shira Ovide, *Dell Stock Off on Deal Veto Worries*, WALL STREET J. (July 6, 2013, 10:27 AM), http://www.wsj.com/articles/SB10001424127887323899704578587421635869116 [https://perma.cc/38GC-Z26X].

[130] *Id.*

[131] Leonard Chazen, *Did the Dell Majority-of-the-Minority Clause Go Too Far?*, LAW360 (July 22, 2013, 6:41 PM), http://www.law360.com/articles/459110/did-the-dell-majority-of-the-minority-clause-go-too-far [https://perma.cc/J6J2-MC6D].

[132] Michael J. de la Merced, *Support Weakens for Dell Founder's Offer*, N.Y. TIMES: DEALBOOK (July 17, 2013, 9:01 PM), http://dealbook.nytimes.com/2013/07/17/support-weakens-for-dell-founders-offer [https://perma.cc/793X-CMDE].

[133] *Id.*

unrelated institutional reasons.[134] On July 18, with 77% of the eligible shares cast and success still uncertain, the Dell board voted to postpone the shareholder meeting for six days.[135]

During those six days, Silver Lake and Michael Dell were forced to admit that $13.65 was not the best they were willing to offer. On July 23, the day before the rescheduled annual meeting, Dell and Silver Lake raised their per-share offer by ten cents,[136] to $13.75, plus an eight-cent special dividend (quickly increased to a thirteen-cent special dividend[137]) on top of an already scheduled third-quarter dividend of eight cents a share.[138] In exchange, they asked the Dell board to replace the majority of the minority *outstanding* condition with majority of the minority votes *cast* — in effect no longer counting abstentions as no votes.[139] For the third time, Silver Lake announced that it had made its "best and final proposal."[140] In an interview with *Bloomberg*, Michael Dell also confirmed that this was (again) his best and final offer.[141] This time, 51% percent of the unaffiliated Dell shares were voted in favor. On October 28, 2013, the Company issued a thirteen-cent special dividend to all shareholders, and the deal closed the next day.[142]

F. The Aftermath

Icahn and Southeastern initially indicated their desire to seek appraisal and encouraged other shareholders to follow suit, but they later reversed course and accepted the merger consideration.[143] Sharehold-

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[134] Sharon Terlep, *Dell Buyout Group Calls for Change in Voting Rules*, WALL STREET J. (July 24, 2013, 7:28 PM), http://www.wsj.com/articles/SB10001424127887323610704578625550322614778 [https://perma.cc/HV3H-CBEC].

[135] David Benoit, Shira Ovide & Sharon Terlep, *Dell Races to Sway Voters, Save Deal*, WALL STREET J. (July 18, 2013, 1:35 PM), http://www.wsj.com/articles/SB10001424127887323309404578613561181774992 [https://perma.cc/WAU2-AD5K].

[136] Dell Inc., Soliciting Material Pursuant to § 240.14a-12 (Schedule 14A) (July 24, 2013).

[137] Liz Hoffman, *Michael Dell Shouldering Buyout's $190M Dividend Alone*, LAW360 (Aug. 14, 2013, 1:54 PM), http://www.law360.com/articles/464814/michael-dell-shouldering-buyout-s-190m-dividend-alone [https://perma.cc/V2XK-BJNN].

[138] Michael J. de la Merced, *Michael Dell Salvages Bid for His Company*, N.Y. TIMES: DEALBOOK (Aug. 2, 2013, 7:12 AM), http://dealbook.nytimes.com/2013/08/02/dell-and-buyers-said-to-be-near-compromise-on-takeover-bid [https://perma.cc/MUZ7-K5JP].

[139] *See* Matt Levine, *Dell Pretty Sure that This Time It's Figured Out This Merger Thing*, DEALBREAKER (Aug. 2, 2013, 4:27 PM), http://dealbreaker.com/2013/08/dell-pretty-sure-that-this-time-its-figured-out-this-merger-thing [https://perma.cc/2VDG-RYWK].

[140] Dell Inc., *supra* note 136.

[141] David Carey, *Michael Dell Says Bid Is His "Best and Final Offer": Interview*, BLOOMBERG (July 28, 2013, 8:03 PM), http://www.bloomberg.com/news/articles/2013-07-29/michael-dell-says-bid-is-his-best-and-final-offer-interview [https://perma.cc/8JM7-PJ6X].

[142] Aaron Ricadela, *Dell Completes $24.9 Billion Leveraged Buyout*, BLOOMBERG (Oct. 29, 2013, 12:28 PM), http://www.bloomberg.com/news/articles/2013-10-29/dell-completes-24-9-billion-leveraged-buyout [https://perma.cc/P8F3-R57G].

[143] *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *19 (Del. Ch. May 31, 2016).

ers holding approximately thirty-two million shares (approximately 3% of Dell shares outstanding) ultimately sought appraisal in Delaware Chancery Court, but due to procedural missteps nearly all of these shareholders lost their appraisal rights.[144] Most significantly, twenty-seven million shares owned by T. Rowe Price were knocked out of the appraisal proceeding due to what the investment firm characterized as a computer error, even though T. Rowe Price had adamantly opposed the deal and had publicly declared its intention to seek appraisal.[145]

For the 5.2 million shares that remained eligible for appraisal, the Delaware Chancery Court held a closely watched trial in October 2015.[146] In May 2016, the court ruled that the fair value of Dell at the time of closing was $17.62 per share, representing a 28% premium over the $13.75 per share deal price.[147] With interest, the shareholders who successfully sought appraisal would receive $20.84 per share. The *Wall Street Journal* reported on its front page that the Dell MBO "shortchanged shareholders by more than $6 billion . . . vindicating critics of the controversial deal who argued it favored Mr. Dell and his partners."[148] But the *Journal* further noted that "the victory is a hollow one for former Dell investors, few of whom are eligible for compensation due to the intricacies of Delaware law."[149]

Meanwhile, Michael Dell was hard at work implementing massive operational changes at his namesake company. Three months after the deal closed, he told the *Dallas Morning News* that "we're all done with whiners" (referencing the former public shareholders), and signaled

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144 *In re* Appraisal of Dell Inc., 143 A.3d 20, 22–23, 32 (Del. Ch. 2016) (holding that plaintiffs owning over 31 million shares of Dell stock did not have a right of appraisal due to failure to meet the Dissenter Requirement); *In re* Appraisal of Dell Inc., No. 9322, 2015 WL 4313206, at *3 (Del. Ch. July 13, 2015, revised July 30, 2015) (finding that plaintiffs owning at least 922,975 shares of Dell stock did not have right of appraisal due to failure of Continuous Holder Requirement since shares were held through another institution); *see also* Steven Davidoff Solomon, *Funds Challenging Dell Bid Find Shares Aren't Really Theirs*, N.Y. TIMES: DEALBOOK (July 21, 2015), http://www.nytimes.com/2015/07/22/business/dealbook/funds-find-they-dont-really-own-dell-shares.html [https://perma.cc/B2J7-XTSA] (discussing 2015 case).

145 *See Appraisal of Dell*, 143 A.3d at 22–23, 32; Matt Chiappardi, *Chancery Knocks T. Rowe Price Funds out of Dell Appraisal*, LAW360 (May 11, 2016, 5:25 PM), http://www.law360.com/articles/794983/chancery-knocks-t-rowe-price-funds-out-of-dell-appraisal [https://perma.cc/5DQG-UQVK]. In June 2016, T. Rowe Price announced that it would compensate its clients nearly $200 million for the mistake. *See* Sarah Krouse, *T. Rowe Price Pays Up for Botched Vote*, WALL STREET J. (June 6, 2016, 6:56 PM), http://www.wsj.com/articles/t-rowe-price-to-reimburse-clients-194-million-for-dell-deal-flub-1465244254 [https://perma.cc/ZZX8-RZPJ].

146 Matt Chiappardi, *Investors Say Dell Worth Twice $25B Buyout in Appraisal Row*, LAW360 (Oct. 5, 2015, 7:46 PM), http://www.law360.com/articles/710783/investors-say-dell-worth-twice-25b-buyout-in-appraisal-row [https://perma.cc/7Y7A-L2PP].

147 *Appraisal of Dell*, 2016 WL 3186538, at *51.

148 Liz Hoffman, *Judge Raps Dell on Buyout*, WALL STREET J., June 1, 2016, at A1.

149 *Id.*

that the prospects for the company were excellent[150] — a sharp contrast from the bleak assessment of future prospects just a year earlier. In November 2014, a year after the MBO, he wrote in the *Wall Street Journal*: "[I]n the past year we have made investments of several hundred million dollars in areas with significant time horizons, such as cloud and analytics . . . ."[151] That same month, *Bloomberg* reported that Michael Dell and Silver Lake had made "a paper gain of at least 90% on their investment" in Dell.[152] In October 2015, Dell announced the acquisition of EMC for $67 billion, the largest tech-company acquisition in history.[153] Tech website *ZDNet* estimated synergies of $1 billion from the deal, observing that "[t]he sales teams are largely complementary and the product lines fit together well."[154] Of course, the Dell shareholders who exited in 2013 will not share in any of these synergies, or in any of the other post-MBO improvements implemented by Michael Dell and his team.[155]

II. PRACTICAL REALITIES IN MBOS

The Dell deal illustrates several features that are present in many MBOs: top management knows more about the company than third parties know; management is thought to be essential for the success of the ongoing enterprise; there is a "ticking clock" on third-party bids, due to the go-shop window; and top management is a net buyer in the transaction. In this Part, I develop a general model of MBOs that generalizes from these features, and I examine the implications of these

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[150] *Michael Dell: After Buyout, 'We're All Done with Whiners'*, DALL. MORNING NEWS (Dec. 15, 2013, 9:03 PM), http://www.dallasnews.com/business/technology/headlines/20131215-michael-dell-after-buyout-were-all-done-with-whiners.ece [https://perma.cc/YN2L-P7MC] (Q: "[W]ill you even consider publicly saying where your business is at or not?" A: "Revenue to date for the company has been about $780 billion, so there's your information. What more do you need to know?" Q: "Somebody will want to know at the end of next year how you are doing." A: "It'll be a lot more than $780 billion.").

[151] Michael Dell, *Going Private Is Paying Off for Dell*, WALL STREET J. (Nov. 24, 2014, 6:47 PM), http://www.wsj.com/articles/michael-dell-going-private-is-paying-off-for-dell-1416872851 [https://perma.cc/6G4X-KQ3F].

[152] David Carey & Jack Clark, *Dell, Silver Lake Said to Reap 90% Gain a Year After LBO*, BLOOMBERG (Nov. 6, 2014, 12:01 AM), http://www.bloomberg.com/news/articles/2014-11-06/dell-silver-lake-said-to-reap-90-gain-a-year-after-lbo [https://perma.cc/YXE2-HSEH].

[153] Ron Miller, *Dell Buys EMC for $67B in Largest Deal in Tech History*, TECHCRUNCH (Oct. 12, 2015), https://techcrunch.com/2015/10/12/dell-buys-emc-for-67b-in-largest-deal-in-tech-history [https://perma.cc/6JSK-FYQD].

[154] Larry Dignan, *Dell Buys EMC for $67 Billion: Will Bigger Be Better?*, ZDNET (Oct. 12, 2015, 11:23 AM), http://www.zdnet.com/article/dell-buys-emc-for-67-billion-will-bigger-be-better [https://perma.cc/3ZJ2-CFWT].

[155] *See* DEL. CODE ANN. tit. 8, § 262(h) (2016) (mandating valuation of shares "exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation").

features for whether the market-check process takes place on a level playing field.

I begin with the intuition that, in general, an auction mechanism should yield effective price discovery in the M&A marketplace.[156] Two prominent auction theorists have developed a theoretical model validating this intuition that an auction always maximizes value.[157] One well-known M&A handbook similarly states:

> [A]uctions are still generally believed to be the best way of ensuring that the highest possible price is obtained. The same sentiment probably drives the seller to use auction methods for sales of divisions or subsidiaries of companies. Also, who can fault a corporate executive for the price he or she agrees to if it was the result of a competitive bid procedure?[158]

In the context of MBOs, this conventional wisdom manifests itself as reliance on a "market canvass" to ensure that management is paying fair value.[159] One implication of this logic is that special committees do not need to negotiate aggressively with management because any below-market offer will be "jumped" by a third-party buyer.[160] Of course, the management buyer, foreseeing this and not wanting to be jumped, will offer fair value in the first instance. The market-check process replaces the special committee's need for meaningful negotiations, because the implicit or explicit auction with third-party buyers does all the "work" of ensuring fair value is paid to the exiting shareholders.

But this logic only holds if third-party bidders can participate on a level playing field. In fact, four institutional details and practical realities make auctions less effective as a tool for price discovery in MBOs: information asymmetries, valuable management, management's finan-

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156 GUHAN SUBRAMANIAN, NEGOTIAUCTIONS: NEW DEALMAKING STRATEGIES FOR A COMPETITIVE MARKETPLACE 34 (2010) ("Just hold an auction, interested parties will show up, and the price will be bid up or down (depending on whether you are buyer or seller) to your advantage.").

157 Jeremy Bulow & Paul Klemperer, *Auctions Versus Negotiations*, 86 AM. ECON. REV. 180, 189 (1996) (arguing that "[w]ith independent signals and risk-neutral bidders, an . . . auction with N + 1 bidders is more profitable in expectation than any negotiation with N bidders," *id.* at 189, and concluding that this "result suggests that the value of negotiating skill is small relative to the value of additional competition," *id.* at 180). Another theoretical model finds that auctions, but not negotiations, are evolutionarily stable in the marketplace. *See generally* Xiaohua Lu & R. Preston McAfee, *The Evolutionary Stability of Auctions over Bargaining*, 15 GAMES & ECON. BEHAV. 228 (1996).

158 STANLEY FOSTER REED & ALEXANDRA REED LAJOUX, THE ART OF M&A: A MERGER/ACQUISITION/BUYOUT GUIDE 486 (3d ed. 1999).

159 See Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729, 730 (2008).

160 Consistent with the prior literature, I define a "jump bid" as a postsigning offer for the company. *See, e.g.*, *id.* at 729–31; *see also* J. Russel Denton, Note, *Stacked Deck: Go-Shops and Auction Theory*, 60 STAN. L. REV. 1529, 1550 (2008) ("A jump bid is a situation in which a third-party makes a bid on a company after an initial merger agreement has been signed.").

cial incentives to discourage an overbid, and (in go-shop MBOs) the ticking-clock problem. These factors are not included in standard economic models of auctions,[161] yet they are important for assessing the effectiveness of MBO processes in practice. I discuss each of these four factors in turn, with illustrations from Dell and other MBOs as appropriate.

In order to estimate the magnitude of these different factors, I constructed a new database of MBOs. I searched the MergerMetrics database for all MBOs (as identified by the "Management Buyout" and/or "13E-3" flag) announced between January 2006 and June 2015. I eliminated transactions smaller 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.[162] I also excluded transactions where the conflicted party was a longtime institutional shareholder and one transaction (U.S. Xpress Enterprises, Inc.) where management's offer was unsolicited or hostile. The resulting sample includes forty-four transactions, with a total transaction value of $100 billion (the "MBO Sample").

