IN THE SUPREME COURT OF THE STATE OF DELAWARE

DFC GLOBAL CORPORATION,	§	
	§	No. 518, 2016
Respondent Below,	§	
Appellant/Cross-Appellee,	§	Court Below: Court of
	§	Chancery of the State of
v.	§	Delaware
	§	
MUIRFIELD VALUE PARTNERS, L.P.,	§	C.A. No. 10107
OASIS INVESTMENTS II MASTER	§	
FUND LTD., CANDLEWOOD SPECIAL	§	
SITUATIONS MASTER FUND, LTD.,	§	
CWD OC 522 MASTER FUND LTD.,	§	
and RANDOLPH WATKINS SLIFKA,	§	
	§	
Petitioners Below,	§	
Appellees/Cross-Appellants.	§	

Submitted: June 7, 2017
Decided: August 1, 2017

Before **STRINE**, Chief Justice; **VALIHURA**, **VAUGHN**, and **SEITZ**, Justices; **LEGROW**, Judge,* constituting the Court *en Banc*.

Upon appeal from the Court of Chancery. **REVERSED** and **REMANDED**.

* Sitting by designation under Del. Const. art. IV, § 12.

STRINE, Chief Justice:

I.

A. DFC

i. DFC's Growth

DFC Global Corporation ("DFC") provides alternative consumer financial services, predominately payday loans. The 2014 transaction giving rise to this appraisal action resulted in DFC being taken private by Lone Star, a private equity firm.

DFC was formed in 1990. Its operations then were entirely in the United States. Since then, it has made more than 100 acquisitions to grow the business worldwide. By the time of the sale giving rise to this appraisal (i.e., the "merger" or “transaction”), DFC operated in ten countries with more than 1,500 locations, in addition to having a substantial internet lending business. But, the bulk of DFC’s revenues came from three main markets: the United Kingdom (47%), Canada (31%), and the U.S. (12%). In the U.S., at the time of the merger, DFC operated 292 stores in 14 states, especially California, Louisiana, and Arizona, and provided loans to enlisted military personnel.

DFC entered Canada in 1996 and had 489 stores there as of the merger. DFC had grown rapidly in Canada, reaching 214 stores by 2004,[8] and, by the time of the merger, DFC could say that it was the “largest alternative financial services retail store network in Canada based upon revenues and profitability.”[9]

Particularly relevant for this appraisal, DFC entered the U.K. market in 1999 and embarked on an ambitious expansion. Six years after DFC entered that market, in 2005, it had 152 stores. By 2009, only four years later, it almost doubled its footprint in the U.K. to 330 stores.[10] And, as of the merger, DFC had nearly doubled its stores in the U.K. again, reaching 601 locations.

The rapid growth of DFC's business can be seen in its overall revenues. In 2004, its last fiscal year before becoming a public company, DFC had total revenues of $270.6 million. As of 2013, the last fiscal year before the merger, its total revenues had increased to $1.12 billion, or 314% higher. And, this masked even stronger growth in certain segments, such as the U.K. market, which experienced some years with over 60% year-over-year growth. DFC's rapid growth can be seen in its strong year-over-year revenue growth post-initial public offering:

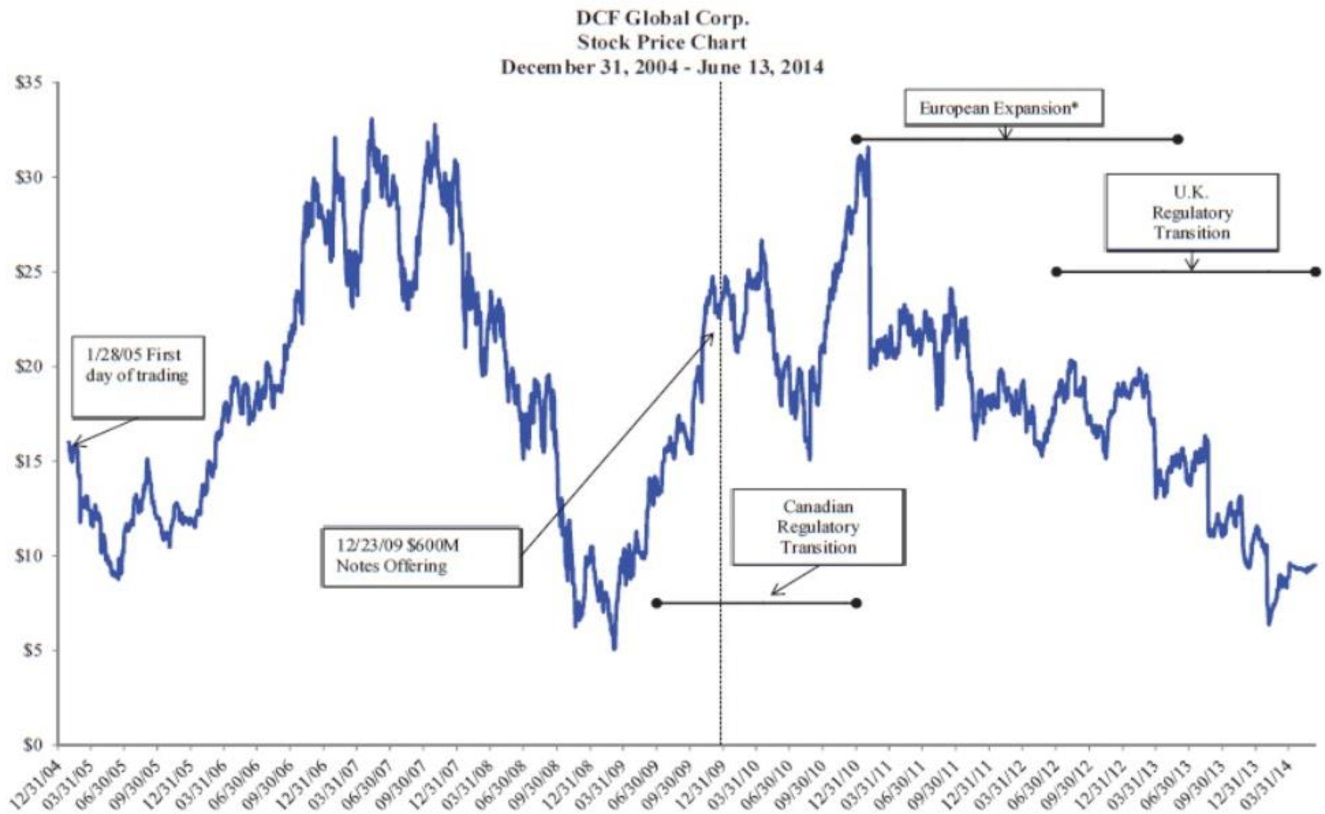
DFC Total Revenue ($, in millions)

	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Revenue	$270.6	$321.0	$358.9	$455.7	$572.2	$530.2	$633.3	$788.4	$1,061.7	1,122.3
YOY Growth	--	*18.6%*	*11.8%*	*27.0%*	*25.6%*	*-7.3%*	*19.4%*	*24.5%*	*34.7%*	*5.7%*

DFC's strong growth exemplifies the payday loan industry's material growth in the past two decades. Not only did the industry's traditional storefront payday lending grow, but the industry's online market also experienced "rapid" growth.

ii. DFC's Equity

DFC's shares were traded on the NASDAQ exchange from 2005 until the merger. Throughout its history as a public company, the record suggests DFC never had a controlling stockholder, it had a deep public float of 39.6 million shares, and, it had an average daily trading volume just short of one million shares. DFC's share price moved sharply in reaction to information about the company's performance, the industry, and the overall economy, as the following chart, prepared by the petitioners' expert, illustrates. The chart shows that regulatory action at different times and by different regulators elicited differing responses by the market.



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iii. DFC's Debt

DFC was a highly leveraged company. Its capital structure was comprised of about $1.1 billion of debt as compared to a $367.4 million equity market capitalization, resulting in a debt-to-equity ratio of 300% and a debt-to-total-capitalization ratio of 75%. DFC's high leverage "was viewed negatively by both equity and debt analysts," and, as of all relevant periods, it maintained a non-investment grade credit rating. Indeed, at the beginning of 2014, one equity analyst noted that revenue declines in DFC's U.K. operation could have negative effects on DFC's ability to both secure new loans and meet the covenants on existing loans. And, later in 2014, Standard & Poor's ("S&P"), a credit rating agency, placed DFC on its Creditwatch Negative list based in large part on "weaker-than-expected financial performance, underpinned by new lending guidelines in the U.K." Later, S&P warned that "[g]iven the extent of the regulatory risk [DFC] is exposed to, we don't foresee an upgrade within the next 12 months."

iv. Regulatory Headwinds

In the years leading up to the merger, DFC faced heightened regulatory scrutiny. In Canada, DFC confronted a new regulatory environment beginning in 2007 when the provinces in which it operated started regulating it, rather than the central government.

In the U.S., the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 created the Consumer Financial Protection Bureau, which was given regulatory, supervisory, and enforcement powers over DFC. At least one industry observer described these changes in the U.S. as "[s]weeping." The Consumer Financial Protection Bureau completed an on-site review of DFC in 2013 and found that DFC was in violation of the Consumer Financial Protection Act. As a result, DFC had to amend its U.S. practices.

