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Further Clarification from Delaware Supreme Court on Deal Price in Statutory Appraisal Actions

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The Delaware Supreme Court offered further guidance this week on the weight to be accorded a negotiated deal price in the context of shareholder appraisal litigation,¹ which of course is important to businesses and counsel involved in M&A transactions that may be subject to judicial review. *DFC Glob. Corp. v. Muirfield Value Partners LP*, No. 518, 2016 (Del. en banc, Aug. 1, 2017). Important take-aways include:

- The Supreme Court emphatically declined to adopt a “presumption that in certain cases involving arms’-length mergers, the price of the transaction giving rise to appraisal rights is the best estimate of fair value.”
- With reference to the specific record before it, the Supreme Court also held, however, that it was improper to accord lesser weight to the deal price based solely on perceived instabilities in the market that, according to the Court of Chancery below, may have undermined the reliability of the market’s assessment of value.
- The Supreme Court rejected a “private equity carve-out,” whereby a deal price negotiated by a financial (rather than a strategic) buyer may be deemed less reliable due to the particular focus and objectives of such buyers.

Thus, while rejecting a judicial presumption that under the right circumstances the deal price *must* be regarded as the “exclusive” indication of fair value, the Supreme Court’s opinion in *DFC Global* reinforces the considerable weight potentially accorded to the transaction price, where that transaction came by way of an arm’s-length process and a robust bidding environment.

Deal Price as an Indication of Value in Delaware Appraisal Litigation

The merger price in an arm’s-length transaction that was subjected to a robust market check typically is regarded by the Delaware courts as a strong indication of fair value in an appraisal proceeding. In fact, under certain circumstances, the Delaware Court of Chancery has attributed 100% weight to the market price in determining fair value.² This is so because an arm’s-length

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¹ The Delaware appraisal statute can be viewed at 8 Del. C § 262.
² See, e.g., *LongPath Capital, LLC v. Ramtron Int’l Corp.*, 2015 WL 4540443, at *20, 25 (Del. Ch. June 30, 2015) (citing authorities and giving 100% weight to transaction price, minus synergies).

transaction price is “forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert)”³

The DFC Global Corporation Appraisal Action

Former stockholders of DFC Global Corporation (“DFC”)⁴ petitioned the Delaware Court of Chancery to appraise the fair value of shares they held when the company was sold to a private equity buyer, Lone Star Fund VIII (U.S.), L.P. (“Lone Star”) for \$9.50 per share in June 2014. The stockholders contended that DFC was sold at a discount to its fair value during a period of regulatory uncertainty that temporarily depressed the market value of the company. Although the Court of Chancery frequently defers to a transaction price that was the product of an arm’s-length process and a robust bidding environment (the Court found both to be present here), the Court also found that price is reliable only when the market conditions leading to the transaction are conducive to achieving a fair price. Similarly, a discounted cash flow model is only as reliable as the financial projections used in it and its other underlying assumptions. The Court of Chancery found that the DFC merger was negotiated and consummated during a period of significant company turmoil and regulatory uncertainty,⁵ calling into question the reliability of the transaction price as well as management’s financial projections and thus the reliability of both the merger price and the proffered discounted cash flow analyses as indications of value. Accordingly, the Court of Chancery concluded that the most reliable determinant of fair value of DFC’s shares came by way of a blend of three imperfect techniques: a discounted cash flow model, a comparable company analysis, and the transaction price, each equally weighted. Based on this blended analysis, the Court determined that the fair value of DFC’s shares when the transaction closed was \$10.21 per share.

Reversal by the Delaware Supreme Court

The opinion reversing the Court of Chancery Court appraisal calculation rested on an array of determinations, including the following:

³ Van de Walle v. Unimation, Inc., 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991).

⁴ DFC’s business focuses on alternative consumer financial services, colloquially known as “payday lending.” DFC was publicly traded on the NASDAQ exchange from 2005 until it was acquired by Lone Star in a merger transaction.

⁵ DFC faced significant competition in the countries in which it operated, although the nature of the competition varied from market to market. DFC also was subject to regulations from different regulatory authorities across its markets. One of the key risks DFC faced was the potential for changes to those regulations that could increase the cost of doing business or otherwise limit the company’s opportunities.

- 1. No presumption.** The Supreme Court rejected DFC’s suggestion (raised for the first time on appeal) that Delaware recognize a *presumption* that in certain cases involving arm’s-length mergers, the price of the transaction giving rise to appraisal rights is the “exclusive,” “best” or “primary” estimate of fair value. Chief Justice Strine observed that such a presumption has no basis in the statutory text, which gives the Court of Chancery the discretion to “determine the fair value of the shares” by taking into account “all relevant factors.” 8 Del. C. § 262(h).
- 2. Record did not support according deal price lesser weight due to regulatory uncertainty.** With respect to the Chancery Court’s determination that the deal price was undercut by DFC’s uncertain position with respect to future regulatory developments, the Supreme Court held that the evidence presented in the appraisal proceeding did not support that determination. On the contrary, the record demonstrated that the equity and credit markets were intensely focused on the extent to which DFC could address the new regulatory burdens and how they affected its potential for future growth, and this was factored into consideration of the deal by potential buyers who declined to proceed as well as by DFC’s ultimate purchaser. Therefore, these risks were part of the matrix of data legitimately considered in determining the intrinsic value of the enterprise under the appraisal construct. The deal price should not have been given less weight due to market risks which, in one form or another, confront many transacting companies in a wide array of industries.
- 3. No private equity “carve-out.”** The Supreme Court likewise rejected the Chancery Court’s conclusion that Lone Star’s status as a financial buyer “focused its attention on achieving a certain internal rate of return and on reaching a deal within its financing constraints, rather than on DFC’s fair value.” Chief Justice Strine noted that all disciplined buyers, both strategic and financial, have internal rates of return that they expect in exchange for taking on the significant risk of a merger. That a buyer focuses on hitting this 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. Likewise, that the buyer’s lenders would not finance the acquisition at a higher price is no reason to conclude that the equity is being undervalued; rather, it reflects the simple fact that the lender will lend commensurate with its expectation of being paid back. Again, the Supreme Court concluded that there was no evidentiary basis to support the assumption that because the buyer was a financial one, the price it paid cannot be deemed a reliable indication of value.



For More Information

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