For each deal in the MBO Sample, I examined the "Background to the Merger" section of the proxy statement as well as public reports to code key features of the deal process. I examined the "Financing" and "Sources of Funding" sections of the proxy statement to determine management's buy-side and sell-side participation in the deal. I obtained stock price data from the Center for Research in Securities Prices (CRSP) database.

I find that approximately half (twenty-one out of forty-four) of the deals in the MBO Sample were go-shop deals, while the remaining twenty-three used the traditional no-shop route.[163] Within the go-shop subsample, I find that eight out of the twenty-one deals (38%) were "pure" go-shops, in which the special committee negotiated solely with

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[161] *Cf.* PAUL KLEMPERER, AUCTIONS: THEORY AND PRACTICE 104 (2004) ("[M]ost of the extensive auction literature . . . is of second-order importance for *practical* auction design."); SUBRAMANIAN, *supra* note 156, at 118 (describing postmortem academic/practitioner conference in New York City on Cable & Wireless America auction, which "contributed to my growing sense that auction theory has little to say about how most real auctions actually work").

[162] *See* John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307, 314 (2000) (using a $50 million size cut-off); Guhan Subramanian, *Post*-Siliconix *Freeze-Outs: Theory and Evidence*, 36 J. LEGAL STUD. 1, 8 (2007) (using a 35% cut-off for identifying controlled companies).

[163] I explain the difference as follows: "[R]ather than canvassing the marketplace first, the seller [in a go-shop deal] negotiates with a single bidder, announces the deal, and then has thirty to fifty days to 'go shop' to find a higher bidder. At the highest level, then, the traditional route involves a market canvass followed by exclusivity with the winning bidder; while the go-shop route in its pure form involves exclusivity with a bidder followed by a market canvass." Subramanian, *supra* note 159, at 730 (footnote omitted).

management and a single PE partner before announcing the deal. The remaining thirteen deals (62%) were "add-on" go-shops, in which the special committee conducted both a pre- and postannouncement market canvass. This split is the opposite of what I reported in my study of 2007–2008 go-shops, in which I found twenty-nine out of forty-eight (60%) were pure go-shops and the remaining nineteen out of forty-eight (40%) were add-on go-shops, though the difference between the two samples is not statistically significant at traditional confidence levels.[164]

I also find an overall "jump rate" of 9% in the MBO Sample, which is consistent with the jump rate reported in Coates & Subramanian (2000) for arm's-length deals[165] and Cain & Davidoff (2011) for MBOs.[166] Two of the MBOs that were jumped were go-shop deals (Silicon Storage Technology and Quest Software), and two were no-shop deals (EGL, Inc. and RAE Systems). The fact that jump rates are approximately the same in MBOs as in arm's-length deals does not necessarily mean that the playing field is level in MBOs, because sophisticated practitioners will price deals according to the perceived risk of third-party competition. That is, management and a PE sponsor would rationally offer less to the special committee (and the special committee would rationally accept less) because the very fact of an unlevel playing field would reduce the threat of third-party competition. In fact, because of the endogeneity of deal pricing, jump rates in MBOs and arm's-length deals should be approximately the same in equilibrium, since there is no reason to believe that the error rate on deal pricing (which in turn drives jump bids) should be different in MBOs versus arm's-length deals.

Instead of drawing inferences from jump rates, then, I examine the four instances of deal jumping to identify the conditions under which the playing field is more level, and jump bids can occur. I examine SST and Quest Software in section II.B below, and EGL and RAE Systems in section II.C.

A. Information Asymmetries

It is well understood that MBO processes present an information-asymmetry problem because management knows more about the company than any third-party bidder. A *Barron's* commentary applied this commonsensical principle to assess the Dell deal when rumors began to float in February 2013:

164 *Id.* at 745.

165 Coates & Subramanian, *supra* note 162, at 315 (reporting 6% jump rate).

166 Matthew D. Cain & Steven M. Davidoff, *Form over Substance? The Value of Corporate Process and Management Buy-Outs*, 36 DEL. J. CORP. L. 849, 886 (2011) (reporting 12.8% jump rate).

> If a fine company like Dell . . . suffers reverses in its stock price and earnings because of how the market views the future of computing and connecting, we outside stockholders can buy a few shares of stock, just sit there, fingers crossed, and hope for better days. But if you are Michael Dell or Dell's top managers or its investment bankers, you are in an entirely different position from the outside investors, even very large outside investors. You are actually in a position to know in detail what Dell is worth, as a whole and segment by segment. You know how changes will move earnings and how much a breakup and sale will yield, compared with the stock valuation at any given time. You can buy the whole company. That way, you can arbitrage the value of the company — what you know to be its real value or, at any rate, its likely value — against the stock price, and make some real money.[167]

The consequence of information asymmetries is the well-known winner's curse problem: if a third-party bidder wins the auction, it knows that it has paid more than the "smart money" (that is, management), in which case it has likely overpaid; and if the third party bids and loses, it has spent time and money with nothing to show for its efforts. As one commentator puts it: "Just as Person B would not want to bid against Person A for the content[s] of Person A's wallet, no financial buyer would want to bid against a financial buyer working with management."[168]

This sentiment is particularly true if management gets a "match right" as part of the merger agreement, which gives management and its PE partner the right to match any competing bid.[169] In the absence of a match right, a third-party bidder might make a bid with a "short fuse" that cannot be shopped back to management.[170] But with a match right, there is no pathway to success for a third-party bidder that does not involve management explicitly declining to make an overbid.

In *Negotiauctions*, I provide implications of the winner's curse problem for bidding strategy:

> [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

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[167] Ben Stein, *Dell Deal: The Same as Insider Trading*, BARRON'S (Feb. 16, 2013), http://www.barrons.com/articles/SB50001424052748704852604578298250396496498 [https://perma.cc/CA73-YGAL].

[168] Denton, *supra* note 160, at 1546.

[169] *See* Subramanian, *supra* note 159, at 735.

[170] *Cf.* SUBRAMANIAN, *supra* note 156, at 129 (giving an example of CBS providing a "short fuse" offer to Paramount so that the studio could not turn to its original offerer, NBC).

value better than anyone else can. . . . [But without an edge,] winner's curse concerns apply in full force.[171]

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

The Dell MBO illustrates these points. Michael Dell is one of the creators of the personal computer industry. He is the founder of Dell and had been the CEO for nearly thirty years before the MBO offer in 2013.[172] That he would have an informational advantage about the future of the personal computer industry and Dell is self-evident. Any winning bidder against Michael Dell would face a serious risk of succumbing to the winner's curse problem. Third-party bidders, foreseeing this dilemma, would rationally be deterred from bidding, absent significant synergies or other private sources of value that would outweigh Dell's informational advantage.[173]

The general phenomenon of information asymmetries in MBOs is well understood and well accepted among M&A practitioners. I now discuss two aspects of transactional practice that are less well developed, but that have the potential to amplify information asymmetries in important ways.

1. Differential Access to Management. — In the modern M&A marketplace, most MBO processes (and M&A deals in general) make use of an electronic data room, through which all bidders get access to the same hard information once they have signed a confidentiality agreement.[174] However, the inside bidder will invariably get a more subjective assessment on the numbers from management than outside bidders will have. This "gloss" and "color" is typically vital to understanding the true financial health of the company. Preferential access is likely not only because the inside PE firm is the preferred partner for management, but also because management may have financial in-

[171] *Id.* at 87–88.

[172] *See Our History*, *supra* note 7.

[173] Blackstone might have been the least susceptible to the information asymmetry problem because of David Johnson — a Blackstone Managing Director who had left Dell as head of M&A just weeks earlier. However, press reports make clear that even Blackstone wanted Michael Dell to stay on as CEO, suggesting that there was still a "special sauce" that he added that David Johnson could not. *See* Matt Wirz & Sharon Terlep, *Blackstone Is Open to Keeping Michael Dell as CEO*, WALL STREET J. (Mar. 27, 2013, 8:56 PM), http://www.wsj.com/articles/SB10001424127887323501004578386593802808294 [https://perma.cc/YY3W-TQMX].

[174] An important exception exists for strategic buyers, which may get limited access to the data room due to confidentiality concerns.

centives to discourage third-party bidders.[175] In this situation, management will have reasons to downplay future performance to third-party bidders, which will deter third parties or at least cause them to bid less.

In theory, this problem of differential and/or biased access to management can be mitigated through contractual commitments. In the J.Crew MBO, for example, CEO Millard ("Mickey") Drexler's Cooperation Agreement required:

> [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.[176]

As is apparent from the plain language, it would be virtually impossible to detect any breach beyond the bright-line requirements; therefore enforceability becomes difficult. It is also important to note that the Drexler Cooperation Agreement is more demanding than those in most MBOs. In the Laureate Education MBO, for example, CEO Douglas L. Becker was merely required to "continue to perform his management functions consistent in all material respects with past practice" during the go-shop phase.[177]

A soft or nonexistent cooperation agreement can fuel information asymmetry concerns among prospective bidders. In the Laureate MBO, for example, a hypothetical winning bidder would logically assume that Becker provided certain color to KKR (his PE partner) on data room items, which caused KKR to drop out of the bidding. This qualitative difference would fuel the winner's curse concerns.

Even if management wished to give the same degree of access to third-party bidders, this is typically not feasible because of the large head start that inside bidders often have against prospective third parties. In the Dell MBO, Silver Lake had access to the data room in early September 2012, while the go-shop bidders did not gain access until February 2013.[178] By the time the go-shop period expired on March

[175] *See infra* section II.C, pp. 624–29.

[176] J.Crew Grp., Definitive Proxy Statement (Schedule 14A), at 91 (Jan. 25, 2011).

[177] Douglas L. Becker et al., General Statement of Acquisition of Beneficial Ownership (Schedule 13D) Ex. 7.15, § 1.2 (Mar. 26, 2007).

[178] *See* Dell Inc., *supra* note 21, at 22, 43; Stephen Grocer, *Timeline: The Battle for Dell*, WALL STREET J. (Mar. 29, 2013, 6:06 PM), http://blogs.wsj.com/deals/2013/03/29/timeline-the-battle-for-dell [https://perma.cc/4GZN-FKL6] (noting the respective times at which Blackstone and Silver Lake were involved in the Dell MBO).

23, Blackstone had had access to the data room for one month, compared to nearly seven months for Silver Lake.[179] A March 30 Evercore email reminded certain Dell employees: "[W]e all have to be mindful that Blackstone is looking to accomplish in 4–6 weeks what [Silver Lake] had six months to do, with the full support and insight of the CEO and founder behind them."[180]

Not only does the inside bidder have a head start, but it also has exclusivity with management until the time that management decides to inform the board. In contrast, during the pre-signing phase, management may have to divide its time between the inside bidder and other PE firms. And post-signing, to the extent that the deal is subject to a go-shop, management will need to divide its time among all the bidders that sign confidentiality agreements.

2. Possibility of Opportunistic Behavior. — In my research on freezeout transactions, I observed that a controlling shareholder can maximize the effect of information asymmetries by executing the freezeout at a time "when it perceives that the market price of the target stock is lower than its intrinsic value."[181] A controlling shareholder 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 judgment rule, particularly if there were some plausible basis for the delay (e.g., reduced risk due to the delay).[182]

The same concern exists in MBOs: management can initiate an MBO when the information asymmetry between insiders and outsiders is the largest and/or manipulate the market price that sets the baseline for the deal price.[183] Consider the MBO of Dole Food Com-

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[179] *See* Dell Inc., *supra* note 21, at 22, 43.

[180] Subramanian, *supra* note 76, at 8 (quoting Email from Naveen Nataraj, Senior Managing Dir., Evercore, to Certain Dell Employees (Mar. 30, 2013) (on file with author)).

[181] Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 32 (2005). 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.

[182] *Id.* at 33.

[183] The combination of information asymmetries and opportunistic timing also highlights why simple analysis of deal premiums in MBOs versus third-party deals is not appropriate. For ex-

pany.[184] Without telling the board, CEO C. Michael Carter cancelled a stock repurchase program on May 28, 2013, which caused the Dole stock price to drop by 10%.[185] Two weeks later, on June 10, Carter and 40% shareholder David Murdock made a buyout proposal to the board at $12.00, which represented an 18% premium over the most recent $10.20 per share price, but only an 8% premium over the stock price the day before the stock repurchase program was cancelled.[186] Carter and Murdock eventually raised their price to $13.50 per share, which the Dole board approved, though their approval relied on Carter's claim of $20 million in cost savings when the real number was $50 million.[187] Two years later, in August 2015, the Delaware Chancery Court found that Murdock's and Carter's deceptive actions had cost the Dole shareholders at least $2.74 per share, or 20% of the deal price, amounting to $148 million in total damages.[188] In a sharply worded opinion, Vice Chancellor Laster observed that "[a]cademic research has found a correlation between management-led buyouts and lowered guidance, increased reserves, and other measures that reduce the apparent performance of a company during periods before the announcement of the buyout,"[189] and further noted that the Dole MBO itself "provides a real-world example of this phenomenon."[190]

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ample, some commentators have defended MBO pricing on the grounds that deal premiums are statistically indistinguishable between leveraged buyouts (LBOs) and MBOs. This analysis misses the point that management can time its offer when intrinsic value is higher than current market price, while third-party bidders have no such informational advantage. Therefore, even if premiums in MBOs and LBOs are the same, it is possible (if not likely) that management pays lower premiums over intrinsic value than third-party buyers. The point is not that opportunistic timing exists in all MBOs, but simply that one implication of opportunistic timing is that simple premium analysis is unable to meaningfully assess the quality of outcomes for noncontinuing shareholders.

184 This deal is not included in the MBO Sample because David Murdock was a controlling shareholder in Dole.

185 *In re* Dole Food Co. Stockholder Litig., No. 8703, 2015 WL 5052214, at *13–14 (Del. Ch. Aug. 27, 2015).

186 *See id.* at *15.

187 *Id.* at *18, *23.

188 *See id.* at *2. The parties eventually settled the case for $114 million. *See* Broc Romanek, *Just as Dole CEO, Execs Agree to Pay $114m in Delaware Settlement, Federal Class Action Filed*, DEALLAWYERS.COM (Dec. 14, 2015), http://www.deallawyers.com/blog/2015/12/just-as-dole-ceo-execs-pay-114m-in-delaware-settlement-federal-class-action-filed.html [https://perma.cc/3TNH-HKQ8].

189 *In re Dole Food*, 2015 WL 5052214, at *26 n.13. Vice Chancellor Laster cited a long string of sources in support of this proposition. *See id.*

190 *Id.*; *see In re* Emerging Commc'ns Inc. S'holder Litig., No. 16415, 2004 WL 1305745, at *32 (Del. Ch. May 3, 2004) ("Because ECM's stock price was depressed, [Chairman & CEO Jeffrey] Prosser abandoned that proposal at the eleventh hour and 'flipped' the deal for his sole personal benefit to take advantage of the temporarily and artificially depressed stock price. That stock price then became the 'floor' for the equally depressed and unfair Privatization price . . . ."); Sealy Mattress Co. of N.J. v. Sealy, Inc., 532 A.2d 1324, 1336 (Del. Ch. 1987) (finding that the defen-

To summarize, while even "plain vanilla" information asymmetries create an unlevel playing field between the inside bidder and prospective third-party bidders, these information asymmetries can be amplified by the practical realities of differential access to management and the possibility of opportunistic behavior. The resulting unlevel playing field creates impediments to a prospective third-party bid, and (by implication) weakens the usefulness of a market check for effective price discovery in an MBO process.