In DFC's most important market—the U.K.—the Office of Fair Trading, DFC's primary regulator there, issued new rules in 2012 for payday lenders restricting their use of continuous payment authority, a method for lenders to automatically collect loan balances from borrowers' checking accounts to withdraw money very quickly after the money is deposited. In spring 2013, the Office of Fair Trading identified a number of deficiencies in DFC's businesses, requiring changes.

Then, in the fall of 2013, the Financial Conduct Authority, which replaced the Office of Fair Trading as DFC's primary U.K. regulator, identified new regulations that it would issue in 2014. One of those new regulations tightened affordability assessments and another restricted rollovers where borrowers defer loan repayments by paying additional interest and fees. Before this regulation, DFC had not limited the number of rollovers its businesses would extend to borrowers, but, after this regulation, DFC would be limited to two rollovers per loan. This was likely to hurt DFC's U.K. business because rollovers allowed payday lenders to charge additional, higher rates of interest and fees and to keep borrowers paying those rates for extended periods of time. Indeed, as a member of DFC's management team before the merger put it, "at one point in time you [could] roll a customer over forever and never have them pay back the loan but just monthly fees." Thus, a rollover is essentially an extension of loan terms such that the borrower pays extra fees and interest and in exchange doesn't have to pay back the loan as quickly as initially required. Rollovers are lucrative. When the U.S. Consumer Financial Protection Bureau examined them, it found that "most payday loans are made to borrowers who renew enough times that they end up paying more in fees than the original loan amount."

Finally, there would be a new cap put in place limiting borrowers' total cost of credit. In February 2014, the Office of Fair Trading warned DFC that it might not be able to meet the Financial Conduct Authority regulations and so, in March and April of that year, DFC had to take additional steps to make sure it could comply. The new U.K. regulations were likely to have a negative effect on DFC's profitability: "As we [DFC's management and board] began to better understand the impact of some of the changes we'd have to make in the U.K., including limiting rollovers, limiting [continuous payment authority], and all the rest, we recognized that that was going to have a negative impact on [DFC's] earnings . . . ."[33]

B. The Sale Process

Facing headwinds at least as prevalent as the tailwinds that had propelled its rapid expansion, DFC engaged Houlihan Lokey Capital Inc., in the spring of 2012, to look into selling the company. Houlihan contacted six private equity sponsors and eventually had discussions with J.C. Flowers & Co. LLC and another sponsor, as well as an interested third party that Houlihan had not contacted. These three potential buyers conducted due diligence, but in August one of the three lost interest, and, in October, J.C. Flowers and the other potential buyer also lost interest. Over

[33] Testimony of John Gavin, DFC former board member .

the next year, Houlihan reached out to thirty-five more financial sponsors and three strategic buyers.

In autumn 2013, DFC attempted to refinance roughly $600 million in Senior Notes. But, the offering was terminated because of insufficient investor interest. If DFC had wanted to go ahead with the refinancing, it would have needed to increase the bonds' coupon rate. Analysts pointed to the S&P credit rating agency's downgrade of DFC from B+ to B after the refinancing was announced and "market uncertainty around payday lending" as two factors that contributed to the termination. To be clearer about what this means, despite the lucrative fees that investment bankers make from refinancing a large tranche of public company debt and syndicating a new issue, Wall Street could not do that for DFC unless DFC was going to compensate new debtholders with a higher interest rate reflecting DFC's uncertain financial condition.

In September 2013, DFC renewed discussions with J.C. Flowers and began discussions with Crestview Partners about a joint transaction. In October, Lone Star expressed interest in DFC. In November, DFC gave the three interested parties financial projections prepared by DFC's management that estimated fiscal year 2014 adjusted EBITDA to be $219.3 million. On December 12, DFC learned that Crestview was no longer interested in pursuing a transaction. On the same day, Lone Star made a non-binding indication of interest in acquiring DFC for $12.16 per share. On December 17, J.C. Flowers made a non-binding indication of interest at $13.50 per share.

On February 28, Lone Star offered to buy DFC for $11.00 per share and requested a 45-day exclusivity period. Lone Star's offer was lower than its previous indication of interest because of U.K. regulatory changes, the threat of increased U.S. regulatory scrutiny, reduced availability of acquisition financing, stock price volatility, and weak value in the Canadian dollar. On March 3, J.C. Flowers informed DFC that it was no longer interested in pursuing a transaction because "it could not get comfortable with the Company's regulatory exposure in the U.K."   On March 11, DFC entered into an exclusivity agreement with Lone Star.

On April 1, DFC's board approved the merger at $9.50 per share.

Within one week of the merger being announced, S&P placed DFC's long-term "B" rated debt on "CreditWatch with negative implications." The merger closed June 13, 2014.

II.

