

Delaware Supreme Court's Ruling in DFC Global Provides Important Clarity on the Role of Deal Price and the Sale Process in Appraisal Proceedings

August 14, 2017

The Delaware Supreme Court, in [an opinion by Chief Justice Strine](#), recently reversed and remanded the Chancery Court's ruling in *DFC Global Corporation v. Muirfield Value Partners, L.P.*¹, an appraisal proceeding to determine the fair value of DFC Global following its acquisition by the private equity firm Lone Star Funds. In recent appraisal decisions, including *DFC Global* and *In re Appraisal of Dell, Inc.*², the Chancery Court declined to rely on the deal price as the best evidence of fair value, notwithstanding a robust sale process. This was due, in part, to flaws that the Chancery Court determined to exist in the ability of the market to establish a fair price. These decisions resulted in appraisal values meaningfully in excess of the deal price, creating significant uncertainty for buyers and sellers in the M&A market. *DFC Global*, a highly anticipated opinion by the Delaware Supreme Court, provides important clarity over the role of the deal price and the sale process in Delaware appraisal proceedings. The Delaware Supreme Court will also have an opportunity to provide further clarity on the role of deal price and the sale process in appraisal proceedings in its upcoming review of the Chancery Court's decision in *Dell*. The *Dell* proceedings will therefore continue to be worth monitoring.

The key elements of the Delaware Supreme Court's decision in *DFC Global*, and its implications for buyers and sellers in future M&A transactions, are outlined below.

- **Road Map for Deference to Deal Price.** In *DFC Global*, the Delaware Supreme Court rejected the proposition that there should be a presumption or bright-line rule that the deal price is the best estimate of fair value in cases involving arm's length mergers.³ In particular, the court took the position that there was no basis under the Delaware appraisal statute for such a presumption. Nevertheless, the Delaware Supreme Court held that the deal price should receive significant deference by the Delaware courts under the facts of *DFC Global*. *DFC Global* therefore creates an important road map (though not a safe harbor) for how to structure sale processes that will likely result in the Delaware courts looking predominately to the deal price in reviewing appraisal claims. The key facts present in *DFC Global* establishing this road map include the following:
 - a competitive market search that lasted a meaningful period of time (in DFC's Global's case, approximately two years) and in which the target approached "every logical buyer" (dozens of financial buyers and several strategic buyers);

¹ No. 518, 2016 (Del. Aug. 1, 2017).

² C.A. #9322-VCL (Del. Ch. May 31, 2016).

³ *DFC Global* can be read to provide somewhat of an invitation to the Delaware legislature to consider additional changes to the Delaware appraisal statute to create a presumption in favor of the deal price, given the Delaware Supreme Court's inability to alter the unambiguous language of the statute. Unless and until the Delaware legislature takes further action on the matter, *DFC Global's* faithfulness to the statutory text may create cover for buyers and sellers to further navigate appraisal risk through statutory alternatives by, for example, reincorporating in a State with no (or at least a less uncertain) appraisal regime in advance of a transaction, assuming a target were to be amenable to doing so.

- an open opportunity for buyers to engage with the target during the sale process without meaningful inhibition of deal protections;
 - the ultimate purchase of the target in an arm's length sale to the highest bidder; and
 - no hint of self-interest during the sale process.
- *Refuting the Deal Price as the Best Estimate of Fair Value.* *DFC Global* indicates that, where a robust and arm's length sale process exists such as that in *DFC Global*, petitioners can refute the deal price as the best estimate of fair value only where they clearly establish that the collective judgment of those participating in the bidding process or the market for the target company's securities lacks reliability. Moreover, the facts establishing this contention must be "grounded in the record and reliable principles of corporate finance and economics". In *DFC Global*, for example, the Chancery Court held the deal price unreliable because DFC Global's stock price was in a "trough" due to regulatory uncertainty in its industry (payday loans). The Supreme Court rejected this conclusion, noting, among other things, that nothing in the record supported the contention that DFC Global's potential buyers were not in the best position to collectively price regulatory risk into their valuation of the company in a competitive bidding process. *DFC Global* therefore indicates that evidence used to refute the reliability of the deal price under facts existing in *DFC Global* would need to be substantial, clearly explained and rooted in firm economic or valuation principles. This aspect of the Supreme Court's upcoming decision in *Dell* will be of particular interest, as there too the Chancery Court found flaws in the market that rendered the deal price unreliable, notwithstanding a robust sale process that passed muster against fiduciary duty claims.
- *Overruling a "Private Equity Carve-out".* *DFC Global* is a favorable opinion for financial sponsors, as the Delaware Supreme Court rejected the contention that the deal price in private equity backed transactions is less reliable than in strategic buyer transactions merely due to the perceived need of a financial sponsor to earn a higher internal rate of return than other hypothetical buyers in negotiating the deal price. The Court of Chancery's decision in *DFC Global* and other recent appraisal proceedings had created uncertainty for financial sponsor-backed deals through the application of the "private equity carve-out". Under this principle, the Court of Chancery had deemed the deal price in *DFC Global* less reliable, notwithstanding a robust sale process, because the private equity buyer was focused on meeting its required internal rate of return in negotiating the deal price. The Supreme Court did "not understand the logic of this finding", particularly in the context of a competitive bidding process in an arm's length transaction and held that the private equity carve-out was not supported by either economic principles or the record. Rather, a private equity buyer's internal rate of return requirements had no rational connection to the fairness of a deal price that results from a competitive, conflict-free process. This portion of the *DFC Global* decision, which will again be tested in *Dell*, therefore provides additional comfort for financial sponsors in a competitive bidding context.⁴

In summary, while not establishing a presumption or bright-line rule, *DFC Global* provides important clarity that the deal price will receive significant deference in appraisal proceedings in circumstances similar to those described above. In a sense, although it is not a safe harbor, in transactions with facts

⁴ Obviously, this favorable ruling is of less use to a sponsor that identifies an acquisition opportunity and is able to convince the target and its board to proceed in negotiating a transaction without a robust sale process. While these sorts of opportunities may not be regularly available in the current legal and market environment, there have been a number of high-profile examples of such transactions in the recent past (e.g., deals in which the controlling shareholder of a target or its important CEO were active and key participants in the take-private).

that are analogous to *DFC Global*, there will be a strong presumption, as a practical matter, that the deal price is reliable evidence of fair value, and that this presumption can be overcome only by clear and substantial evidence, supported by well-accepted economic or valuation principles. It will be interesting to see how the Delaware Supreme Court applies the principles of *DFC Global* to its expected decision in *Dell*. Hopefully, the *Dell* decision will provide additional clarity for M&A buyers and sellers and their advisors for future take-privates.

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