B. Valuable Management

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 management).

MBOs are often initiated by valuable management. The Dell MBO provides a rare opportunity to quantify this value, due to the natural experiment of Michael Dell leaving and then rejoining Dell in 2004 and 2007 respectively. In both instances, the announcements were surprises to the marketplace, making them relatively clean for event study analysis.[191] When Dell announced that he would be giving up the CEO role on March 4, 2004, the company's market capitalization declined by approximately $1.2 billion.[192] This market reaction occurred despite the fact that 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 Dell's return as CEO was announced on January 31, 2007, the company's market capitalization increased by approximately $2.5 billion.[193]

The private value created by valuable management changes third-party bidding strategy in an important way. In a common-value auc-

dants engaged in a "calculated effort to depress the price of Sealy until the minority stockholders were eliminated by merger or some other form of acquisition").

[191] For an example of event study analysis, see Bo Becker, Daniel Bergstresser & Guhan Subramanian, *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable's Challenge*, 56 J.L. & ECON. 127 (2013).

[192] *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *43 (Del. Ch. May 31, 2016).

[193] *Id.* The Delaware Chancery Court accepted these analyses as a rough approximation of the valuable-management problem in the Dell MBO. *See id.* The court continued that "Mr. Dell's relationships with customers may have been one of the sources of his value," citing evidence from contemporaneous sources. *See id.* at *43 n.42.

tion, bidders' signals are "affiliated,"[194] 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 to me:

> 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 was 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 have all the confidential information, I know I can bid a nickel more and still have a good deal." And he was absolutely right.[195]

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).

In contrast, when management is a critical ingredient for the ongoing success of the company, a market canvass 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. Third-party bidders cannot simply "bid a nickel more" because they don't necessarily have access to the same valuable management.[196]

Information asymmetries and valuable management are two distinct causes of third-party bidder deterrence — one can exist without the other. Consider information asymmetry but nonvaluable management: management knows better than outsiders what the company is worth, but management does not add private value itself. Or consider

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[194] *See* Paul R. Milgrom & Robert J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 ECONOMETRICA 1089, 1096 (1982) (identifying implications of affiliated signals for deal process design).

[195] Guhan Subramanian, *The Drivers of Market Efficiency in* Revlon *Transactions*, 28 J. CORP. L. 691, 700 (2003) (quoting Interview with Stephen Fraidin, Partner, Fried, Frank, Harris, Shriver & Jacobson, in New York, NY (June 15, 2000)).

[196] *See, e.g.*, Adam Shell & Matt Krantz, *HCA Agrees to Be Bought Out for $20.8 Billion*, USA TODAY (July 25, 2006, 3:31 AM), http://usatoday30.usatoday.com/money/industries/health/2006-07-24-hca_x.htm [https://perma.cc/CP8L-9TAN] ("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.").

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.

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 significant wedge between the insider bidder and third-party bidders.[197]

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 market canvass in an MBO process. Management does not have an obligation to work with third-party bidders, but when management chooses not to do so (either implicitly or explicitly), and when management is valuable, a market canvass process is no longer a useful mechanism for price discovery. The general point is that valuable management converts a common-value situation into a private-value situation, fuels information-asymmetry problems, and creates an unlevel playing field between the inside bidder and potential third-party bidders.

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[197] Directors might extract some or all of this wedge through their own compensation arrangements with their PE partner. Assuming that any prospective third-party buyer would simply match these compensation arrangements, the valuable-management problem would become smaller, and the auction would become closer to a common-value auction, because management would have taken some fraction of its own value "off the table." However, the magnitude of the valuable-management problem makes it unlikely that the full surplus could be extracted through standard compensation arrangements (that is, salary and bonus). Recall for example the estimates of $1.2–$2.5 billion in the case of Michael Dell. As a practical matter, in any deal where the valuable-management problem was nontrivial, management would have to extract its value through a higher price for its equity on the sell-side, or a lower price on the buy-side. The former strategy would raise significant fiduciary duty concerns, *cf. In re* Delphi Fin. Grp. S'holder Litig., No. 7144, 2012 WL 729232, at *17 (Del. Ch. Mar. 6, 2012) (finding that plaintiffs were "reasonably likely to be able to demonstrate at trial that in negotiating for disparate consideration and only agreeing to support the merger if he received it, Rosenkranz [the CEO] violated duties to the stockholders"), and neither strategy finds any precedent in the MBO Sample. In fact, positive valuable management might leave some of its value on the table precisely in order to create a wedge that protects the deal, which then improves the long-term profitability of the deal for management. Even if management did negotiate for some substantial fraction of the surplus that it added, management could not extract from the deal the "negative surplus" that would arise among rank-and-file employees if valuable management left the company due to a third-party overbid. (Consider for example the value loss to Dell Inc. if Michael Dell left the company due to an overbid.) This negative surplus puts another wedge between the inside bidder and prospective outside bidders, in ways that are analytically identical to the positive surplus created by valuable management. I thank Professor Louis Kaplow for helpful conversations on this point.

When management is not valuable, the other three sources of bidder deterrence in 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 (discussed in section II.D below), because there is no need for time-consuming due diligence as soon as the inside bid is revealed. Therefore, third-party bids in MBO processes are most likely when the private value added by management is small or nonexistent.

To illustrate this last point, consider the MBO of Silicon Storage Technology (SST). CEO Bing Yeh and COO Yaw Wen Hu partnered with Prophet Equity to offer $2.10 per share for the company, or $201 million in total value, on November 13, 2009.[198] Yeh held 11.3% of the shares and Hu held 1.4% of the shares at the time of the deal,[199] and both were expected to roll over their stakes into the new company.[200] Analysts commented on the low price (amounting to a 13% premium over the announcement-day share price),[201] and the stock closed that same day at 7% above the offer price.[202] One SST director (Bryant Riley) voted against the proposed MBO and then resigned from the board.[203] The deal included a forty-five-day go-shop period to look for a higher bidder.[204]

On February 3, Microchip Technology offered $2.85 per share.[205] After a bidding contest with Cerberus,[206] 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.[207]

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198 Josh Beckerman, *$2.10 a Share Is Only a Memory for Silicon Storage*, WALL STREET J. (Mar. 8, 2010, 9:16 PM), http://blogs.wsj.com/privateequity/2010/03/08/213-a-share-is-only-a-memory-for-silicon-storage [https://perma.cc/9WQS-VCE9].

199 Complaint for Breach of Fiduciary Duties at 2–3, Fisher v. Silicon Storage Tech., Inc., No. 109CV157444 (Cal. Super. Ct. Nov. 16, 2009), 2009 WL 3869623.

200 Beckerman, *supra* note 198.

201 *Id.*; *see, e.g.*, Brenon Daly, *A Management Buy-Under at Silicon Storage Technology?*, INORGANIC GROWTH (Nov. 18, 2009), https://blogs.the451group.com/techdeals/semiconductors/a-management-buy-under-at-silicon-storage-technology [https://perma.cc/2CYY-YKUQ].

202 *See* Beckerman, *supra* note 198 (noting that the stock closed at $2.24 per share after the announcement).

203 Daly, *supra* note 201.

204 Beckerman, *supra* note 198.

205 *Id.*

206 *Id.*

207 *Microchip Tech Sews Up Silicon Storage Deal*, N.Y. TIMES: DEALBOOK (Apr. 9, 2010, 5:18 AM), http://dealbook.nytimes.com/2010/04/09/microchip-tech-sews-up-silicon-storage-deal [https://perma.cc/E3S8-6U5Q].

Yeh left SST at the closing,[208] suggesting that Microchip did not view him as essential for the ongoing enterprise.

Similarly, 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.[209] Smith owned approximately 34% of the company, which gave him a substantial leg-up in the sixty-day go-shop process.[210] None other than Dell Inc. nevertheless made a superior proposal at $25.50 per share.[211] If 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; (2) a breakup fee of 2.0% of the transaction value if shareholders voted down the deal (that is, a "naked no vote" termination fee); and (3) a 3.5% breakup fee if the Dell offer were subsequently trumped.[212] After a prolonged bidding contest, Dell won with an offer of $28.00 per share.[213] The deal closed in July 2012, and Smith (like Yeh) left the company shortly thereafter.[214]

In both SST and Quest, I infer that management was not essential to the ongoing enterprise from the fact that both CEOs left shortly after the deal closed. This feature has important implications for bidder deterrence: as noted above, when the private value of management is small or nonexistent, third-party bidders can effectively free ride off inside bids, which mitigates the information-asymmetry problem and the ticking-clock problem.

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[208] *See* Letter from Bing Yeh, CEO, Greenliant Systems, to Valued Customers and Partners (May 24, 2010), http://www.greenliant.com/dotAsset/43008.pdf [https://perma.cc/D2Z9-8HRM] (announcing his departure from SST to start Greenliant Systems). Hu also left SST shortly after the deal closed. *See* Press Release, Inotera Memories, Inc., Inotera Announces Change in Executive Management Team: Dr. Yaw Wen Hu Appointed as Senior Vice President (Aug. 30, 2010), http://www.inotera.com/NR/rdonlyres/BBB98D92-E896-452D-AE16-06766C21D462/690/20100830ChangeinExecutiveManagementTeam.pdf [https://perma.cc/8264-WBKQ].

[209] Steven Davidoff Solomon, *Novel Maneuvers in Battle for Quest Software*, N.Y. TIMES: DEALBOOK (June 21, 2012, 2:06 PM), http://dealbook.nytimes.com/2012/06/21/novel-maneuvers-in-battle-for-quest-software [https://perma.cc/KLT5-ATTC].

[210] *See id.*

[211] Press Release, Quest Software, Quest Software Announces Receipt of Superior Proposal, BUS. WIRE (June 14, 2012, 8:29 AM), http://www.businesswire.com/news/home/20120614005739/en/Quest-Software-Announces-Receipt-Superior-Proposal [https://perma.cc/3VY2-VREF]; *see also* Julie Bort, *Here's Why Dell Went Overboard and Spent $2.4 Billion to Nab Quest Software*, BUS. INSIDER (July 2, 2012, 12:12 PM), http://www.businessinsider.com/heres-why-dell-went-overboard-and-spent-24-billion-to-nab-quest-software-2012-7 [https://perma.cc/3YKC-JU8T] ("Dell and Quest Software officially revealed what the world already knew: that Dell was in a bidding war against a band of private equity firms to buy Quest Software.").

[212] *See* Press Release, Quest Software, *supra* note 211.

[213] *See* Bort, *supra* note 211.

[214] Chris Casacchia, *Dell Confirms Quest Software CEO's Departure*, ORANGE COUNTY BUS. J. (Dec. 14, 2012), http://www.ocbj.com/news/2012/dec/14/dell-confirms-quest-software-ceos-departure [https://perma.cc/HX9N-2MV4].

C. Management Financial Incentives to Discourage Overbids

In the more common situation where management is valuable, a natural way for a third-party bidder to mitigate the private value problem described in the prior section 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.

A CEO is 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.

Assessing the direction of a conflict of interest in the corporate context typically involves calculating the percentage ownership for the conflicted party on the buy-side and sell-side. In the case of Commonwealth REIT, for example, observers noted that the father-and-son team of Adam and Barry Partnoy owned 100% of Reit Management & Research (RMR) but only 0.8% of Commonwealth REIT; therefore they had financial incentives to engineer transactions between RMR and Commonwealth that favored RMR.[215] In the case of Satyam, commentators observed after the fact that Satyam Chairman Ramalinga Raju and Managing Director Rama Raju owned approximately 35% of Maytas Properties ("Satyam" spelled backwards) and Maytas Infrastructure, but only about 9% of Satyam; therefore they would have incentives to construct deals that favored Maytas over Satyam.[216]

The MBO context is different because of the leverage that is typically introduced on the buy-side of the transaction. Consider a stylized example, in which an all-equity public company has a value of $100 and 100 shares outstanding. Management owns 20% of the shares, worth $20. In the MBO, management will roll over five shares to the

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[215] *See, e.g.*, *CommonWealth Can Make Us Commoners Wealthy*, SEEKING ALPHA (Feb. 26, 2013), http://seekingalpha.com/article/1228401-commonwealth-can-make-us-commoners-wealthy [https://perma.cc/UF3J-QGCS] ("The management and board members for Commonwealth own only 0.8% of the outstanding shares of CommonWealth, but own 100% of RMR. The estimate by Corvex/Related that [Commonwealth REIT] has paid out $209 million of management fees to RMR — during a period in which [Commonwealth REIT's] market cap has declined by $647 million — draws this relationship into question.").

[216] Rumman Ahmed, *Satyam Says Its Founders' Stake Is at Risk*, WALL STREET J. (Dec. 30, 2008, 12:01 AM), http://www.wsj.com/articles/SB123055977029539303 [https://perma.cc/Q69H-FSBN].

new entity; its PE partner will supply $5 of capital for another five shares; and debt financing will replace the remaining ninety shares. In this transaction management owns 20% of the equity on the sell-side (twenty out of one hundred shares) and 50% on the buy-side (five out of ten shares), yet it still favors a higher price in the MBO because it is selling fifteen out of its twenty shares into the deal. If a 10% overbid comes in with the same leverage on the buy-side, management will sell its fifteen shares for $16.50 rather than $15, and still roll over five shares for 50% of the equity. As long as management is a net seller in the MBO, it will favor a higher price even if its percentage interest on the buy-side is greater than its percentage interest on the sell-side.[217] Conversely, if management is a net buyer — for example, rolling over 100% of its equity and injecting additional cash — then it prefers a lower price in the MBO.

This analysis has implications for the CEO's receptivity to engaging 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, in order to maximize the price paid to exiting shareholders, 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.

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. Recognizing this problem, third parties in net-buyer situations will rationally be deterred from bidding. The magnitude of the deterrence will depend on the magnitude of the private value that the CEO and management bring to the table, as well as the magnitude of the CEO's financial incentive on the buy-side of the transaction.

To see what can happen instead when management is the net seller, consider the MBO of RAE Systems, announced in September 2010. The initial deal with Battery Ventures had management selling $29.2 million of shares and buying $21.4 million of shares; therefore, management was the net seller. The $1.60 per share deal price, representing a $95 million total transaction value,[218] was trumped by a $1.75

[217] This interest in pushing the price up is of course constrained by management's PE partner, who is unambiguously a buyer and therefore wants to push the price down.