Before us, DFC's central argument is that a judicial presumption in favor of the deal price should be established in appraisal cases where the transaction was the product of certain market conditions. DFC argues that those conditions pertain to this case and the Court of Chancery erred by not giving presumptive and exclusive weight to the deal price.

When reviewing a decision in a statutory appraisal, we use an abuse of discretion standard and grant significant deference to the factual findings of the trial court.[79] This Court "will accept [the Court of Chancery's] findings if supported by the record . . . ."[80]

[79] *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214, 217 (Del. 2010).
[80] *In re Shell Oil Co.*, 607 A.2d 1213, 1219 (Del. 1992).

B.

i.

A

similar argument was presented and rejected recently by this Court in *Golden Telecom*.[84] In *Golden Telecom*, the respondent company argued that this Court "should adopt a standard requiring conclusive or, in the alternative, presumptive deference to the merger price in an appraisal proceeding."[85] In rejecting that argument, this Court focused on the key language in 8 *Del. C.* § 262, stating that dissenting shareholders "shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock under the circumstances described" elsewhere in the section.[86] The statute elaborates:

> Through such proceeding the Court shall determine the fair value of the shares exclusive of any element of value arising from the

[84] 11 A.3d 214 (Del. 2010). *Golden Telecom* was an odd case to argue for deference to the deal price. The transaction in this case and the ones in the many cases when the Court of Chancery has found that the deal price was the best evidence of value reflected the results of a non-conflicted, open market check. *E.g., In re PetSmart, Inc.*, 2017 WL 2303599, at *27–*31 (Del. Ch. May 26, 2017); *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *LongPath Capital, LLC v. Ramtron Int'l Corp*., 2015 WL 4540443, at *25–*26 (Del. Ch. June 30, 2015); *Merlin P'rs LP v. AutoInfo, Inc.*, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015); *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726 (Del. Ch. Jan. 30, 2015); *Huff Fund Investment Partnership v. CKx, Inc*., 2013 WL 5878807, at *11–*14 (Del. Ch. Nov. 1, 2013); *Union Illinois 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 357–58 (Del. Ch. 2004). By contrast, the transaction in *Golden Telecom* was conflicted and did not involve a process whereby buyers not tied to the company's major stockholders would have felt welcome to bid and succeed. In fact, Golden Telecom's two largest shareholders owned more of the buyer than they did of Golden Telecom. *Glob. GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 508 (Del. Ch. 2010), *aff'd*, 11 A.3d 214 (Del. 2010).

[85] *Golden Telecom*, 11 A.3d at 216.

[86] 8 *Del. C.* § 262.

> accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.[87]

In particular, this Court focused on § 262's requirement that the Court of Chancery consider "all relevant factors" and that "fair value" entails "the value to the stockholder of the firm as a going concern."[88] Thus, this Court concluded:

> Section 262(h) unambiguously calls upon the Court of Chancery to perform an *independent* evaluation of "fair value" at the time of a transaction. It vests the Chancellor and Vice Chancellors with significant discretion to consider "all relevant factors" and determine the going concern value of the underlying company. Requiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, *even in the face of a pristine, unchallenged transactional process*, would contravene the unambiguous language of the statute and the reasoned holdings of our precedent. It would inappropriately shift the responsibility to determine "fair value" from the court to the private parties. Also, while it is difficult for the Chancellor and Vice Chancellors to assess wildly divergent expert opinions regarding value, inflexible rules governing appraisal provide little additional benefit in determining "fair value" because of the already high costs of appraisal actions.[89]

DFC would have us depart from the reasoning of *Golden Telecom*. But, we are not convinced we should do so. As *Golden Telecom* found, § 262(h) gives broad discretion to the Court of Chancery to determine the fair value of the company's shares, considering "all relevant factors." That statutory language was a key feature

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[87] *Id*. at § 262(h).
[88] *Golden Telecom*, 11 A.3d at 217.
[89] *Id*. at 217–18 (second emphasis added).

in *Weinberger v. UOP, Inc.*[90]

[90] 457 A.2d 701 (Del. 1983). *Weinberger* was itself not an appraisal case but this Court recognized its interpretation of the appraisal statute as binding on appraisal proceedings as well. *See, e.g.*, *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 296 (Del. 1996).

By the time of *Weinberger* in 1983, important developments in corporate finance and economics had occurred, such as the articulation of the capital asset pricing model and the efficient market hypothesis, and concepts related to those, such as the discounted cash flow method of valuation.[96]

[96] BRADFORD CORNELL, CORPORATE VALUATION 39 (1993) (describing, in a book published in 1993, the "voluminous" literature on the efficient market hypothesis and pointing to two papers, including one from 1970, as the "best summaries"); RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 214 (2008) ("In the mid-1960s three economists—William Sharpe, John Litner, and Jack Treynor—produced an answer to [the problem of determining expected risk premia]. Their answer is known as the capital asset pricing model or CAPM.")

ii.

