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Delaware Supreme Court Provides Guidance on Factors to Consider in Appraisal Valuation Procedure in Context of DFC Global Appraisal Action

In *DFC Global Corp. v. Muirfield Value Partners, L.P.*,¹ the Delaware Supreme Court reversed and remanded the Court of Chancery's appraisal decision relating to the 2014 acquisition of DFC Global Corporation, an international non-bank provider of alternative financial services (a "payday lender"), by a private equity buyer, Lone Star. Although the Supreme Court declined to adopt a presumption in favor of the transaction price established through a robust, arm's-length sales process as the best measure of fair value, it nonetheless found that the Court of Chancery abused its discretion in failing to accord the transaction price greater weight under the circumstances of the case. The decision is significant because it addresses, among other things, the weight that the Court of Chancery should give to transaction price in determining fair value, whether the transaction price resulting from a transaction in which the winning bidder was a private equity buyer whose pricing analysis reflected its desire to achieve a targeted rate of return can be a reliable indicator of fair value, and the need for the Court of Chancery's fair value determination to be grounded on the facts in the record and accepted financial principles.

Despite DFC's urging, the Supreme Court declined to adopt a presumption in favor of the transaction price as the best measure of fair value in appraisal cases in which the transaction was the product of a robust market check, even in circumstances where there was a rich information base and a welcoming environment for potential buyers. Adhering to its 2010 *Golden Telecom* decision,² the Supreme Court reaffirmed its view that "[r]equiring the Court of Chancery to defer – conclusively or presumptively – to the merger price, *even in the face of a pristine, unchallenged transactional process*, would contravene the unambiguous language of the [appraisal] statute" and would "inappropriately shift the responsibility to determine 'fair value' from the court to the private parties." In light of the fact that the Delaware appraisal statute gives the Court of Chancery broad discretion to independently determine the fair value of a company's shares, considering "all relevant factors," the Supreme Court declined to essentially rewrite the statute and create a presumption in favor of the transaction price, but invited the Delaware General Assembly to do so.

The Supreme Court did, however, endorse the use of the transaction price in determining the fair value of DFC. The Supreme Court explained that its "refusal to craft a statutory presumption in favor of the deal price when certain conditions pertain does not in any way signal [the Court's] ignorance to the economic reality that the sale value resulting from a robust market check will often be the most reliable evidence of fair value, and that second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous." The Supreme Court also noted several objective factors that supported the fairness of the transaction price for DFC, including the failure of other buyers to pursue the company when they had an opportunity to do so, the unwillingness of lenders to support a transaction, a rating agency's assignment of a negative credit watch on the company's long-term debt, and the company's failure to meet its own projections. The Supreme Court also reiterated that Delaware case law under the appraisal statute values the company on a stand-alone basis, and excludes any value that might be attributed to a synergy premium that a buyer might pay to gain control of the company.

¹ *DFC Global Corp. v. Muirfield Value Partners, L.P.*, No. 518, 2016 (Del. Aug. 1, 2017).

² *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010).

In the opinion below, the Court of Chancery had found that the sales process was robust and conflict-free, but afforded equal weight to each of three valuation metrics: the transaction price of \$9.50 per share, its own discounted cash flow (DCF) valuation of \$13.07 per share, and its comparable companies valuation of \$8.07 per share, arriving at a valuation of \$10.21 per share, representing a 7.5% premium over the transaction price. The Supreme Court found that the two reasons why the Court of Chancery accorded one-third weight to the transaction price were unsupported by the record. First, the Supreme Court rejected the conclusion that regulatory uncertainty facing DFC undermined the reliability of the transaction price, observing that the record demonstrated that prospective buyers as well as the equity and debt markets had factored regulatory risk into the market price for DFC's shares. Second, the Supreme Court held that the "private equity carve out" that the Court of Chancery seemed to recognize was "not one grounded in economic literature" or the record, noting that "all disciplined buyers, both strategic and financial, have internal rates of return" and that a buyer's focus on its own internal rate of return "has no rational connection to whether the price it pays as a result of a competitive process is a fair one." Thus, the Supreme Court did not view the transaction price produced where the winning bidder was a private equity buyer as an unreliable indication of fair value simply as a result of the private equity buyer's focus on its own internal rate of return. Notably, this view is consistent with the Court of Chancery's recent *PetSmart* appraisal decision³ and departs from certain other appraisal cases, including *Dell*,⁴ which is currently on appeal to the Supreme Court.

Finally, the Supreme Court criticized the Court of Chancery for failing to explain the basis for assigning one-third weight to each valuation metric, a decision that was in tension with the Court of Chancery's own findings about the robustness of the market check. The Supreme Court emphasized that while the Court of Chancery has broad discretion in determining fair value, it must explain "with reference to the economic facts before it and corporate finance principles, why it is according a certain weight to a certain indicator of fair value."

Despite the fact that the Delaware Supreme Court declined to adopt a bright-line rule requiring deference to the transaction price, its reversal of the Court of Chancery's appraisal decision reaffirms the Delaware courts' general view that the transaction price resulting from a robust, conflict-free, and arm's-length sales process will often be the most reliable evidence of fair value of a company's shares. The pending appeal in the *Dell* appraisal action is likely to provide additional guidance on this topic, in the context of a determination of fair value in a management-led buyout.

³ *In re Appraisal of PetSmart, Inc.*, C.A. No. 10782-VCS (Del. Ch. May 26, 2017).

⁴ *In re Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016).