[218] *RAE Systems to Sell Itself for $95 Mln*, REUTERS (Sept. 20, 2010, 8:53 AM), http://www.reuters.com/article/raesystems-idUSSGE68J0IR20100920 [https://perma.cc/92YG-T8UC].

per share offer from Vector Capital/CITIC Capital Partners.[219] Robert Chen, cofounder and CEO of RAE Systems, abandoned Battery Ventures, as he was contractually permitted to do, and agreed to partner with Vector/CITIC in its overbid. In the press release announcing the new deal, he stated:

> We are delighted to be working with Vector Capital. The founding team felt strongly that Vector was by far the best partner for RAE. . . . We believe Vector and CITIC Capital Partners have the global capabilities, technology expertise and financial resources that will further our shared long-term vision and to further expand the worldwide customer base for our products.[220]

Ordinarily this kind of commentary would have to be taken with a grain of salt, but in this situation Chen's new partner had made Chen and his management team more money with its overbid because management were net sellers. Anticipating this, Vector/CITIC could feel comfortable making an overbid. In April 2013, less than three years later, the company was sold to Honeywell for $340 million in cash, more than three and a half times the original offer price from management.[221]

The net-buyer/net-seller distinction has not been identified by commentators to date, yet it is vitally important for determining the incentives of a pivotal party — indeed often the "kingmaker" — in an MBO transaction. To make the point tangible, consider again the Dell MBO. The Dell–Silver Lake offer planned for Michael Dell to roll over his entire 16% equity stake into the new company;[222] in addition he would contribute $750 million of new equity.[223] Therefore, he would be a net buyer of shares, which means he would have a financial incentive to push the deal price down rather than up. Any third-party overbid that was similarly structured to include Dell as a net buyer would cost him 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 Michael Dell even more money.

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[219] *RAE Systems Announces Agreement to Be Acquired by Vector Capital for $1.75 per Share in Cash*, MKT. WIRED, (Jan. 18, 2011, 2:49 PM), http://www.marketwired.com/press-release/rae-systems-announces-agreement-be-acquired-vector-capital-175-per-share-cash-nyse-sai-1381879.htm [https://perma.cc/L93V-4GLX].

[220] Vector Capital, *Vector Capital Completes Acquisition of RAE Systems, Inc.*, PR NEWSWIRE (June 16, 2011, 6:10 PM), http://www.prnewswire.com/news-releases/vector-capital-completes-acquisition-of-rae-systems-inc-124034944.html [https://perma.cc/E4EA-AMRH].

[221] *RAE Systems, a Vector Capital Portfolio Company, Enters into Agreement to Be Acquired by Honeywell*, RAE SYSTEMS BY HONEYWELL (Apr. 23, 2013), http://www.raesystems.com/news-events/press-room/rae-systems-vector-capital-portfolio-company-enters-agreement-be-acquired [https://perma.cc/8WL4-D86Z].

[222] *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *43 (Del. Ch. May 31, 2016).

[223] *Id.*

Some numbers highlight the magnitude of the problem. If an overbid increased the debt and equity in proportion with the deal price, keeping all else equal, each dollar increase in the deal price would cost Michael Dell an additional $263 million.[224] If instead an overbid were funded entirely with equity (perhaps because the deal already used the maximum feasible debt), each dollar increase in the deal price would cost Michael Dell an additional $1.1 billion.[225] If instead Michael Dell kept his equity commitment the same and the PE firm contributed the additional equity, he would lose voting control at any deal price above $15.73.[226] For example, at a $20 per share deal price, he would own 28% of the post-MBO company. These examples illustrate that regardless of what lever was pulled, any overbid structured similarly to the Dell–Silver Lake offer (that is, with Michael Dell as a net buyer of shares) could only cost him more. Foreseeing all of this, third-party bidders considering an overbid would understand that Michael Dell would be a reluctant partner in their bid.

Of course, a third party could structure its bid to make Dell a net seller rather than a net buyer. In this scenario, 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. But such a structure would go against Michael Dell's revealed interest — maybe his key interest — to increase (not decrease) his ownership of Dell.[227]

The straightforward analysis of Dell's financial incentives illustrates the catch-22 when management is a net buyer: 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 him free shares in the post-MBO company — but this of course would reduce the PE firm's returns from the deal.

To assess the magnitude of the net buyer problem, I examined each deal in the MBO Sample to determine whether management was a net seller or a net buyer. Out of the forty-four deals in the MBO Sample, I found that management was a net buyer in seven deals (including Dell), and management was a net seller in thirty-one deals. In

[224] Guhan Subramanian, Dell Sensitivity Analysis Model (on file with the Harvard Law School Library).

[225] *Id.*

[226] *Id.*

[227] *See* Dell Inc., *supra* note 21, at 40 ("Representatives of Wachtell Lipton [Mr. Dell's counsel] and Simpson Thacher [Silver Lake's counsel] subsequently confirmed to representative[s] 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.").

three deals, management was neutral — selling exactly as much as it bought — invariably because management was rolling over 100% of its equity but injecting no further capital. These deals are analytically similar to deals in which management is a net buyer, because any overbid would require greater leverage, which would then reduce management's post-MBO returns. Across these forty-one deals, the mean (median) sell-side stake in the MBO Sample is $428.2 million ($62.9 million) and the mean (median) buy-side stake is $288.1 million ($30.8 million).[228]

In the 24% of deals (ten out of forty-one) where management was a net buyer or neutral, data on deal premiums indicate some cause for concern. When management was a net buyer or neutral in the MBO Sample, the average final deal premium (calculated as the final deal price over the share price sixty days prior to deal announcement) is 16.8%, compared to 35.1% in the thirty-one deals where management was a net seller. This difference is statistically significant at 90% confidence using a Wilcoxon signed-rank test,[229] and is directionally consistent with the common sense notion that when management is a net buyer the price will be lower than when management is a net seller. The evidence suggests an important difference between (what I call) a management buyout (that is, management is a net seller) and a management buy-in (management is a net buyer).[230]

The mechanism behind this empirical finding can likely be found, at least in part, in the fact that the special committee will inevitably need guidance from management as to the viability of the management projections. When management is a net buyer, they will have incentives to "talk down" the projections, which gives the special committee less ammunition and less backbone to demand price increases. When

[228] In the remaining three deals, there was either insufficient information contained in the proxy statement, or management's buy-side equity stake had not yet been determined at the time of the proxy solicitation.

[229] This test is preferred over a traditional *t*-test when the population cannot be assumed to be normally distributed. In the case of deal premiums, practitioner experience and investment banker data indicate that the distribution is truncated at 0% (since public-company deals rarely get done at less than the market price) and has a long right tail. I thank Fernán Restrepo for this point.

[230] Commentators have proposed various definitions for these terms. Wikipedia defines a "management buy-in" (MBI) as a transaction where "a management team from outside the company raises the necessary finance, buys it, and becomes the company's new management." *Management Buy-in*, WIKIPEDIA (Feb. 17, 2016, 11:46 AM), https://en.wikipedia.org/wiki/Management_buy-in [https://perma.cc/95L5-7LAN]; *see also* Nick Wilson & Mike Wright, *Private Equity, Buy-outs and Insolvency Risk*, 40 J. BUS. FIN. & ACCT. 949, 953 (2013) (defining an MBI as an "MBO where the management team acquiring ownership are outsiders"). Professors Matthew Cain and Steven Davidoff propose instead that MBIs should be defined as "transaction[s] where management is a participant but is not the organizing or controlling party." Cain & Davidoff, *supra* note 166, at 895.

management is a net seller, they will have incentives to "talk up" the projections, which gives the special committee more conviction to push for price increases. While the special committee is likely to recognize the direction of the bias, it would take a brave special committee member to second-guess management's assessment that the projections are a "stretch goal" (if management is a net buyer) or "highly achievable" (if management is a net seller). The empirical evidence supports this conclusion. In fact, a sophisticated PE buyer may want to structure the deal to make management a net buyer precisely in order to fuel these management incentives.

Other causal chains are possible as well. For example, management might decide to become a net buyer in the transaction precisely because the deal price is low. Alternatively, net buyers may be a different kind of management than net sellers. In particular, more valuable management might be more likely to be net buyers, and therefore have more leverage to push the price down, because the private value element in the deal is larger, which in turn creates a larger wedge between inside and outside buyers.

D. The Ticking-Clock Problem in Go-Shop MBOs

The information-asymmetry problem, the valuable-management problem, and management's financial incentives to discourage overbids exist to varying degrees in MBOs. All three of these factors are amplified in go-shop MBOs, compared to standard MBOs, because of the ticking-clock problem.

In the MBO Sample, nearly half (twenty-one out of forty-four) were subject to a go-shop process. The 48% incidence is substantially higher than the approximately 20% incidence for go-shop clauses in PE buyouts overall. There is no obvious explanation for why go-shop incidence should be substantially higher in MBOs than in arm's-length deals. One possible explanation is that special committees are more willing to conduct a pre-signing market-check process against an arm's-length buyer than against an inside buyer.

Among the go-shop deals in the MBO Sample, go-shop periods are generally between thirty and sixty days. The mean (median) number of days to find a third-party bidder was forty-four and a half days (forty-five days). The ticking clock puts a hard stop on the due diligence process, which in turn exacerbates the information-asymmetry problem. Information asymmetries are also fueled by the fact that potential bidders during the go-shop process get management's only partial attention. During the tight timeframe of the go-shop window, management will need to divide their time among the (typically several) bidders that sign confidentiality agreements.

Interestingly, a go-shop is more likely as transaction size increases. The mean (median) go-shop deal in the MBO Sample had a transaction value of $3.3 billion ($983 million), compared to a transaction value of $1.4 billion ($465 million) in traditional no-shop deals. Or put the other way, go-shop incidence was 38% among below-median transactions and 57% among above-median transactions. This breakdown is counterintuitive because transaction size exacerbates the ticking-clock problem, in two ways.

First, size influences the feasibility of a proposal within the go-shop window, for the obvious reason that larger companies are more difficult to understand, involve more risk, and require more due diligence. Evidence from Blackstone's due diligence process in the Dell MBO illustrates how tight even a forty-five-day window can be. On April 4, 2013, ten days after the go-shop period had expired, a news report cited sources saying that Blackstone's due diligence process was "still in the early stages," and Blackstone was "just starting to put together a business plan."[231] That Blackstone was "still in the early stages" ten 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 forty-five days that the Dell go-shop window provided. Third parties, foreseeing all this, would rationally be deterred from starting in the first place.[232]

Second, larger deals influence the feasibility of assembling a consortium bid, which is often essential in a larger deal — either due to diversification requirements of the PE fund or financing constraints, or just to share the risk of such a massive investment. Among the ten going-privates larger than $15 billion, six involved consortium bidders.[233] 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 months, putting aside the time it would take for due diligence on the actual target company. As an illustration of this point, not a single jump bid in the

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[231] Nadia Damouni & Poornima Gupta, *DEALTALK–Blackstone Heading to Texas to Firm Up Dell Strategy*, REUTERS (Apr. 5, 2013, 3:24 PM), http://www.reuters.com/article/dell-blackstone-idUSL2N0CR0Y920130405 [https://perma.cc/D2U4-MVVZ].

[232] *See* Steven Davidoff Solomon, *Flawed Bidding Process Leaves Dell at a Loss*, N.Y. TIMES: DEALBOOK (Apr. 23, 2013, 7:30 PM), http://dealbook.nytimes.com/2013/04/23/a-flawed-bidding-process-leaves-dell-at-a-loss [https://perma.cc/4VCP-UJG3] ("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 war. A go-shop becomes just a cover-up for a pre-chosen deal.").

[233] The six were: 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); and ALLTEL (TPG, Goldman Sachs). The four going-privates larger than $15 billion that did not involve a consortium buyer were: Dell (Silver Lake); Hilton Hotels (Blackstone); First Data Corp. (KKR); and Equity Office Properties (Blackstone).

MBO Sample came in the form of a consortium bid.[234] This (non)finding highlights the enormous difficulty of arranging a consortium bid when a go-shop clock is ticking.

III. EFFECTIVE DEAL PROCESS DESIGN

Part III of this Article provided a taxonomy of four factors that can create an unlevel playing field in MBOs. The implication is that practitioners should not assume that a standard market-check process will ensure that fair value is paid to noncontinuing shareholders in an MBO. Instead, more potent devices are needed. This Part identifies deal process design solutions to fix the unlevel-playing-field problem in MBOs.

A. Board Control

The first and perhaps most important procedural point is that the board — not management — should run the process. While this principle is straightforward in theory, it is in tension with the practical reality that management is typically central to the transaction — they represent a source of value for the PE firm, and management has financial incentives to initiate an MBO. One approach would be to prohibit management from discussing their own employment, compensation, and equity arrangements with PE firms until the board has picked the buyer.[235] But there are two problems with this categorical approach. The first is one of enforcement: a bright-line rule would prevent formal employment agreements between the buyout group and managers, but it could not prevent implicit understandings, or private conversations, that inevitably would result during the due diligence process. A second problem arises on the buy side: if managers are essential to the deal, the PE firm may be unwilling to proceed if the sell-

[234] The closest to a consortium jump bid among the go-shop companies in the MBO Sample occurred when Microsoft successfully jumped Quadrangle's agreement to buy media-services company Greenfield Online (Greenfield). In October 2007, ZM Capital (ZM) 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 one press report, "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), https://www.pehub.com/2008/09/kind-of-a-big-deal-2 [https://perma.cc/HK3X-QD9S].

[235] *See, e.g.*, Catalina Mktg. Corp., Definitive Proxy Statement (Schedule 14A), at 28 (July 9, 2007) ("Mr. Buell [Catalina CEO] advised H&F [PE firm Hellman & Friedman] that he believed H&F's proposal for a 15% option pool was reasonable and consistent with that contemplated by other bids received by Catalina, but no agreement was reached at that time, and Mr. Buell agreed that the terms of management's employment, compensation, and equity arrangements would be negotiated following the execution of any definitive agreement.").

er cannot "deliver" management (in the form of signed employment agreements) at the closing. Management too might look for alternatives outside the company, or might not be as cooperative as they should be in the process, if they are not guaranteed employment in the continuing enterprise. The irony, then, of prohibiting employment agreements in MBOs is that PE firms will pay a lower price because management has left or might leave — precisely the opposite of the intended objective of such a rule.

A better way to operationalize the principle that the board runs the process is through contractual provisions with management well before any MBO process begins. Top managers should agree, as part of their employment agreement, to gain permission from the board before initiating any discussions with PE firms about possible MBO transactions,[236] and to promptly bring any inbound indications of interest from PE firms to the board.[237] In addition, top management should contractually agree not to give confidential information to any PE firms until and unless the PE firm signs a confidentiality agreement with the board. This mechanism would create incentives for management to go to the board early because only then will their PE partner receive confidential information.[238]

To see the potential bite of such agreements, consider the J.Crew buyout, in which CEO Mickey Drexler and PE firm Texas Pacific Group (TPG) had no incentive to inform the J.Crew board early because TPG was receiving confidential information as early as September 15, 2010 — three weeks before the board was informed (on October 7, 2010), and two months before TPG signed a confidentiality agreement with the company (on November 16, 2010).[239] Or consider the buyout of NTS, Inc., in which CEO Guy Nissenson spoke with PE

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[236] For a counterexample, see Station Casinos Inc., Definitive Proxy Statement (Schedule 14A), at 17 (July 9, 2007) ("At that [board] meeting, Frank J. Fertitta III and Lorenzo J. Fertitta informed the board that they desired to explore the possibility of a going-private transaction with respect to Station."). In fact, the Fertittas had approached a "prominent real estate development firm" as a potential buyout partner one month before asking permission from the board to do so. *Id.*

[237] *See, e.g.*, Penn Nat'l Gaming, Inc., Definitive Proxy Statement (Schedule 14A), at 25 (Nov. 7, 2007) ("[R]epresentatives of several private equity firms . . . separately contacted Peter M. Carlino, Chairman and Chief Executive Officer of Penn National, to inquire whether the Company would be willing to consider a potential negotiated acquisition. Mr. Carlino reported these inquiries to Penn National's directors . . . .").