Since *Weinberger*, and *Golden Telecom* itself, the key language in § 262 that those cases focused upon has remained unaltered. But, DFC would have us put a judicial gloss on the broad "all relevant factors" language, by determining that a particular factor is more relevant than others when certain conditions pertain. We do not, however, view the statutory language as inviting us to do so. Nor are we persuaded it is advisable to do so.

As we shall discuss, we have little quibble with the economic argument that the price of a merger that results from a robust market check, against the back drop of a rich information base and a welcoming environment for potential buyers, is probative of the company's fair value. But, not only do we see no license in the statute for creating a presumption that the resulting price in such a situation is the "exclusive," "best," or "primary" evidence of fair value, we do not share DFC's confidence in our ability to craft, on a general basis, the precise pre-conditions that would be necessary to invoke a presumption of that kind. We also see little need to do so, given the proven record of our Court of Chancery in exercising its discretion to give the deal price predominant, and indeed exclusive weight, when it determines, based on the precise facts before it that led to the transaction, that the deal price is the most reliable evidence of fair value.[102] For these reasons, we adhere to our prior ruling in *Golden Telecom*. If the General Assembly determines that a presumption of the kind sought is in order, it has proven its attentiveness to our appraisal statute and is free to create one itself.

As our preceding discussion presages, our refusal to craft a statutory presumption in favor of the deal price when certain conditions pertain does not in any way signal our ignorance to the economic reality that the sale value resulting from a robust market check will often be the most reliable evidence of fair value, and that second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous. In fact, the Chancellor himself, and his colleagues on the Court of Chancery, understand this, as both the decision in this case and other decisions of the Court make clear.

[102] *See* cases cited *supra* note 84.

i.

Of course, the definition of fair value used in appraisal cases is a jurisprudential concept that has certain nuances that neither an economist nor market participant would usually consider when either valuing a minority block of shares or a public company as a whole. But, those features do nothing to undermine the ability of the Court of Chancery to determine, in its discretion, that the deal price is the most reliable evidence of fair value in a certain case, and that's especially so in cases like this one where things like synergy gains or minority stockholder discounts are not contested. In fact, if one were to look at the face of our appraisal statute, a case like the one before us today might seem simple. Precisely because DFC's shares were widely traded on a public market based upon a rich information base, the "fair value of the stockholder's shares of stock"[106] held by minority stockholders like the petitioners, would, to an economist, likely be best reflected by the prices at which their shares were trading as of the merger.

But, in *Cavalier Oil Corporation v. Harnett*,[107] and other cases,[108] this Court eschewed that reading of the statute and adopted a definition of fair value that is a

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[106] 8 *Del. C.* § 262.
[107] 564 A.2d 1137, 1144 (Del. 1989).
[108] *See e.g.*, *Cede & Co.*, 684 A.2d at 298; *Tri-Cont'l Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950).

jurisprudential, rather than purely economic, construct. That definition requires according the petitioner in an appraisal her pro rata share of the appraised company's value as a "going concern."[109] By requiring that petitioners be afforded pro rata value, the Court required that any minority discount be ignored in coming to a fair value determination.[110] At the same time, by valuing the company on its value as a "going concern," the Court seemed to require the excision of any value that might be attributable to expected synergies by a buyer, including that share of synergy gains left with the seller as a part of compensating it for yielding control of the company.[111] As the Court of Chancery observed in *Union Illinois*,[112] *Cavalier Oil* and its progeny seem to require the court to exclude "any value that the selling company's shareholders would receive because a buyer intends to operate the subject company, not as a stand-alone going concern, but as a part of a larger enterprise, from which synergistic gains can be extracted."[113]

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[109] *Cavalier Oil*, 564 A.2d at 1144.
[110] *Id.* at 1145.
[111] *Id.* at 1144 ("[T]he company must be first valued as an operating entity by application of traditional value factors, weighted as required, but without regard to post-merger events or other possible business combinations."). The Court later said that, in order to value a company as a going concern, synergies must be excluded. *M.P.M. Enterprises, Inc. v. Gilbert*, 731 A.2d 790, 797 (Del. 1999) ("[S]ection 262(h) requires that the Court of Chancery discern the going concern value of the company irrespective of the synergies involved in a merger.").
[112] *Union Illinois 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340 (Del. Ch. 2004).
[113] *Id.* at 356.

Market prices are typically viewed superior to other valuation techniques because, unlike, e.g., a single person's discounted cash flow model, the market price should distill the collective judgment of the many based on all the publicly available information about a given company and the value of its shares.[120] Indeed, the relationship between market valuation and fundamental valuation has been strong historically. As one textbook puts it, "[i]n an efficient market you can trust prices, for they impound all available information about the value of each security."[122] More pithily: "For many purposes no formal theory of value is needed. We can take the market's word for it."[123] But, a single person's own estimates of the cash flows are just that, a good faith estimate by a single, reasonably informed person to predict the future. Thus, a singular discounted cash flow model is often most helpful when there isn't an observable market price.

