

DELAWARE SUPREME COURT GIVES GUIDANCE ON APPRAISALS; MORE TO COME

The Delaware Supreme Court last week handed down its ruling on the first of a pair of appraisal cases it has been considering. Last week's decision was in the [DFC Global](#) case; the other pending appraisal case is [Dell](#).

In last week's ruling the Court reversed and remanded the Chancery Court's decision in [DFC Global](#). The Chancery Court had declined to adopt the negotiated deal price as the best evidence of fair value, choosing instead to assign the deal price only an equal one-third weighting with two other valuation metrics despite finding the sale process "pristine." The Chancery Court did so because (according to the Chancery Court) the regulatory and other developments affecting DFC temporarily distorted its market valuation, and because the private equity-backed purchaser had return-on-investment criteria that limited what it was willing to pay.

The Supreme Court appeared unimpressed by that reasoning. It found on the first point that especially here, where DFC had a large equity capitalization, the market for its shares was liquid, and equity analyst coverage helped investors in DFC's shares be well-informed about its prospects, there was no basis to conclude the market was mispricing the regulatory and other risks faced by DFC. On the second point, the Supreme Court crisply observed that all buyers of companies can be expected to have return criteria that limit how much they are willing to pay.

However, the Supreme Court declined to adopt a bright-line rule requiring deference to the negotiated deal price in appraisal cases in which the sale process appears to have been appropriately robust, noting the Delaware appraisal statute directs the Chancery Court to consider "all relevant factors" in determining the fair value of an acquired company's shares. But the Supreme Court noted with apparent approval that in a series of recent appraisal cases, the Chancery Court has concluded after considering all relevant factors that the negotiated deal price provides the best evidence of fair value.

The Supreme Court's opinion emphasizes the importance of adhering to the appraisal statute and in doing so noted the statute directs determination of fair value "exclusive of any element of value arising from the accomplishment or

"Like any factor relevant to a company's future performance, the market's collective judgment of the effect of regulatory risk may turn out to be wrong, but established corporate finance theories suggest that the collective judgment of the many is more likely to be accurate than any individual's guess."

Delaware Supreme Court,
August 1, 2017

"[A]ll disciplined buyers, both strategic and financial, have internal rates of return that they expect in exchange for taking on the large risk of a merger, or for that matter, any sizeable investment of its capital. That 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."

Delaware Supreme Court,
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expectation of the merger." This part of the ruling is technically *dictum* but nonetheless will provide a basis for defendants in future appraisal proceedings to contend that any portion of a negotiated deal price allocable to merger synergies should be excluded from fair value, and that the undisturbed pre-merger trading price of the target's shares is the best indication of fair value. Either of these theories, if accepted by the Chancery Court in an appraisal proceeding, would generate a fair value appraisal below the negotiated deal price.

The Supreme Court's decision in Dell, when issued, should provide further valuable guidance.

"Historically, appraisal actions have had the most utility when private companies are being acquired or for public companies subject to a conflicted buyout, situations where market prices are either unavailable altogether or far less useful. When, as here, the company had no conflicts related to the transaction, a deep base of public shareholders, and highly active trading, the price at which its shares trade is informative of fair value, as that value reflects the judgments of many stockholders about the company's future prospects, based on public filings, industry information, and research conducted by equity analysts."

Delaware Supreme Court,
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