[238] A contractual commitment in the employment agreement would also prevent management from having discussions with PE firms solely in their capacity as shareholders. *See, e.g.*, 99 Cents Only Stores, Definitive Proxy Statement (Schedule 14A), at 20 (Dec. 12, 2011) (reporting that conversations between management and a PE firm, Leonard Green & Partners (LGP), prior to informing the board were "exploratory only and were initiated by the Gold/Schiffer family in their capacity as shareholders").

[239] *See* J.Crew Grp., *supra* note 176, at 23–30.

firm Tower Three Partners regarding a potential transaction on March 14, 2013, entered into a confidentiality agreement on April 10, discussed his position and equity rollover in late July, but told the board only on August 6 — nearly five months after the initial discussions about an MBO.[240] Both J.Crew and NTS were "trains that had left the station" well before the board was informed. Both deals were facilitated by the fact that management was not contractually obligated to go to the board in order to have discussions about a possible MBO or to give its PE partner confidential information.

In contrast, consider the Seitel MBO. PE firm ValueAct Capital signed a confidentiality agreement during the week of April 17, 2006, but did not gain access to management to discuss retention until six months later.[241] According to the proxy statement, the Special Committee kept a tight hand on the wheel:

> William Blair [the special committee's investment bankers] reported that ValueAct Capital had again requested to begin discussions with certain Seitel management personnel. William Blair noted that some assurance as to the retention of management would be important to ValueAct Capital. The special committee permitted ValueAct Capital to begin discussions with management, provided William Blair was present to monitor such discussions and ensure that the best interests of Seitel's unaffiliated stockholders were protected.[242]

Or consider the Getty Images MBO, in which the board set out two important ground rules for the process: First, members of the management team "were prohibited from having any contact with any of the private equity sponsors or strategic parties involved in the process without representatives of Weil Gotshal [the special committee's lawyers] or Goldman Sachs [the special committee's bankers] present."[243] Second, members of management "were prohibited from discussing any employment or incentive compensation terms with any sponsor or strategic party until the end of the process if the board determined to pursue a sale transaction[,] and then only with the prior consent of the members of [the] board [who were independent]."[244]

On one hand, the special committee must keep management from affiliating too closely with its favorite partner, in order to leave the process open for full and robust competition. On the other hand, the special committee must allow PE sponsors to understand (and pay for) the value that management brings to the table. While the Seitel/Getty Images approach has the benefit of keeping the special

[240] *See* NTS, Inc., Definitive Proxy Statement (Schedule 14A), at 13–14 (Jan. 23, 2014).
[241] *See* Seitel, Inc., Definitive Proxy Statement (Schedule 14A), at 14, 20 (Jan. 9, 2007).
[242] *Id.* at 20.
[243] Getty Images, Inc., Definitive Proxy Statement (Schedule 14A), at 15 (May 22, 2008).
[244] *Id.*

committee in control of the process, it creates the risk that the PE firm will have to shade its bid downward because it doesn't have full visibility into the value of management. Contractual arrangements with management to bring potential offers promptly to the attention of the board, and to channel all confidentiality agreements through the board, would strike the proper balance between these competing objectives.

B. Broad Market Canvass

In conducting their market canvass, special committees should recognize that a post-signing market check is not as effective as pre-signing competition, due to the ticking-clock problem. During the pre-signing phase, the special committee can control the timeline so that all bidders can conduct adequate due diligence before having to submit a bid. The special committee can also keep management on the sidelines, or at least not committed to a preferred buyout partner, during the pre-signing phase.[245] All of this changes during a post-signing go-shop process.

While this point may seem straightforward, it is in tension with the empirical finding that nearly 50% of MBOs use go-shop processes, compared to approximately 20% of LBOs in general. There is no obvious reason why go-shops would be used more often in MBOs than in LBOs. One possibility is that special committees are more willing to insist on a pre-signing market check against arm's-length buyers than they are against their own management team. Whatever the explanation, Part III.D explains why special committees should not assume that a market canvass conducted post-signing is the same as a market canvass conducted pre-signing.

Of course, for exactly the same reasons, management and its PE partner will prefer to defer buy-side competition to a post-signing go-shop. In the 99 Cents Only Stores MBO, for example, the then-Chairman of the Board David Gold and CEO Eric Schiffer, along with

[245] If structured properly, "stapled" financing can also facilitate a level playing field during the pre-signing phase. *See, e.g.*, Seitel, Inc., *supra* note 241, at 14 ("Seitel arranged with the assistance of William Blair and at no cost to Seitel, for a commercial bank not affiliated with William Blair to offer acquisition financing to potential acquirers of up to $450 million, which we refer to in this proxy statement as 'stapled financing.' The special committee believed that the existence of stapled financing would encourage potential bidders."); *cf.* Getty Images, Inc., *supra* note 243, at 17–18 ("Goldman Sachs indicated to the sponsors that they were being requested to use these [leverage] assumptions only so that the board of directors would have an equal basis for comparing their indications of interest and that it did not constitute the amount of debt financing or terms for such financing that the sponsors would be expected to obtain in connection with any potential transaction. Goldman Sachs also indicated that it was not proposing to provide any financing for a potential transaction with the Company.").

PE partner LGP, attempted to shut down a pre-signing market canvass:

> On March 29, 2011, Latham & Watkins[,] . . . LGP's legal counsel, . . . suggested that the Company enter into a definitive merger agreement with LGP, based on the March 10, 2011 proposal from LGP and the Gold/Schiffer Family, that would include a go-shop provision allowing the special committee to solicit alternative transactions for some period of time after signing the definitive merger agreement.[246]

Special committees often cave to this request due to the implicit[247] or explicit[248] threat that the offer will disappear. One possible interpretation of the fact that go-shop processes are disproportionately used in MBOs is that special committees are unwilling to stand up to such "hardball" tactics by management. While there is no single correct response in this situation, the special committee should consider the value of the deal to management. In particular, if management initiates the deal (which occurs 60% of the time in the MBO sample), management may be exploiting an information asymmetry and therefore would be unlikely to walk away. If the special committee is nevertheless unwilling to "call management's bluff" on this process question, the special committee should gain something (ideally, a price bump) in exchange for giving up a pre-signing market check. But in order to have this discussion, the special committee must understand (and communicate to management its understanding) that a post-signing go-shop is not equivalent to a pre-signing market canvass.

The continuation of the 99 Cents Only Stores proxy statement (discussed above) illustrates best practices in this arena:

> Following this discussion [with Morrison & Foerster, its legal counsel], the special committee concluded that it would be more beneficial to the Com-

[246] 99 Cents Only Stores, *supra* note 238, at 24.

[247] *See, e.g.*, Kinder Morgan, Inc., Definitive Proxy Statement (Schedule 14A), at 17 (Nov. 15, 2006) ("Although the special committee considered conducting a formal auction for Kinder Morgan, after consulting with its advisors, the special committee determined that such an auction process was likely to cause harm to Kinder Morgan that would outweigh any potential benefits, including the risk of no interested parties participating in an auction, which might reduce the special committee's strength in any eventual negotiations with the buyout group."); The Sports Auth., Inc., Definitive Proxy Statement (Schedule 14A), at 7 (Mar. 31, 2006) ("The Special Committee further noted the risks associated with [a pre-signing] auction process, including the risk that Leonard Green [the PE buyer] might offer a lower price in a contested auction or choose not to enter into an auction at all, leaving open the possibility that the Company might be left with no transaction.").

[248] *See, e.g.*, United Surgical Partners Int'l, Inc., Definitive Proxy Statement (Schedule 14A), at 18 (Mar. 20, 2007) ("During the meeting, representatives of Welsh Carson X [the PE buyer] and Citigroup [its banker] stated that, if the Company was to undertake a broader process to sell the Company or any other process involving other potential buyers prior to the execution of a definitive agreement . . . , Welsh Carson X would not likely participate in such process and would likely rescind its offer.").

> pany's shareholders for the special committee to review the position and outlook of the Company and strategic alternatives that may be available to it and to conduct a market check prior to signing a merger agreement and directed Morrison & Foerster to so inform Latham. In April and May 2011, similar proposals were made by LGP and advisers to the Gold/Schiffer Family, who suggested that such a process might allow the special committee to take advantage of the then favorable financing market conditions. In each case, the special committee considered the proposal, but concluded that it would be more beneficial to the Company's shareholders for the special committee to complete its review of the Company and conduct a market check prior to signing a merger agreement.[249]

Sure enough, Lazard (the special committee's bankers) contacted fifty-one parties pre-signing.[250] The result was a bidding contest between Leonard Green (the incumbent) and Ares Management: LGP's initial $19.09 bid increased to $20 and then $21; Ares responded at $21.50 and then $22.00.[251] The special committee was able to extract 15% more by recognizing that a pre-signing market check was preferable to a post-signing go-shop.

The importance of a pre-signing market canvass should also be reflected in contingency fees for the investment bankers involved in the deal. Contingency fees are generally desirable because they align incentives and force bankers pitching for the business to put their money where their mouth is. However, these contingency fees should not be skewed to favor either pre-signing or post-signing bids. The Sports Authority fee arrangement for Merrill Lynch illustrates a properly structured incentive fee:

> Merrill Lynch is acting as financial advisor to the Special Committee in connection with the merger. Under the terms of its engagement, Sports Authority has agreed to pay Merrill Lynch a transaction fee, payable upon consummation of any transaction or series of transactions in which a third party acquires directly or indirectly at least fifty percent of the stock, assets, revenues, income or business of Sports Authority, or otherwise gains control of the Company. The transaction fee payable to Merrill Lynch is equal to the sum of (x) 0.50% of the purchase price paid in connection with any such sale transaction, up to a purchase price that reflects a price per share of $36.00 or less, and (y) 2.00% of the amount, if any, by which the purchase price paid in the sale transaction exceeds a purchase price implied by a price per share of $36.00.[252]

Pre-signing, Merrill Lynch assisted the Sports Authority special committee in negotiating the price from Leonard Green up

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[249] 99 Cents Only Stores, *supra* note 238, at 24.
[250] *Id.* at 25.
[251] *Id.* at 27, 29–30, 58.
[252] The Sports Auth., Inc., *supra* note 247, at 22.

from $34.00 per share to $37.25 per share.[253] Once the deal price crossed $36.00, Merrill Lynch's incentive agreement went four times more "into the money," which meant that Merrill Lynch had high-powered incentives to extract as much as possible from the buyer. But the important feature of this agreement structure is that Merrill Lynch was indifferent about a price bump either pre- or post-signing.

To see a counterexample with perverse deal incentives, consider Evercore's incentives in the Dell MBO. Recall that the special committee retained Evercore on January 10, 2013, 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 proposal" 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.[254] Because Evercore would not receive a contingent fee for any third-party bid made during the pre-signing phase, 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),[255] Evercore had financial interests that were directly opposed to its client, the Dell special committee.

The special committee held an in-person meeting on January 15, 2013, just after Evercore was retained.[256] 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.[257]

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,

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253 *Id.* at 6–7.
254 Dell Inc., *supra* note 21, at 80.
255 *Id.* at 1, 69.
256 *Id.* at 36.
257 *Id.* at 37.

even though JPMorgan was present at the January 15 meeting.[258] The one obvious party that could have been contacted pre-signing was Blackstone.[259] Not only did Blackstone have firepower equivalent to or greater than Silver Lake, KKR, and TPG, all of whom were contacted pre-signing,[260] but a Blackstone Senior Managing Director, Dave Johnson, was also formerly Dell's head of M&A.[261] Whatever the root cause of this decision, it is clear from the terms of Evercore's compensation arrangement that Evercore had a financial interest in recommending 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.

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, Blackstone was on an unlevel playing field. In a March 30 email, 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."[262] (Recall that this is the same Evercore that recommended against contacting Blackstone pre-signing.) 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.[263]

There is a curious aftermath to the Evercore contingency fee story. Even though Blackstone and all other bidders declined to bid during the go-shop period, Evercore received a $3.1 million contingent fee due

[258] *Id.* at 36 (noting that representatives of Debevoise, BCG, Evercore, and JPMorgan were present for the in-person meeting).

[259] In addition to Blackstone, Evercore anticipated that Hewlett-Packard (HP) would also be interested. *In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *13 (Del. Ch. May 31, 2016). During the go-shop period, Evercore presented analyses to HP representatives estimating that "a Dell-HP combination could achieve $3–4 billion in annual cost synergies." *Id.* But "HP never accessed the data room and did not submit an indication of interest." *Id.*

[260] *Id.* at *8–9.

[261] *See* Kosman, *supra* note 83 (noting that "Blackstone might have had an edge" because Johnson had just joined Blackstone from Dell).

[262] Subramanian, *supra* note 76, at 8.

[263] *See Appraisal of Dell Inc.*, 2016 WL 3186538, at *42 ("The extent of Blackstone's efforts gives a sense of what was required. To get to Excluded Party status, Blackstone had to spend in excess of $25 million and assemble a due diligence team that filled a ballroom, and Blackstone is one of the world's most sophisticated private equity firms. Blackstone also retained Dell's former head of M&A and strategy, Dave Johnson, to lead its acquisition team and had the benefit of his insights.").

to the price bump from Michael Dell–Silver Lake.[264] As described in section I.E, this increase was due to shareholder pressure from Icahn and Southeastern, and had nothing to do with an outside offer generated by Evercore. Evercore's contingent fee was nevertheless triggered by any superior offer that appeared during the go-shop process. Technically, the $13.65 to $13.83 price bump met this definition, even though it was unrelated to Evercore's efforts. Not only did Evercore's retention agreement create perverse incentives, but it was overly broad to boot.

To summarize, the Dell special committee should have considered what the 99 Cents Only Stores special committee already knew, that pre-signing competition should be preferred to an after-the-fact go-shop process. The Dell MBO also highlights the importance of aligning banker incentives to reflect this core principle.

C. *Cooperation Commitments from Management*

In order to mitigate the information-asymmetry problem and the valuable-management problem, boards should insist on cooperation agreements from management as a condition for considering an MBO. At a minimum, these agreements should include: (1) working with the special committee to provide information to potential third-party bidders;[265] (2) leaving open the possibility of working with such third-party bidders in the event that they bid more;[266] and (3) if management's share ownership is significant, agreeing to vote for any higher bid, as directed by the special committee.[267] More potent tools should be considered as well. For example, if the valuable-management problem is particularly severe, the special committee might demand that management work for some period of time (say,

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[264] *See* Dell Inc., *supra* note 21, at 80–81.

[265] *See, e.g.*, J.Crew Grp., Inc., Cooperation Agreement (Form 8-K) Ex. 2.2, at 1 (Nov. 23, 2010) (agreeing to "(i) participation in meetings, presentations, due diligence sessions and other sessions with Persons . . . that have indicated an interest in making a Takeover Proposal . . . , (ii) assistance in preparation of solicitation materials, offering documents and similar documents to be used in connection with such efforts, and (iii) cooperating and assisting in obtaining any consents, waivers, approvals and authorizations for and in connection with any Takeover Proposal").