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[122] BREALEY ET AL., *supra* note 96, at 373.
[123] *Id.* at 13.

Other realities emphasize why real world transaction prices can be the most probative evidence of fair value even through appraisal's particular lens. As the preceding discussion emphasizes, fair value is just that, "fair." It does not mean the highest possible price that a company might have sold for had Warren Buffett negotiated for it on his best day and the Lenape who sold Manhattan on their worst. Rather, as the Court of Chancery has put it in another context:

> A fair price does not mean the highest price financeable or the highest price that fiduciary could afford to pay. At least in the non-self-dealing context, it means a price that is one that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.[126]

Capitalism is rough and ready, and the purpose of an appraisal is not to make sure that the petitioners get the highest conceivable value that might have been procured had every domino fallen out of the company's way; rather, it is to make sure that they receive fair compensation for their shares in the sense that it reflects what they

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[126] *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).

deserve to receive based on what would fairly be given to them in an arm’s-length transaction.

iii.

DFC argues that, with a company like itself, it was particularly unlikely that the market would somehow miss out if it had great growth prospects. After all, DFC's stock was listed on a major U.S. exchange, traded actively, and had moved sharply over the years when the company was poised for growth or facing dimming prospects. And, DFC was also actively examined by the debt markets, which rated and analyzed its creditworthiness. And of course, here, these market participants' judgments were supplemented by those of the numerous strategic and financial buyers who were contacted by Houlihan during the sales process and given a chance to buy DFC and to receive non-public information about it.

Because the Court of Chancery found that the sales process was robust and conflict-free, DFC argues that the Court of Chancery erroneously relied on two factors to diminish the role of the deal price in its fair value determination. To wit, that: i) DFC "appeared to be in a trough, with future performance depending on the outcome of regulatory decision-making that was largely out of the company's control"; and ii) Lone Star's status as a financial sponsor "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."[136] Although the Court of Chancery has broad discretion to make findings of fact, those findings of fact have to be grounded in the record and reliable principles of corporate finance and economics.

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[136] 2016 WL 3753123, at *22.

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First, the Chancellor found that the deal price was unreliable because DFC was in a trough with future performance dependent upon the outcome of regulatory actions, but he cited no economic literature to suggest that markets themselves cannot price this sort of regulatory risk. The payday lending industry is hardly unusual in being subject to regulatory risks. Publicly traded companies in industries like tobacco, energy, pharmaceuticals, and certain commercial products are subject to close regulation, the development of which can affect their future cash flows. Precisely because of that reality, the market's assessment of the future cash flows necessarily takes regulatory risk into account as it does with all the other reasonable uncertain factors that affect a company's future.[137] In this case, the payday lending industry was long subject to regulatory risk, albeit of a changing character. As

[137] Since the 1980s, a robust economics literature has developed around the premise that "unanticipated changes in regulation result in a current change in security prices, and the price change is an unbiased estimate of the value of the change in future cash flows to the firm." G. William Schwert, *Using Financial Data to Measure Effects of Regulation*, 24 J.L. & ECON. 121, 121–22 (1981); *see also* John J. Binder, *Measuring the Effects of Regulation with Stock Price Data*, 16 RAND J. ECON. 167, 181 (1985) (conducting event studies around regulatory changes in regulated industries and finding "it is extremely difficult to find announcements in the regulatory process that are unanticipated by the market, even when the announcements are carefully studied to eliminate those that do not appear to have a major effect on expectations"). And, the corollary of that is "[i]f regulation has implications for the value of securities, the effects of regulation are impounded into prices at the time when they are first anticipated. Subsequent security returns only reflect the equilibrium expected returns to assets of comparable risk, unless the actual effects of regulation deviate from the originally anticipated effects." Schwert, *supra*, at 122.

one equity analyst report observed, regarding the industry, "[r]egulatory risk is persistent, but [it] has always been."[139]

Beyond the reality that prevailing economic theories assume that markets take information about all sorts of risk, including regulatory risk, into account and price that information into the things traded on those markets, the record reveals that equity analysts, equity buyers, debt analysts, debt providers and others were in fact attuned to the regulatory risks facing DFC. For one thing, in the years leading up to the merger, DFC's stock price fluctuated, but it had an overall downward trend. Although the Canadian regulatory reform did not appear to negatively affect DFC's stock price, the extensive U.K. regulatory overhaul did seem to contribute to the decline in stock price. This highlights an important point.

