

What Is the Fair Value of a Stock? The Delaware Supreme Court Rejects Bright-Line Rule in Favor of the Transaction Price

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The Delaware Supreme Court, sitting *en banc*, recently reversed and remanded the Court of Chancery's appraisal decision in *DFC Glob. Corp. v. Muirfield Value Partners, L.P.* ("*DFC Global*"),^[i] a highly publicized opinion in which the Court of Chancery rejected the transaction price as the most reliable measure of fair value and valued the stock of DFC Global Corporation ("*DFC*") at a premium.^[ii]

In sum, the Court of Chancery held that the fair value of the stock of DFC, a publicly traded payday lending firm, was \$10.21 a share, which is approximately a 7 percent premium above the \$9.50 deal price paid to DFC stockholders in June 2014, when shares were sold to Lone Star Fund VIII (U.S.), LLP ("*Lone Star*"), a private equity firm, following a two-year sale process.^[iii] Although the Court of Chancery explained that it "frequently defers" to the transaction price when it involves a robust sale process, it found that the DFC transaction occurred, *inter alia*, during a period of turmoil and regulatory uncertainty for DFC; therefore, the transaction price and management's projections were unreliable. Further, the Court of Chancery assessed three valuation methodologies: a discounted cash flow analysis, a multiples-based comparable company analysis, and the final transaction price. Although the Court of Chancery found each methodology to be "imperfect," it determined that the fair value of DFC was best determined by weighing all three equally.

On appeal, DFC argued in favor of a bright-line rule that the transaction price was the best evidence of fair value when it was the product of a robust sale process. However, Chief Justice Strine, writing for the Supreme Court, rejected adopting such a bright-line rule, finding no basis for it in light of the appraisal statute's requirement that the Court of Chancery consider "all relevant factors" in determining fair value.^[iv] The Supreme Court held that under the facts (as found by the Court of Chancery), the transaction price was likely the best evidence of fair value, given that it "resulted from an open process, informed by robust public information, and easy access to deeper, non-public information, in which many parties with an incentive to make a profit had a chance to bid."^[v]

The Delaware Supreme Court held that the Court of Chancery abused its discretion in giving only one-third weight to the transaction price. First, the Supreme Court rejected the Court of Chancery's finding that certain regulatory developments made the market's assessment of DFC less reliable. The Supreme Court found that the Court of Chancery failed to cite any literature to suggest that the markets could not price this regulatory risk. Instead, the Supreme Court found that it is not unusual for the payday lending industry to be subject to such risk, equity analysts and buyers were aware of the risks DFC faced, and the markets factored the risk into the pricing.

Second, the Supreme Court rejected the Court of Chancery's decision to give less weight to the transaction price because Lone Star was a financial buyer that required a specific rate of return on the deal. The Supreme Court provided "[t]hat a buyer focuses on hitting its 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," particularly where there were other facts supporting the transaction price, such as a lack of conflicts of interest.[vi]

Third, the Supreme Court rejected the Court of Chancery's decision to increase the perpetuity growth rate from 3.1 percent to 4.0 percent in its discounted cash flow analysis after it found at reargument that it made a clerical error. The Supreme Court found this decision was not rationally supported in the record because the increase did not account for, *inter alia*, the fact that DFC had experienced "nearly a generation of rapid growth" and DFC was experiencing regulatory "pushback" affecting its profitability and working capital.[vii]

Accordingly, the Delaware Supreme Court reversed and remanded the matter to the Court of Chancery to reassess the weight given to all relevant factors in determining fair value, suggesting—but not requiring—that the transaction price be the most reliable indication of fair value under the circumstances.

DFC Global clarifies the role of the transaction price in appraisal proceedings. The Delaware Supreme Court, relying upon the plain language of the appraisal statute and its decision in *Golden Telecom, Inc. v. Glob. GT LP*,^[viii] declined to adopt a bright-line presumption in favor of the transaction price where the transaction involves a robust, arm's-length sales process. Nevertheless, the Supreme Court seemed to suggest that the transaction price, when a product of a robust sales process, would often be the "best evidence of fair value."^[ix] Further, the Supreme Court advised the Court of Chancery that 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 value."^[x]

It will be important to follow *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd. et al.* ("*Dell*"),^[xi] which is currently before the Delaware Supreme Court and scheduled to be heard this month. Similar to *DFC Global*, *Dell* is an appraisal decision in which the Court of Chancery rejected the transaction price as the most significant indicator of fair value (despite a fair process) in valuing the stock at nearly a 30 percent premium.^[xii] Thus, it will be interesting to see if the Supreme Court integrates its *DFC Global* opinion in *Dell*.

[i] No. 518, 2016, 2017 WL 3261190 (Del. Aug. 1, 2017).

[ii] *In re Appraisal of DFC Glob. Corp.*, 2016 WL 3753123, at *1 (Del. Ch. July 8, 2016), *rev'd sub nom. DFC Glob. Corp. v. Muirfield Value Partners, L.P.*, No. 518, 2016, 2017 WL 3261190 (Del. Aug. 1, 2017).

[iii] A summary of the Court of Chancery's opinion below is available here: <http://www.mccarter.com/Delaware-Law-Updates-What-Is-the-Fair-Value-of-a-Stock-Delaware-Court-of-Chancery-Rejects-the-Transaction-Price-as-the-Most-Reliable-Measure-07-28-2016/>.

[iv] See 8 *Del. C.* § 262(h).

[v] *DFC Glob. Corp.*, 2017 WL 3261190, at *1.

[vi] *Id.* at *22.

[vii] *Id.* at *24.

[viii] 11 A.3d 214 (Del. 2010).

[ix] See *DFC Glob. Corp.*, 2017 WL 3261190, at *1, 15.

[x] *Id.* at *31.

[xi] C.A. No. 565, 2016.

[xii] See hyperlink provided in note iii for a summary of the Court of Chancery's opinion.