[266] *See, e.g.*, HCA Inc., Definitive Proxy Statement (Schedule 14A), at 26 (Oct. 17, 2006) ("As instructed by the special committee, the management discussions were conditioned on management's 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.").

[267] *Cf.* Subramanian, *supra* note 159, at 759 ("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." (citations omitted)).

six months), on a consulting basis, with any higher bidder that might appear.[268]

Of course, for precisely the same reasons that the special committee will want management to cooperate with other buyers, PE firms will want to gain commitments from management not to cooperate. In the Kinder Morgan MBO, for example, the proxy reports:

> [O]n May 28, 2006, Mr. Richard Kinder [founder and CEO of Kinder Morgan], at the request of GSCP [Goldman Sachs Capital Partners], executed a letter providing that, for a period of 90 days, so long as GSCP was pursuing a potential transaction involving Kinder Morgan, Mr. Kinder would not engage in any discussions or negotiations with any third party related to Mr. Kinder's continued service as a senior manager or director of Kinder Morgan in connection with a bid by such third party to acquire Kinder Morgan or a material portion of its business.[269]

Once the Kinder Morgan special committee was constituted, it requested that Kinder terminate this agreement with GSCP, which Kinder and GSCP agreed to do.[270] The Kinder Morgan special committee understood that keeping management open to other buyers was vital to the overall success of their process.

In order to enforce cooperation agreements, "unchaperoned" meetings between management and PE firms should be prevented.[271] In the Dell MBO, Michael Dell promised to consider working with anybody,[272] but the *New York Post* reported that he would not roll over his $3.6 billion equity stake for anyone other than Silver Lake.[273] Of course, this would leave a massive equity hole that a third-party bidder (but not Silver Lake) would have to fill. There is no

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[268] *See, e.g.*, Douglas L. Becker et al., *supra* note 177, at 1 (requiring Mr. Becker to "continue to perform his management functions consistent in all material respects with past practice" or to "provide such consulting services to the Company as the Acquiring Party may reasonably request" for up to six months on a full-time basis and an additional six months on a part-time basis, if requested by the Acquiring Party in an Alternative Transaction Agreement).

[269] Kinder Morgan, Inc., *supra* note 247, at 14.

[270] *Id.* at 15–16.

[271] *Compare* 99 Cents Only Stores, *supra* note 238, at 29 ("Ares held an un-chaperoned meeting with members of the Gold/Schiffer Family and Guggenheim on September 23 to discuss the following pre-approved topics: post-acquisition corporate and capital structure and post-acquisition corporate governance arrangements."), *with* MEMSIC, Inc., Definitive Proxy Statement (Schedule 14A), at 26 (Aug. 6, 2013) ("To ensure a fair and robust bidding process, the Special Committee decided that a member of the Special Committee and/or representatives of RBC [financial advisor to the Special Committee] would accompany management representatives and attend each of the scheduled meetings in California along with the representatives of management. . . . The Special Committee also agreed that Dr. Zhao [President & CEO] should be reminded of the importance of his maintaining a neutral stance in his communications with bidders on our behalf.").

[272] *See* Dell Inc., *supra* note 82, at 3–4.

[273] Kosman, *supra* note 83 ("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.").

documentation of this side deal, but it becomes possible if meetings are unchaperoned by counsel. In the Dell MBO, it was noted by some observers that Michael Dell and Silver Lake Managing Partner Egon Durban owned houses in the same part of Hawaii, and some of their planning for the deal took place there.[274] The ambiguity about what Michael Dell and Silver Lake had agreed to would not exist if the cooperation agreement required all meetings with PE firms to be chaperoned by counsel or members of the special committee.

D. Approval from a Majority of the Disinterested Shares

All deals in the MBO Sample were conditioned upon approval from a special committee of independent directors, or its functional equivalent.[275] The reason is that Delaware case law has made clear that special committee approval cleanses the taint of conflict, which then permits the court to apply business judgment review deference in assessing the transaction.[276]

Once the special committee and the full board have approved the deal, the final procedural hurdle is approval from a majority of the shares.[277] In this vote, management typically has a significant leg up, because management usually owns a large stake and will vote its shares in favor of the deal. Within the MBO Sample, the mean (median) management stake is 11.7% (6.3%). This means that management must get 38% out of the remaining 88% to approve the deal, or 43% of the disinterested shares. Put differently, a majority of the disinterested shares could vote against the deal, yet it could still go through because of the management support. And in cases such as Vitria Technologies (where management owned 34%)[278] or RAE Systems (management owned 31%)[279] the shareholder vote in favor of the deal is a foregone conclusion.

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274 Serena Saitto et al., *Dell's Mitzvah Rescued Buyout as JPMorgan's Lee Warned of Perils*, BLOOMBERG (Oct. 29, 2013, 4:52 PM), http://www.bloomberg.com/news/articles/2013-10-29/dell-s-mitzvah-rescued-buyout-as-jpmorgan-s-lee-warned-of-perils [https://perma.cc/4T9R-Z58N].

275 For example, in some cases, a special committee is not formally constituted by the board, but the independent directors are given sole authority to negotiate the deal with management. Cain and Davidoff report only 87% special committee incidence. *See* Cain & Davidoff, *supra* note 166, at 883. My inclusion of functional equivalents to special committees may explain the difference.

276 *See infra* section IV.A, pp. 650–53.

277 Delaware requires, as a default matter, approval from a majority of the outstanding shares. *See* DEL. CODE ANN. tit. 8, § 251(c) (2016). Other states require only that a majority of the shares voted. *See* MODEL BUS. CORP. ACT § 11.04(e) (AM. BAR ASS'N 2010); *see also* AM. BAR ASS'N, THE 2016 REVISION OF THE MODEL BUSINESS CORPORATION ACT (2016) (noting that the majority of states have adopted the Model Business Corporation Act).

278 Vitria Tech., Inc., Definitive Proxy Statement (Schedule 14A), at 68 (Feb. 8, 2007).

279 *See* RAE Sys. Inc., Annual Report (Form 10-K/A), at 13 (Apr. 29, 2011).

In the context of freezeouts (buyouts by controlling shareholders), deals are regularly conditioned upon approval by a special committee *and* approval from a majority-of-the-minority shares (a.k.a. a "MOM condition").[280] The reason is that Delaware case law encourages both procedural protections.[281] This two-part approach represents the controlled-company analog to the approvals required in an arm's-length deal: namely, approval by the board and approval by a majority of the shares outstanding.[282] The constraints play different roles: special committee approval represents a back-and-forth negotiation, while a MOM condition provides a binary yes-or-no check against a lowball price agreed to by a captured, supine, or negligent special committee.

While the two-part approach is commonplace in freezeouts, only 21% of deals in the MBO Sample are conditioned upon approval from a majority of the disinterested shares. This result is not surprising given the Delaware doctrine of MBOs: once the special committee has blessed the deal, there is no further doctrinal benefit to disinterested shareholder approval.

In defense of the different procedural protections in freezeouts versus MBOs, one might argue that a special committee has greater leverage in an MBO because it can solicit third-party offers. But a central claim of this Article is that such reliance on a plain-vanilla market check is unwarranted because the playing field is unlikely to be level. The same concerns that underlie the MOM condition in a freezeout, then, should push special committees to insist on approval from a majority of the disinterested shares in MBOs. This is particularly true when management holds 20+% of the company — close to a control stake, but not sufficient to trigger the doctrine of freezeouts that encourages a MOM condition as a matter of the controller's self-interest. The special committee should also insist on approval from a majority of the disinterested shares when the four factors enumerated in Part III are present. That is, when there are information asymmetries, management is valuable, management is a net buyer, and/or there is a ticking clock, the same logic that encourages MOM conditions in freezeouts (namely, the nonavailability of outside buyers) should drive special committees to insist on disinterested shareholder approval in MBOs.

280 *See* Subramanian, *supra* note 181, at 16–17; Subramanian, *supra* note 162, at 11–12.

281 *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014); *see also In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 642–48 (Del. Ch. 2005).

282 *See* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 800–01 (2003); Subramanian, *supra* note 181, at 60–61.

E. Ex Ante Inducement Fees

Another tool in the special committee's repertoire should be ex ante inducement fees. Inducement fees are generally uncommon in MBOs; when they are used at all, they are invariably offered ex post, to keep an existing bidder in the mix. In the Dell MBO, for example, after Blackstone made its initial offer it negotiated for and received an inducement fee that would reimburse Blackstone for its out-of-pocket expenses up to $25 million.[283] While ex post inducement fees can be useful (assuming that the bidder's threat of walking away is credible), ex ante inducement fees should be considered as well, particularly when the four factors identified in Part III indicate that the playing field is not level. For example, a special committee might extract a concession from the MBO group to reimburse out-of-pocket expenses for any third-party bidder that makes a bona fide superior proposal at least 5% higher than the deal price, even if the third party does not win in the end. Although this kind of ex ante fee would be a radical innovation, in some MBOs it may be justified (if not essential) in order to achieve some semblance of a level playing field.

In view of the benefit that a third-party bidder can bring to the final deal price, special committees should also consider inducement fees (whether ex ante or ex post) that go beyond reimbursement of out-of-pocket expenses. In general, a third party contemplating entry into an MBO faces not just out-of-pocket costs, but also opportunity costs (of not being in other deals that have a more level playing field) and reputational costs (of bidding in a situation against an inside bidder, where there is no clear path to success).[284] Special committees should be willing to consider inducement fees that reflect these costs as well.

In the Quest Software MBO, for example, the special committee gave Dell (the third-party bidder) a novel three-part inducement: (1) an option for Dell to acquire 19.9% of the Quest shares; (2) a breakup fee of 2.0% of the transaction value, which amounted to approximately $40 million, if shareholders voted down the deal; and (3) a 3.5% breakup fee, amounting to $70 million, if the Dell offer were subsequently trumped.[285] After a prolonged bidding contest, Dell won with an offer of $28 per share, representing a 22% increase (amounting to

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[283] Dell Inc., *supra* note 21, at 48.

[284] *See generally* Coates & Subramanian, *supra* note 162 (presenting typical motivations for breakup fees and empirical evidence on their magnitude).

[285] *See* Press Release, Quest Software, *supra* note 211.

more than $400 million) over the initial $23 per share offer from management.[286]

While the Quest inducement fee may seem like a no-brainer in view of the fact that it paid for itself several times over, consider the counterexample of the Kerzner MBO in March 2006. Founder and CEO Sol Kerzner made an offer to buy out the other shareholders at $76 per share, amounting to $2.5 billion in total value, subject to a forty-five-day go-shop period.[287] On April 11, 2006, twenty-two days into the go-shop process, "Party A" expressed interest in acquiring the company.[288] However, as a condition for its entry, Party A insisted on: (1) reimbursement of its expenses in the event that it made a firm offer at $78 per share or better; and (2) 4% of its bid (amounting to approximately $100 million) if Party A's offer was facially higher than the management bid but the special committee still accepted the management bid.[289] The Kerzner proxy statement explained the request as follows:

> [D]ue 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 . . . .[290]

The Kerzner special committee nevertheless rejected this proposal, but made an undisclosed counterproposal on the inducement fee issue.[291] The parties failed to reach agreement, and Party A withdrew from the process.[292]

While it is never easy to judge a special committee acting in the "heat of battle," from an outside perspective the original offer from Party A seems unobjectionable: reimbursement of expenses only if Party A created enormous value for the public shareholders (for example, a standard 10% overbid would be worth $250 million), and an additional $100 million only if the playing field was so unlevel that the special committee favored the lower bid anyway. The inducement fee proposed by Party A was analytically similar to the banker contingent fees discussed in section III.B above, in the sense that they paid off for

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[286] Evelyn M. Rusli, *Dell Acquires Quest, a Big Software Maker, for $2.4 Billion*, N.Y. TIMES: DEALBOOK (July 2, 2012, 8:48 AM), http://dealbook.nytimes.com/2012/07/02/dell-to-buy-quest-software-for-2-4-billion [https://perma.cc/EMN2-3TH2].

[287] Kerzner Int'l Ltd., Transaction Statement (Schedule 13E-3/A) Ex. 99.A.1, at 6, 16–17 (July 20, 2006).

[288] *Id.* at 18.

[289] *Id.*

[290] *Id.*

[291] *Id.*

[292] *Id.*

Party A only in the event that Party A significantly increased the price paid to the Kerzner shareholders. The general point, without trying to judge the specific case of the Kerzner MBO, is that special committees should consider inducement fees as a more potent device for creating a plausibly level playing field in MBOs.

F. Information Rights and No "Last Look"

Match rights have become ubiquitous in PE deals generally, not just in MBOs, and as such they tend to be conceded by the special committee.[293] A match right gives the initial bidder three to five business days to negotiate exclusively and "in good faith" with the special committee, in the event that a superior offer is made, to see if the initial bidder can trump the third-party bid.[294] Of course, from the buyer's perspective, the point of a match right is not just to give itself a "last look," but to deter third-party bids in the first place. This deterrence effect is particularly salient in the context of MBOs, where winner's curse concerns will run rampant. As described in section II.A, match rights eliminate the possibility of a third-party bid with a short fuse, which cuts off a potential pathway to success for a third-party bidder.[295] A prospective bidder will "look forward and reason back" to envision one of two outcomes: either it bids and wins, in which case it has paid more than the "smart money"; or it bids and loses, in which case it has nothing to show for its efforts. For this reason it is well-accepted among academics and practitioners that match rights deter third-party bids.[296]

The solution for special committees in MBOs is to resist match rights, in favor of "information rights" (keeping the initial bidder informed of third-party bids), or even better, no information rights or match rights whatsoever. While this approach would be unusual in MBOs today, it would reflect the parties' recognition of the unlevel playing field and the importance of preserving a pathway to success for potential third-party bidders. To the extent that buy-side lawyers might protest that match rights are "market" in MBOs today (that is, standard practice), it should be pointed out that match rights are a relatively recent phenomenon in the M&A marketplace. In the MBO

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[293] *See* Guhan Subramanian, *Business Negotiations: Matching Rights — The Fundamentals*, HARV. L. SCH.: PROGRAM ON NEGOT. (Oct. 28, 2013), http://www.pon.harvard.edu/daily/business-negotiations/business-negotiations-matching-rights-the-fundamentals [https://perma.cc/VP6U-9RL3].

[294] Dell Inc., *supra* note 80, at 45–46.

[295] *See supra* pp. 613–15.

[296] *See, e.g.*, Brian JM Quinn, *Re-Evaluating the Emerging Standard of Review for Matching Rights in Control Transactions*, 36 DEL. J. CORP. L. 1011, 1012–13 (2011).

Sample, match rights appeared in 69% of transactions as late as 2006; they became ubiquitous only by 2009.