Historically, appraisal actions have had the most utility when private companies are

[139] JOHN HECT ET AL., INITIATING ON NON-PRIME CONS. FIN, JEFFRIES at 1.

[143] *Cooper v. Pabst Brewing Co.*, 1993 WL 208763, at *8 (Del. Ch. June 8, 1993) ("Where there is an established market for a corporation's stock, market value must be considered in appraising the value of the corporation's shares."); *Cede & Co.*, 1990 WL 161084, at *18 ("[M]arket price is a relevant factor of some weight where the market is active and where no special consideration indicating that it should be given no weight is present.").

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.[144]

And, during the relevant period, DFC's regulatory risk was being watched by two other key sets of folks who had money at stake: potential buyers in the sale process and participants in the debt markets.

The buyers who were part of the sales process—and who ultimately decided not to pursue a transaction with DFC—considered regulatory risk. In the spring of 2012, Houlihan contacted six financial sponsors about a possible transaction. Three parties were interested and conducted due diligence. But, by October of that year, all three lost interest. Over the next year, Houlihan contacted an additional thirty-five financial sponsors and three strategic buyers. Three interested parties emerged and were given access to management's projections. Lone Star and J.C. Flowers

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[144] *See, e.g.*, BREALEY ET AL., *supra* note 96, at 373 ("In an efficient market you can trust prices, for they impound all available information about the value of each security."); CORNELL, *supra* note 96, at 39 ("[O]n average, market forecasts and market valuations will be at least as accurate as those produced by individual investors and appraisers, no matter how expert.").

submitted non-binding indications of interest in late 2013, and only one party, Lone Star, continued to express interest after receiving additional projections from management in early 2014.[145] That these other potential buyers dropped out of the sales process after receiving confidential information about DFC suggests that these parties were aware of the "trough" DFC was in at the time and the uncertain future regulatory risk it faced, and ultimately did not think a transaction with DFC was

[145] Admittedly, the petitioners point to evidence from Lone Star's files indicating that it thought it was taking an opportunity to buy DFC at trough pricing and that it could reap the upside of this risk. One would expect a buyer to think it made a wise decision with an upside, and, to be candid, it is in tension with the statute itself to argue that the subjective view of post-merger value of the acquirer can be used to value the respondent company in an appraisal, as the statute's exclusion of transaction-specific value seems to be directed at the concern a buyer who pays fair value should not have its economic upside for taking that risk expropriated in the appraisal process, a result that if it were the law, would discourage sales transactions valuable to selling stockholders. That a buyer views itself as having struck a good deal is far from reliable evidence that the resulting price from a competitive bidding process is an unreliable indicator of fair value. For starters, here the Court of Chancery's own comparable companies analysis and that of the petitioners' expert if he used the median multiple resulting from his analysis suggested that Lone Star was paying a substantial premium to gain control of DFC at $9.50. And, one would think that the buyer who paid the highest price in a competitive process had the most confidence there was an upside and must think that post-purchase gains would justify its purchase; otherwise, no sale would ever occur in the world. That Lone Star expected to profit does not mean that the collective view of value that results from the deal price is not a reliable indicator of fair value; to hold otherwise, is to adopt a non-binary view of fair value in which only the upside view of what could happen in the future is taken into account.

worth pursuing. Indeed, J.C. Flowers cited the regulatory risk facing the company as its reason for not wanting to pursue a transaction with DFC.

Finally, the debt markets for DFC took into consideration the regulatory risk DFC was facing. In the fall of 2013, the same time that Houlihan was actively seeking buyers for DFC, DFC attempted to refinance around $600 million in Senior Notes. But, there was not enough investor interest and the offer was terminated. In other words, participants in the public bond markets weren't convinced they would get their money back if they gave it to DFC, and DFC was not offering enough interest to compensate investors for the risk they saw in the company. Furthermore, in a May 2014 presentation to certain rating agencies, DFC discussed the recent U.K. regulatory changes and the challenges it was causing DFC, including its negative effect on DFC's revenue.[146] DFC also discussed the U.S. regulatory environment and mentioned that the Consumer Financial Protection Bureau had conducted an on-site review of DFC in 2013, and since then the company undertook certain corrective actions to enhance compliance.[147] At the same time, DFC claimed that there was long-term opportunity to grow and expand as competitors struggled under the stricter regulatory framework. But, the Chancellor found that one of the reasons Lone Star lowered its offer to $9.50 was because its financing available for the transaction had

[146] DFC Rating Agency Presentation at B261.
[147] *Id.* at B262.

fallen by $100 million due to DFC's reductions in projected EBITDA, which were of course related to the stricter regulations in the U.K. This confirms that debt investors also cared about and tracked DFC's regulatory challenges and took them into account when deciding if and at what yield it would invest in DFC's debt. As is the case with refinancings, so too do banks like to lend and syndicate the acquisition debt for an M&A transaction if they can get it done. That is how they make big profits. That lenders would not finance a buyout of DFC at a higher valuation logically signals weakness in its future prospects, not that debt providers and equity buyers were all mistaken. So did the fact that DFC's already non-investment grade debt suffered a downgrade in 2013 and then was put on a negative credit watch in 2014.

