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Delaware Court of Chancery Applies Business Judgment Rule Standard of Review to Controlling Stockholder Going Private Merger

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On May 29, 2013, in *In re MFW Shareholders Litigation,* Chancellor Strine of the Delaware Court of Chancery (the "Court") answered what he characterized as an open question (never decided definitively by the Delaware Supreme Court), i.e., what is the appropriate standard of review to be applied to a going private merger that is conditioned upfront by a controlling stockholder on approval by *both* a properly empowered, independent special committee and an informed, uncoerced majority-of-the-minority stockholder vote. Granting summary judgment for defendants in the post-merger damages action context, the Court, after analyzing the circumstances surrounding the transaction, found that the appropriate standard of review was the business judgment rule, not the heightened entire fairness standard of review. In so doing, Chancellor Strine provided guidance as to when the business judgment rule is appropriate in reviewing such circumstances.

Background

Nearly two decades ago, in *Kahn v. Lynch Commc'n Sys.*, 638 A.2d 1110 (De. 1994), the Delaware Supreme Court held that the entire fairness standard of review applied to controlling stockholder going private transactions. Unlike the deferential business judgment presumption, the entire fairness standard of review typically entails a rigorous analysis of whether both the process (or fair dealing) component of a transaction, as well as the price or substantive result, are entirely fair. Typically, at the outset, the controlling stockholder or other fiduciaries being sued have the burden of demonstrating entire fairness when such review applies. In *Kahn v. Lynch,* the Delaware Supreme Court held that transaction approval by either a properly empowered, independent committee or an informed, uncoerced majority-of-the-minority provision could shift the burden of proof under the entire fairness standard from defendant(s) to plaintiff(s). Over the years, it has often been debated whether, or under what circumstances, using both such approval methods might take the transaction out of entire fairness review altogether and into the more deferential business judgment rule standard. In the *MFW* decision, Chancellor Strine reviewed the intervening extensive case law and concluded that the Delaware Supreme Court has never definitively decided this issue in the negotiated merger context.

M&F Worldwide ("MFW") is a holding company that, prior to the merger, was 43.4% owned by MacAndrews & Forbes, which is entirely owned by Ronald Perelman. The MFW board of directors consisted of 13 members, including Perelman, who was both the chairman of MFW and the chairman and CEO of MacAndrews & Forbes. Perelman explored taking MFW private via MacAndrews & Forbes,

and engaged a bank to advise it. MacAndrews & Forbes submitted a proposal to MFW that it would buy its remaining shares for $24 in cash with the conditions that (1) the MFW board appoint a special committee of independent directors to consider the proposal and make a recommendation to the MFW board, and (2) the transaction would be subject to a nonwaivable condition requiring the approval of a majority of the shares not owned by MacAndrews & Forbes.

A special committee was formed with four independent directors that was empowered to, and did, hire its own legal and financial advisors and negotiate the terms of the offer, which it was able to increase from $24 to $25 per share. It was given the power to say no definitively to MacAndrews & Forbes with the promise that MacAndrews & Forbes would not proceed with any going private proposal that did not have the support of the special committee. The special committee studied a full range of financial information to inform itself, including evaluating other buyers who might be interested in purchasing MFW and whether there were other strategic options available, and receiving valuations from its financial advisor.

The special committee met eight times during the course of three months and, after receiving an opinion from its financial advisor that the price was fair, unanimously decided to accept the offer. Eight directors voted unanimously to recommend the offer to the stockholders. The stockholders were provided with a proxy statement containing the history of the merger and recommending they vote in favor of the transaction. Plaintiffs did not allege any failure of disclosure or acts of coercion. The merger was approved by an affirmative vote of the majority of the minority stockholders, with 65% of them approving the merger, and the merger closing that day. The merger price was a 47% premium to the closing stock price before the offer.

The Decision

In granting summary judgment to defendants, the Court held that the business judgment rule may be invoked as the appropriate standard of review in such transactions if six conditions are met: (i) the controlling stockholder conditions the procession of the transaction upfront on the approval of both a special committee and a majority of the minority stockholders, (ii) the special committee is independent, (iii) the special committee is empowered to freely select its advisors and to "say no definitively," (iv) the special committee meets its duty of care, (v) the majority of the minority vote is informed (i.e., based on sufficient disclosure), and (vi) there is no coercion of the minority. The Court emphasized why it is important that the two protections of independent, adequately empowered committee and majority-of-the minority stockholder approval be conditions imposed early in the transaction: "From inception, the controlling stockholder knows that it cannot bypass the special committee's ability to say no. And, the controlling stockholder knows it cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move. From inception, the controller has had to accept that any deal agreed to by the special committee will also have to be supported by a majority of the minority stockholders." Indeed, the Court also noted that the "upfront promise not to bypass the special committee or the majority-of-the-minority condition limits the potential for any retributive going private effort."

The Court acknowledged that a stockholder plaintiff that can plead facts supporting a rational inference that any of the six conditions did not exist could state a claim and go on to receive discovery in a litigation challenging such a transaction. If, after discovery, triable issues of fact remained about any of such conditions, and if those conditions are not found to exist by a court at trial, the court would then conduct a substantive fairness review. Here, however, the Court concluded there were no triable issues of fact regarding the independence of the special committee, its ability to employ financial and legal advisors and its exercise of that ability, its empowerment to negotiate the

transaction and "definitively to say no to the transaction," its fulfillment of its duty of care, or as to the fully informed and noncoercive nature of the majority-of-the-minority vote. Accordingly, summary judgment for the defendants was granted.

Conclusion

The *MFW* decision provides helpful guidance to both transaction planners and M&A litigators. It should be considered early in the transaction planning stage, given the importance of conditioning the process up front on the requisite approvals, and ensuring that any special committee is independent, and properly empowered and functioning. In addition to these important issues, attention should be devoted to documenting the special committee's efforts to meet its duty of care, in making an informed decision regarding whether to support the transaction (or any alternatives), and the terms, if any, on which such a transaction would be advantageous for the minority stockholders to sell their shares to the controlling stockholder.

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