Another benefit of resisting a match right is that it forces management to put full value on the table in its initial bid, knowing that it might not get a chance to respond to a higher bid. To see this dynamic, consider again the Kerzner MBO from 2006. Consistent with the finding that match rights were not ubiquitous at that time, the merger agreement contained only limited information rights for Sol Kerzner and his PE partner.[297] During the forty-five-day go-shop process, JPMorgan contacted thirty-five potential acquirors, eleven of which signed confidentiality agreements.[298] According to the proxy statement:

> JPMorgan also reported that interested parties had requested confirmation that the investor group not be permitted to participate in the post-signing auction or submit a revised proposal to acquire the company prior to the special committee accepting a superior proposal from a third-party. In response to such requests and in order to promote the post-signing auction, on March 30, 2006, the special committee informed the investor group that the investor group would not be permitted to submit a revised proposal to acquire the company as part of the post-signing auction but, if it wished to do so, would be permitted to submit a revised proposal by April 3, 2006.[299]

In effect, the special committee was narrowing the information flows back to the incumbent bidder, in order to induce third-parties to bid. Interestingly, Sol Kerzner and his buyout partner did not increase their bid in response to the invitation from the special committee.[300] One interpretation of this result is that Sol Kerzner had already put full value on the table in his initial $76 per share offer, anticipating the possibility that he would not get a last look at a competing offer precisely because he had no match right.

As noted in the prior Part, "Party A" did contemplate making an overbid, but could not reach agreement with the special committee on the structure and magnitude of its inducement fee.[301] At the time of my 2008 study of go-shop deals, the Kerzner MBO was the closest case of an actual third-party bidder entering into a go-shop MBO process.[302] This finding highlights the magnitude of the unlevel playing field when all four of the factors identified in Part III are present: information asymmetries, valuable management, management incentives

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[297] Kerzner Int'l Ltd., *supra* note 287, at 1, 4, 69.
[298] *Id.* at 17.
[299] *Id.*
[300] *Id.* at 20.
[301] *See id.* at 18.
[302] *See* Subramanian, *supra* note 159, at 758 & n.117.

to discourage an overbid (because Sol Kerzner was a net buyer in the transaction), and a ticking clock due to the forty-five-day go-shop period. The fact that Party A even contemplated a bid in this context might be explained by the fact that the absence of a match right gave it a potential pathway to success.

In the scenario where Party A actually did make a bid, it might seem counterintuitive that the special committee would not shop this offer back to Sol Kerzner. However, it is well understood that hands-tying ex ante can maximize value for the seller, even though ex post it would be desirable to go back to the initial bidder for an overbid.[303] As a contractual matter, Party A would of course make its offer on the condition that it not be shopped back to Sol Kerzner. This bid condition is feasible only if the special committee does not have a contractual obligation to take Party A's offer back to Sol Kerzner.

To summarize, the Kerzner MBO illustrates how the absence of a match right can induce third-party bids. Once special committees acknowledge the degree to which the playing field is unlevel in MBOs, they should resist match rights, not only to induce bids but also to induce management to put full value on the table in the first instance.

G. Summary

Part III of this Article provides a taxonomy of four factors that can create an unlevel playing field in MBOs. Special committees and their advisors can use the taxonomy to assess the extent to which the playing field is level, and (by extension) the extent to which a plain-vanilla market canvass will provide a meaningful check on an MBO offer.

This Part enumerates more potent tools that special committees should keep in their negotiating toolkit in the event that the special committee concludes that the playing field is not level. The key point is that an unlevel playing field does not need to be accepted as a given, but rather can be remedied by certain deal process tools. This Part provides empirical evidence that the need for such tools may be particularly acute when management is a net buyer in the MBO.

The following table summarizes the key deal process design solutions proposed in this Part:

[303] *But see* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936–39 (Del. 2003).

SUMMARY OF KEY DEAL PROCESS DESIGN TOOLS TO LEVEL THE PLAYING FIELD IN MBOS

Tool to Level the Playing Field	Best Practice Example	Best Practice Counter-Example
Board Controls the Process	*Getty Images*: "[M]embers of our management were prohibited from having any contact with any of the private equity sponsors or strategic parties . . . without representatives of Weil Gotshal or Goldman Sachs present . . . ."[304]	*NTS*: CEO held discussions with PE firm starting in March 2013 but told the board only in August.[305]
Pre-signing Market Canvass	*99 Cents Only Stores*: "[T]he special committee considered the proposal [to shut down the process], but concluded that it would be more beneficial to the Company's share-holders [to] . . . conduct a market check prior to signing a merger agreement."[306]	*Dell*: Evercore "expressed the view that it would not be beneficial to contact additional parties at the current [pre-signing] stage of the process."[307]
Cooperation Commitments with Management	*J.Crew*: Drexler agreed to "participat[e] in meetings, presenta-tions, due diligence sessions and other sessions with Persons . . . interest[ed] in making a Takeover Proposal."[308]	*Kinder Morgan*: "Mr. Richard Kinder, at the request of GSCP, executed a letter providing that, for a period of 90 days . . . Mr. Kinder would not engage in any discus-sions or negotiations with any third party . . . ."[309]
Ex Ante Inducement Fees	*Quest Software*: Dell (third-party bidder) received stock option lock-up, 2.0% breakup fee, and an addi-tional 3.5% if Dell offer were sub-sequently trumped.[310]	*Kerzner International*: Board de-clined condition for entry from "Party A" for (1) reimbursement of expenses in the event of an overbid; and (2) 4% breakup fee if Party A made a higher bid and board still supported management bid.[311]
Information Rights & No Last Look	*Kerzner International*: "[T]he spe-cial committee informed the inves-tor group that the investor group would not be permitted to submit a revised proposal to acquire the company as part of the post-signing auction . . . ."[312]	(Match rights ubiquitous in MBO Sample)

[304] Getty Images, Inc., *supra* note 243, at 15.
[305] *See* NTS, Inc., *supra* note 240, at 13–14.
[306] 99 Cents Only Stores, *supra* note 238, at 24.
[307] Dell Inc., *supra* note 21, at 37.
[308] J.Crew Grp., Inc., *supra* note 265, at 1.
[309] Kinder Morgan, Inc., *supra* note 247, at 14.
[310] *See* Press Release, Quest Software, *supra* note 211.
[311] Kerzner Int'l Ltd., *supra* note 287, at 18.
[312] *Id.* at 17.

Of course, each situation is different, and the special committee will need to balance its demands for process tools against the risk that management will walk away. But in any instance where management is resistant to a process move — for example, a demand for information rights rather than match rights, or cooperation commitments from management — the special committee should naturally wonder what management is afraid of, other than a higher bid. That is, while it would be quite natural for management to resist substantive concessions (for example, a higher price), an unwillingness to give on the process tools identified in this Part should be interpreted by the special committee as at least suggestive evidence that management is concerned about higher bidders — which makes the need for more potent process tools all the more important. At the very least, special committees should trade off process concessions against the deal price — for example, by extracting a higher offer in exchange for a match right, rather than conceding it as boilerplate.

IV. IMPLICATIONS FOR DELAWARE COURTS

In this Part, I apply the conclusions from Part III and Part IV to provide three doctrinal implications for Delaware courts. *First*, Delaware courts should import the procedural requirements of freezeout transactions to MBOs, so that only MBOs that provide for approval from a majority of the unaffiliated shares qualify for business judgment review. As the Delaware Supreme Court has recently articulated in the freezeout context, the purpose is not to extend entire fairness review, but rather to encourage the procedural protection of approval from the unaffiliated shares. *Second*, when the four factors identified in Part III are present and the more potent structural devices identified in Part IV are not, Delaware courts should not assume that a market check, and particularly a market check conducted through a pure go-shop process, satisfies the board's *Revlon* duties. Again, the willingness of Delaware courts to expect such devices would encourage (and give backbone to) special committees asking for them in the first place. And *third*, in appraisal proceedings, Delaware courts should presume that the deal price provides the best indication of fair value if — but only if — it is the result of an arm's-length negotiation, subject to a meaningful market check as described in this Article. The remainder of this Part explains each of these points in more detail.

A. Standards of Review for MBOs

In the recent decision *Kahn v. M&F Worldwide Corp.*,[313] the Delaware Supreme Court completed the trajectory of a long line of Delaware case law bolstering the procedural protections for minority shareholders in freezeout transactions. Specifically, the Court held that freezeouts are subject to business judgment review, and not the more stringent entire fairness review, if and only if the deal is conditioned upon approval from a special committee of independent directors and approval from a majority of the minority shares.[314] This two-prong approach is the controlled-company equivalent of board approval and shareholder approval in the arm's-length context.[315]

In contrast to the deep Delaware case law on freezeouts, the case law on MBOs is remarkably thin.[316] Because there is no case squarely articulating the standard of review for MBOs, commentators generally reason by analogy from non-MBO cases that involve conflicts of interest.[317] These cases generally reference the ordinary conflict-of-interest rules embodied in section 144 of the Delaware General Corporation Law,[318] which Delaware courts have interpreted to provide that the taint of self-dealing is cleansed, and only business judgment review applies, if the transaction is approved by either the disinterested directors *or* a majority of the disinterested shares.[319] For example, *In re Wheelabrator Technologies, Inc. Shareholders Litigation*[320] involved the purchase of an additional 33% of shares in Wheelabrator by Waste Management, which already owned 22% of the company.[321] Vice Chancellor Jacobs held that the taint of self-dealing by Waste Management was extinguished, and the transaction would be subject only

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[313] 88 A.3d 635 (Del. 2014).

[314] *Id.* at 644.

[315] *See* DEL. CODE ANN. tit. 8, § 251 (2016).

[316] *See* Cain & Davidoff, *supra* note 166, at 874 ("In contrast to freeze-outs, there has been very little case-law addressing the proper regulation of MBOs."). Instead of articulating a standard of review, modern MBO case law has generally focused on whether the target board has satisfied its *Revlon* duties. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 115–23 (Del. Ch. 2007) (evaluating change of control transaction based on whether the directors chose a reasonable course of action under *Revlon*); *see also In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 192–99 (Del. Ch. 2007) (same); *In re* Topps Co. S'holders Litig., 926 A.2d 58, 82–93 (Del. Ch. 2007) (same).

[317] *See, e.g.*, Cain & Davidoff, *supra* note 166, at 874 (citing *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194 (Del. Ch. 1995)); Iman Anabtawi, *Predatory Management Buyouts*, 49 UC DAVIS L. REV. 1285, 1308 & n.59 (2016) (citing *In re* Shoe-Town, Inc. Stockholders Litig., No. C.A. 9483, 1990 WL 13475, at *4 (Del. Ch. Feb. 12, 1990)).

[318] DEL. CODE ANN. tit. 8, § 144(a)(1)–(2) (2016).

[319] *See, e.g.*, *Wheelabrator Techs.*, 663 A.2d at 1205 & n.8.

[320] 663 A.2d 1194.

[321] *Id.* at 1197.

to business judgment review, because it had been approved by a majority of the disinterested shares.[322]

Absent authority to the contrary, commentators have extrapolated from *Wheelabrator* and similar cases to infer that MBOs should be lumped with generic conflict transactions rather than with freezeouts.[323] Certainly practitioners have acted as if this inference is correct: as reported in section III.D, only 21% of deals in the MBO Sample are conditioned upon approval from a majority of the disinterested shares, presumably because there is no doctrinal benefit from seeking disinterested shareholder approval if the special committee has already approved the deal.[324]

And so there is a distinction: buyouts by controlling shareholders require both special committee approval and disinterested shareholder approval in order to receive business judgment review, while MBOs require either special committee approval or disinterested shareholder approval in order to achieve the same judicial deference. The question is whether this distinction between freezeouts and MBOs makes sense. The *Wheelabrator* court found that it did:

> The participation of the controlling interested stockholder is critical to the application of the entire fairness standard because . . . the potential for process manipulation by the controlling stockholder, and the concern that the controlling stockholder's continued presence might influence even a fully informed shareholder vote, justify the need for the exacting judicial scrutiny and procedural protection afforded by the entire fairness form of review.[325]

Consistent with the logic of *Wheelabrator*, Cain and Davidoff argue in favor of the doctrinal contour between freezeouts and MBOs because "in an MBO as opposed to a freezeout, a per se requirement of a majority of minority condition appears inappropriate since in MBO transactions management often lacks a controlling stake in the target."[326] As a result, "a special committee requirement[, which] can function in all circumstances," is appropriate for MBO transactions.[327]

However, a central claim of this Article is that the same "process manipulation" and "influence" that motivate heightened scrutiny for freezeouts are equally prevalent, if not more so, when management is part of the buyout group, even if management does not control a majority of the shares. In freezeouts, Delaware corporate law requires both special committee approval and the backstop check of a majority-

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[322] *Id.* at 1205 & n.8.
[323] *See, e.g.*, Anabtawi, *supra* note 317, at 1308; Cain & Davidoff, *supra* note 166, at 874.
[324] *See supra* pp. 641–42.
[325] 663 A.2d at 1205.
[326] Cain & Davidoff, *supra* note 166, at 899.
[327] *Id.*

of-the-minority condition because of the concern that a special committee cannot operate effectively against a controlling shareholder — either because (as a practical matter) the controller dominates the special committee or because the special committee cannot solicit outside offers against a controlling shareholder. The same concern exists in MBOs: a special committee must rely on management — for example, to guide it on the validity of the projections — and a special committee cannot meaningfully solicit outside offers when the playing field is unlevel.

In summary: for precisely the same reasons that the Delaware Supreme Court has encouraged special committee approval and majority-of-the-minority approval in freezeout transactions, Delaware courts should encourage special committee approval *and* approval from a majority of the unaffiliated shares in MBOs. Doctrinally, this would not require any reformulation of existing Delaware law because *Wheelabrator* and similar cases did not involve MBOs, and therefore could be readily distinguished. The Delaware courts would simply have to clarify that MBOs should be subject to the same procedural protections as freezeouts, rather than being lumped with generic conflict transactions.[328]

Under the proposed approach, MBOs would be subject to business judgment review if and only if they are conditioned upon approval from both the special committee and a majority of the unaffiliated shares. The added procedural protection would better reflect the practical realities and institutional details described in Part III of this Article. They would also give special committees the most backbone to insist on the deal process design measures described in Part IV. And as

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[328] In contemporaneous work on what she terms "predatory MBOs," Professor Iman Anabtawi argues that requiring disinterested shareholder approval "does not add any meaningful protection" because "[l]ike disinterested directors, those shareholders are at an informational disadvantage with respect to the value of their company." Anabtawi, *supra* note 317, at 1325. Instead, she advocates for minimizing the information asymmetry between management and shareholders by either "requir[ing] participating managers to disclose to the neutral decision-making party of the target all soft information," *id.* at 1330, or "encourag[ing] conflicted managers to remove themselves from participating in the acquisition process on behalf of the MBO group," *id.* at 1332. While I share Anabtawi's general concerns about MBOs, I am skeptical that information asymmetries can be eliminated or even meaningfully mitigated in an MBO context through either of these procedural moves. Even if information asymmetries could be reduced through process refinements, there are still the practical realities of differential access to management, opportunistic timing, and potential manipulation of the market price that sets the baseline for the deal price. *See supra* section II.A, pp. 613–19. While admittedly not a perfect backstop, requiring approval from a majority of the unaffiliated shares provides an important protection against an agreement made by a special committee. *See supra* section III.D, pp. 641–42. In the Dell MBO, for example, it was the threat of a "no" vote from Carl Icahn and Southeastern that caused the final price bump, from $13.65 to $13.83 per share. *See supra* section I.E, pp. 607–08. This pressure was feasible only because the deal was conditioned upon approval from a majority of the unaffiliated shares outstanding. *See id.*

a backstop, the doctrinal shift proposed here would impose entire fairness review on transactions where these procedural protections did not exist.

