

DFC Global Ruling: Investors Dodge a Bullet, But Watch Out for Shrapnel....

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On August 1, 2017, the Delaware Supreme Court issued its much-awaited opinion (available [here](#)) in the appraisal of *DFC Global Corp.* This appraisal garnered the attention of the M&A community and raised major concerns for investors because DFC Global requested the Delaware Supreme Court to adopt a bright-line rule that would eviscerate an effective appraisal remedy in almost every third-party merger. Specifically, DFC Global requested the Supreme Court to adopt a rule that would require the lower courts to apply the negotiated deal price as the "fair value" of the company. We were co-counsel representing 21 leading finance and law professors in an *amicus curiae* brief arguing against the proposed "deal price" rule (available [here](#)). DFC Global's request for a bright line rule limiting shareholder rights did not arise in a vacuum. Rather, it emerged against a backdrop of the Delaware courts sharply curtailing merger-related fiduciary duty litigation. As we and others have explained elsewhere, the Delaware courts' commendable efforts to stop frivolous shareholder actions have gone too far and resulted in inadequate accountability for corporate fiduciaries (available [here](#)). ***DFC Global - Clear Rejection of a Blanket "Deal Price" Rule, But*** Like "eminent domain" rights, Section 262 of the Delaware General Corporation Law gives dissenting stockholders (acting only for their own shares) the right to appraisal when their stock is taken from them against their will. The statute represents a sensible tradeoff: minority stockholders cannot hold up mergers (which once required unanimous approval), but their personal property rights are judicially protected through an important check on improper or careless behavior by corporate fiduciaries. Historically, objecting investors did not have to prove breach of duty or affirmative wrongdoing to show that the fair value exceeded the merger price. Rather, Section 262 directed the Court of Chancery to "take into account all relevant factors" in determining fair value. Petitioners (investors) and respondents (acquired companies) in appraisal actions bore equal burdens of proof and the Court made an independent determination as to value. In *DFC Global*, the Supreme Court expressly refused to adopt a blanket rule requiring the Chancery Court to defer to the deal price in public company mergers. This is an important vindication of stockholders' fundamental right to seek relief if their company is merged and shares taken against their will. Following a lengthy analysis, the Supreme Court reversed the Court of Chancery's underlying opinion on "fact-specific" grounds. The Supreme Court identified several types of transactions that will remain subject to a traditional fair value assessment and not be tied to the deal price. In particular, the Supreme Court highlighted that the sale of DFC Global was "not a situation where a company conducts an auction to sell itself and only after a winning bidder is locking in at a particular price does good news start to flow in." In other words, no matter the quality of the sales process leading to signing up a deal, positive changes affecting the target company or its industry that take place between signing and closing of the deal will

remain a valid basis for appraisal. The Supreme Court also strongly suggested that transactions involving "public companies subject to a conflicted buyout" remain appropriate for a traditional fair value assessment because in those situations market prices are "far less useful." That said, *DFC Global* arguably moves away from the historic concern for dissenting investors by strongly suggesting that it places more trust in the "market" and in "the larger universe of equally avid capitalists" than in the judges of the Chancery Court to determine "fair value." The Supreme Court emphasized that a court, assisted by expert analyses in an adversary proceeding, typically cannot make a more reliable determination of fair value than "the collective judgment embodied in the market price." We have reservations about this premise. Multiple factors - including the realities of market dynamics (and decreased judicial accountability), nonpublic company information (including long-term projections), and the inherent minority discount in the stock price of publicly traded companies - suggest that mergers may often be approved by target boards and a majority of shareholders even though the deal price is not a reliable proxy for the company's standalone "fair value." ***DFC Global - Reiterating Deference to the Court of Chancery's Discretion, But*** The Supreme Court reiterated its long-standing precedent of deferring to the discretion of the Court of Chancery's judges to assess and weigh evidence in reaching its conclusions, noting that the Court had a "proven record" of exercising nuanced judgment as needed. In our view, as a historical matter, the sophisticated judgment of the Chancellor and Vice Chancellors has been critical to the Delaware Court of Chancery's recognition as one of the world's most venerated business courts. However, we are concerned about the way the Supreme Court actually applied the "abuse-of-discretion" standard in *DFC Global*. Both parties filed cross-appeals. The Supreme Court spent under ten pages explaining its rejection of the blanket "deal price rule" and about three pages explaining why the petitioners' cross-appeal provided no basis to reject the trial judge's discretion. The Supreme Court spent the vast majority of its 85-page opinion accepting the Respondents' challenges to the trial court and sharply criticizing the Chancery Court's factual analysis and assessment of the company's value. Through this approach, the Supreme Court may be suggesting that, going forward (and notwithstanding the discretion it nominally gives the Court of Chancery), the trial judge will have to provide extensive detail supporting its reasons for deviating from the deal price in public company mergers. Investors might question whether the rigor the Supreme Court demands from the lower court is a one-way street: historically trial court judgments have been given broad deference when the court simply equates the deal price with fair value, but face rigorous scrutiny when the court departs from the deal price. If the Chancery Court perceives that its rulings will face intense second-guessing only if it rules in ways that are beneficial for investors, it may default to the deal price to avoid scrutiny and the risk of reversal. How the trial judges react to this ruling, including what the Chancellor does on remand, will be important indicators of whether the Court of Chancery's historic discretion is becoming illusory with respect to rulings that confirm investor rights. ***DFC Global - Confirming the Need for Rigorous Analysis of the Merger Process*** We have always believed that stockholders assessing whether to seek appraisal should undertake a thorough review of the merger process and other market factors in addition to conducting a valuation analysis. *DFC Global* confirms and solidifies that view. Investors should continue to subject potential appraisals to a rigorous vetting process to ensure that there are cogent reasons to deviate from the deal price. In our view, this observation is nothing new, but it is more important than ever. If you are interested in learning more about this case and about any further developments, please contact:

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