Thus, the record demonstrates that the markets factored regulatory risk into DFC's pricing. Although the Court of Chancery gave DFC credit for being in a "unique position," that story was the same one that DFC told to sell itself to numerous buyers, the debt markets, and its existing stockholders. That this growth story was not accepted by the markets does not mean that the markets ignored it.[152] Rather, 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.

b.

The second reason the Chancellor gave for finding the deal price unreliable was that Lone Star, a private equity firm, required a specific rate of return on its transaction with DFC. But, all 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.[153] 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.[154] That is especially

[152] Consistent with the market's reaction, there is also evidence in the record to support the proposition that DFC was not going to navigate the U.K. regulatory changes it faced in 2014 without experiencing commercial losses as it did the Canadian changes.

[153] BREALEY ET AL., *supra* note 96, at 129–30 (describing internal rates of return as a prevalent form of analysis for companies engaging in new projects); *see also id*. at 118 fig. 6.2 (describing survey result that seventy-six percent of CFOs use internal rate of return for evaluating investment projects); *cf. id*. at 891–93 (arguing that mergers should be analyzed based on determining if the merger results in economic gain, i.e., if the two firms are worth more together than apart).

[154] Indeed, were it true that hitting an internal rate of return was somehow incompatible with achieving fair value, it would be hard to explain the results of studies that have shown that for specific sets of targets in auction-type situations, financial sponsor buyers, who ostensibly are the most disciplined users of internal rates of return to make investment decisions, place a higher value on them than strategic buyers, despite the conventional wisdom that strategic buyers can count on greater value from mergers through synergies. Alexander S. Gorbenko & Andrey Malenko, Strategic and Financial Bidders in Takeover Auctions, J. CORP. FIN. (forthcoming) (manuscript 4–5), https://ssrn.com/abstract=1559481. And, of course, private equity buyers have to compete with strategic buyers and thus the potential synergy gains of other buyers and its effect on the bids they

so when there are objective factors that support the fairness of the price paid, including: i) the failure of other buyers to pursue the company when they had a free chance to do so; ii) the unwillingness of lenders to lend to the buyers because of fears of being paid back; iii) a credit rating agency putting the company's long-term debt on negative credit watch; and iv) the company's failure to meet its own projections. Importantly, the Court of Chancery determined that there was no conflict of interest. Indeed, the court observed that "[t]he deal did not involve the potential conflicts of interest inherent in a management buyout or negotiations to retain existing management—indeed, Lone Star took the opposite approach, replacing most key executives."

Especially untenable is the idea that the deal price cannot be relied upon as a reliable indicia of fair value because lenders would not finance the acquisition by Lone Star at a higher price. Lenders get paid before equity.[156] They make profits by lending. If lenders fear getting paid back, then that is not a reason to think that the equity is being undervalued. Furthermore, the fact that the ultimate buyer was alone at the end provides no basis for suspicion given the Chancellor's own view of

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can make will influence the price any buyer of any type has to pay to prevail. Relatedly, the absence of synergistic buyers for a company is itself relevant to its value.

[156] WILLIAM J. CARNEY, CORPORATE FINANCE 195 (2005) (comparing equity and debt as substitutes and noting that debt instruments "are promises to pay a fixed sum on a specified date, together with periodic payments of interest" distinct from equity, which is "a residual claim, entitled to all remaining assets on liquidation after all other claims are paid.").

the process and the uncontradicted evidence of record finding that: i) there was no conflict of interest; ii) Houlihan had approached every logical buyer; iii) no one was willing to bid more in the months leading up to the transaction before management significantly adjusted downward its projections; and iv) management continued to miss its targets after Lone Star was the only buyer remaining. Thus, the record does not include the sorts of flaws in the sale process that could lead one to reasonably suspect that the ultimate price paid by Lone Star was not reflective of DFC's fair value. For these reasons, we cannot sustain the Chancellor's decision to give only one-third weight to the deal price because the factors he cited in giving it only that weight were not supported by the record.

III.

Taken together, our findings require us to reverse and remand this case to the Chancellor to reassess his conclusion as to fair value in light of our decision. We do not retain jurisdiction, and leave the Chancellor with the discretion to address the open issues using procedures he finds the most helpful. The Chancellor need not reopen the evidentiary record, and the extent of further submissions of the parties, *if any*, is entirely within his discretion, based on his determination as to what is most helpful to him.