In that fairness inquiry, Delaware courts should use the taxonomy of factors from Part III and the deal process design measures from Part IV to assess whether the process was fair. Courts should keep in mind that not all MBOs are created equal: a go-shop MBO with valuable management that holds 20% of the shares and stands as a net buyer in the transaction is very different from an MBO in which management obtains modest equity stakes after a PE firm has already reached agreement with the special committee. Courts should take these factors into account when applying entire fairness review.

B. Application of Revlon *Duties*

In addition to the possibility of entire fairness review, Delaware case law imposes *Revlon* duties in MBOs.[329] In *Revlon*-land, the Delaware Supreme Court has explained that "[t]he directors' role remains an active one, changed only in the respect that they are charged with the duty of selling the company at the highest price attainable for the stockholders' benefit."[330] While subsequent case law has clarified that a formal "put out the gavel" auction is not required,[331] practitioner and academic commentary makes clear that the core principle — to get the highest possible price — remains unchanged. Joe Flom, a founding partner of Skadden Arps, put it as follows:

> The way I look at [*Revlon*] is very simple. If you're selling the company, you've got to make sure that the premium is realized for your shareholders, because they're not going to have another chance. So you have to adopt . . . a process, and your judgment is completely critical as to how you're going to structure it [t]o try to get the best price.[332]

Delaware courts have made clear that satisfying *Revlon* duties requires some kind of market check.[333] As discussed in this Article, the post-signing go-shop process is disproportionately the tool of choice for conducting the market check in an MBO.[334] Delaware courts have

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[329] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986).

[330] *Id.* at 184 n.16.

[331] *See* Subramanian, *supra* note 195, at 699.

[332] *See id.* at 699 n.52 (citing Interview with Joseph H. Flom, former Managing Partner, Skadden, Arps, Slate, Meagher & Flom, in N.Y.C. (June 15, 2000)).

[333] *See* Subramanian, *supra* note 159, at 737 (citing Barkan v. Amsted Indus., 567 A.2d 1279, 1287 (Del. 1989)). *C & J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust*, 107 A.3d 1049 (Del. 2014) provides the most recent articulation of what *Revlon* requires. *See id.* at 1067 (stating that *Revlon* requires that the transaction be subject to an "effective market check," which means that the board must have the opportunity to receive higher bids).

[334] *See supra* section II.D, pp. 629–31.

confirmed that a properly structured go-shop process can satisfy the board's *Revlon* duties in an MBO transaction.[335]

The findings presented in this Article suggest that courts should not categorically accept the premise that a market check — whether conducted pre-signing or post-signing — satisfies the target board's *Revlon* duties. Instead, courts should use the taxonomy of factors presented in Part III to assess the degree to which the playing field is level, and then, in view of this analysis, assess the degree to which the Special Committee has designed the deal process to create a level playing field. To the extent the playing field is not level, courts should encourage (and therefore give special committees backbone for insisting on), for example, a pre-signing market canvass (rather than a post-signing go-shop), cooperation commitments from management, ex ante inducement fees, and information rights (rather than match rights). The point is twofold: (1) a market check can satisfy a board's *Revlon* duties only if it is conducted on a level playing field; and (2) it is feasible for special committees to construct a level playing field in MBOs, but only if they use the more potent deal process tools described in Part IV of this Article.

Courts should be particularly wary when management is valuable and/or when management is a net buyer in the MBO. This Article presents theoretical reasons and empirical evidence indicating why these two factors, individually and together, can thwart a meaningful market check. Courts should also be wary of post-signing go-shop processes rather than pre-signing market checks. Particularly when the deal is subject to a pure go-shop, courts should look for more potent deal process design tools in order to mitigate the ticking-clock problem.

C. Reliance on Deal Price in Appraisal Proceedings

It is well documented that the use of appraisal has increased dramatically over the past decade.[336] Factors that have contributed to this increase no doubt include the above-market interest rate provided by the Delaware statute,[337] the endorsement of "appraisal arbitrage"

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[335] *See, e.g.*, *In re* Topps Co. S'holders Litig., 926 A.2d 58, 86 (Del. Ch. 2007).

[336] *See, e.g.*, Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1551 (2015) (reporting a "sea change" in the use of appraisal in Delaware).

[337] *See* DEL. CODE ANN. tit. 8, § 262(h) (2016) (shareholders generally entitled to Federal Reserve discount rate plus 5%). Delaware recently enacted amendments to the appraisal statute that seek to reduce appraisal arbitrage motivated primarily by above-market interest rates. *See* H.R. 371, 148th Gen. Assemb., Reg. Sess. (Del. 2016) (permitting the surviving corporation in a merger to pay dissenting shareholders a cash amount, and having interest accrue only on any difference between the cash amount and the appraised value).

by the Delaware courts,[338] and the emergence of hedge funds that focus on appraisal.[339] Critics of this development in transactional practice generally argue that it is yet another example of excessive litigation in the M&A context.[340] Proponents argue that appraisal provides meaningful protection for dissenting shareholders in situations where the sell-side process does not constitute a breach of fiduciary duty yet also does not yield fair value.[341]

Delaware judges have an impossible task in appraisal proceedings. In contrast to investment bankers who simply produce ranges for fair value (typically captured on a single PowerPoint slide, known as the "football field," in their final presentation to the board), Delaware judges are required to produce a point estimate of value. In this artificially precise task, a string of recent Delaware appraisal opinions has relied heavily on the deal price.[342] In principle, this reliance makes sense: "fair value" is inherently amorphous, and if the process is good then a court should feel comfortable deferring to the result of that process.

This Article identifies specific procedural protections that courts should look for before deferring to the deal price. The critical point is this: the price obtained in an arm's-length deal should be presumed to be fair value, but an arm's-length deal needs to have procedural pro-

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338 *See In re* Appraisal of Transkaryotic Therapies, Inc., No. 1554, 2007 WL 1378345, at *3 (Del. Ch. May 2, 2007). Subsequent Delaware case law has also endorsed the principle of appraisal arbitrage. *See, e.g.*, *In re* Appraisal of Dell Inc., No. 9322, 2015 WL 4313206, at *23 (Del. Ch. July 13, 2015, revised July 30, 2015) ("In a market economy, the ability to transfer property, including intangible property, is generally thought to be a good thing; it allows the property to flow to the highest-value holder, thereby increasing societal wealth. . . . It is not apparent to me why a right held by the equity side of the capital structure should be treated differently . . . .").

339 *See* Wei Jiang et al., *Appraisal: Shareholder Remedy or Litigation Arbitrage?* 45 tbl.1 (Columbia Bus. Sch. Research Paper No. 16-31, 2016), http://ssrn.com/abstract=2766776 [https://perma.cc/3ZGB-K9EB] (finding that hedge funds are responsible for nearly 74% of total dollar volume of appraisal complaints in the period 2000–2014, and that Merion Capital by itself accounts for over 25% of total dollar volume).

340 *See, e.g.*, Lisa A. Rickard, Opinion, *Delaware Flirts With Encouraging Shareholder Lawsuits*, WALL STREET J. (Nov. 14, 2014, 5:48 PM), http://www.wsj.com/articles/lisa-rickard-delaware-flirts-with-encouraging-shareholder-lawsuits-1416005328 [https://perma.cc/CH2X-3JND] (identifying appraisal arbitrage as one of two types of M&A litigation "brought by small, pirate-like investors" that is causing shareholder litigation to reach "epidemic levels").

341 *Cf. In re* Appraisal of Ancestry.com, Inc., No. 8173, 2015 WL 399726, at *16 (Del. Ch. Jan. 30, 2015) ("Of course, a conclusion that a sale was conducted by directors who complied with their duties of loyalty is not dispositive of the question of whether that sale generated fair value.").

342 *See, e.g.*, Merion Capital LP v. BMC Software, Inc., No. 8900, 2015 WL 6164771, at *18 (Del. Ch. Oct. 21, 2015); LongPath Capital, LLC v. Ramtron Int'l Corp., No. 8094, 2015 WL 4540443, at *20 (Del. Ch. June 30, 2015); Merlin Partners LP v. AutoInfo, Inc., No. 8509, 2015 WL 2069417, at *17–18 (Del. Ch. Apr. 30, 2015); *In re Appraisal of Ancestry.com*, 2015 WL 399726, at *23–24; Huff Fund Inv. P'ship v. CKx, Inc., No. 6844, 2013 WL 5878807, at *13 (Del. Ch. Nov. 1, 2013); *see also* M.P.M. Enters., Inc. v. Gilbert, 731 A.2d 790, 797 (Del. 1999) ("A merger price resulting from arm's-length negotiations where there are no claims of collusion is a very strong indication of fair value.").

tections that ensure a meaningful negotiation and a level playing field. For example, a court should be reluctant to presume that fair value was paid to minority shareholders in an ostensibly arm's-length deal if management is valuable (and continues to be post-closing), the initial deal is subject to a match right, and the termination fee is significant. These features have previously been thought to be sufficiently generic that they do not compromise the arm's-length nature of the deal. This Article demonstrates why that assumption may be incorrect in some cases.

As with the other reforms proposed in this Part, this narrowing of the reliance on the deal price for appraisal proceedings would have desirable ex post effects (ensuring minority shareholders receive fair value) but also desirable ex ante effects: buyers and sellers seeking to limit their appraisal risk will provide the procedural protections described in this Article, in order to increase the likelihood that the court will presume that the deal price provided fair value in any subsequent appraisal proceeding.

Yet again (one last time), the Dell MBO illustrates these principles. My conversations with senior M&A practitioners during the pendency of the Dell appraisal suggest that many believed that the procedural protections in that deal were sufficient to cleanse the taint of conflict. The existence of the Special Committee, the prolonged negotiation between Michael Dell and that committee, and the fact that several private equity firms contemplated a bid and walked away meant that the best evidence of fair value was the $13.75 deal price. But closer examination reveals that the Special Committee failed to meaningfully mitigate the information asymmetries, the valuable-management problem, management's financial incentives to discourage overbids, and the ticking-clock problem. Vice Chancellor Laster acknowledged the presence of all four of these factors in the Dell MBO.[343] He concluded: "The sale process functioned imperfectly as a price discovery tool, both during the pre-signing and post-signing phases. . . . Because it is impossible to quantify the exact degree of the sale process mispricing, this decision does not give weight to the Final Merger Consideration [of $13.75 per share]."[344] Instead, Vice Chancellor Laster used a discount-

[343] *See In re* Appraisal of Dell Inc., No. 9322, 2016 WL 3186538, at *42–43 (Del. Ch. May 31, 2016) (acknowledging information asymmetries); *id.* at *43–44 (acknowledging valuable-management problem); *id.* at *43 (acknowledging Michael Dell's financial incentives to discourage overbids); *id.* at *40 (acknowledging the ticking-clock problem).

[344] *Id.* at *51; *see also id.* at *44 ("Taken as a whole, the Company did not establish that the outcome of the sale process offers the most reliable evidence of the Company's value as a going concern.").

ed cash flow approach to value Dell at $17.62 per share, 28% higher than the deal price.[345]

Practitioners have argued that the Dell appraisal represents a radical departure from the trajectory of Delaware appraisal case law that deferred to the deal price.[346] In fact, this Article demonstrates why the decision is highly consistent with the principle that the deal price provides the best indication of fair value if — but only if — it is the result of an arm's-length negotiation, subject to a meaningful market check.

CONCLUSION

This Article identifies four factors that can create an unlevel playing field in MBOs: information asymmetries, valuable management, management financial incentives to discourage overbids, and the ticking-clock problem. This taxonomy of four factors allows special committees to assess the degree to which the playing field is level in an MBO. To the extent that the playing field is not level, this Article provides tools that special committees can use to correct the problem: things like contractual commitments from management that allow the board to run the process; pre-signing rather than post-signing market canvasses; information rights rather than match rights; ex ante inducement fees; and approval from a majority of the disinterested shares. While all of these more potent deal technologies have appeared sporadically over the past decade, they need to be deployed more consistently by special committees, especially when all four of the factors noted above are present. This Article also identifies ways that the Delaware courts can encourage these more potent devices when appropriate: through the threat of entire fairness review, the application

[345] *Id.* at *51. Vice Chancellor Laster went out of his way to find that the Dell board did not violate its fiduciary duties. *See id.* at *29. The fact that the Dell board could fulfill its fiduciary duties and still miss fair value by 28% highlights the importance of the appraisal remedy — including appraisal arbitrage — to fill the gap between the two concepts. Matt Levine provides a somewhat tongue-in-cheek critique of the decision. *See* Matt Levine, *Michael Dell Bought His Company Too Cheaply*, BLOOMBERGVIEW (June 1, 2016, 11:38 AM), https://www.bloomberg.com/view/articles/2016-06-01/michael-dell-bought-his-company-too-cheaply [https://perma.cc/N2GG-4N55] ("The proof that $17.62 was the fair price is that *no one was willing to pay it*.").

[346] *See* LEWIS R. CLAYTON & STEPHEN P. LAMB, PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP, CLIENT MEMORANDUM: IMPLICATIONS OF THE RECENT DELL APPRAISAL DECISION (2016), https://www.paulweiss.com/media/3581253/13jun16_dell.pdf [https://perma.cc/P9P8-648J]. *In re Appraisal of DFC Global Corp.*, No. 10107, 2016 WL 3753123 (Del. Ch. July 8, 2016) was the first Delaware appraisal case after the *Dell* decision. Chancellor Bouchard awarded the petitioners $10.21 per share, which was 7% more than the $9.50 per share deal price. *Id.* at *23. Unlike the *Dell* appraisal, the Court awarded a one-third weight to the deal price. *Id.* The Court noted: "Although this Court frequently defers to a transaction price that was the product of an arm's-length process and a robust bidding environment, that price is reliable only when the market conditions leading to the transaction are conducive to achieving a fair price." *Id.* at *1.

of *Revlon* duties, and the degree of reliance on the deal price in appraisal proceedings. These refinements to the background corporate law would better reflect the practical realities of MBOs, would mirror the evolution of freezeout doctrine, and would give more leverage to special committees negotiating for such conditions in the first place.

The debate on the effectiveness of procedural safeguards in MBOs, and the desirability of MBOs more generally, implicates more than just wealth transfers between managers and public shareholders. As I have described in prior work, shareholders are willing to take minority positions based on a core expectation that they will be treated fairly. Without legal constraints on opportunistic behavior by a controlling shareholder or management, this basic expectation is defeated. In MBOs, management holds an inside position and can exploit its greater visibility on intrinsic value to execute an MBO opportunistically. Without constraints on such behavior, investors would face a "heads I win; tails you lose" situation: if the company has a strong outlook, management will execute an MBO and take for itself all of the upside. If the company does not, management will allow external capital providers to stay along for the ride. Rational investors, at least over time, would either decline to invest or would pay less for equity positions. The result would be reduced access to capital and/or a higher cost of capital for entrepreneurs.

This Article proposes specific tools for special committees and doctrinal reforms for the Delaware courts that would avoid this outcome. The resulting social welfare effect would be far greater than the effect of the recent reforms in freezeout transactions, for the simple reason that such reforms would affect every public company. Not every company has a controlling shareholder, but every company must have management.