

ClientAlert

Mergers & Acquisitions

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Delaware Court of Chancery Finds Business Judgment Rule Review Standard Applicable to Controlling Stockholder Merger Conditioned on the Approval of Both an Independent Special Committee and a Majority-of-the-Minority Stockholder Vote

A recent decision of the Delaware Court of Chancery, *In re MFW Shareholder Litigation*, held that the business judgment rule standard of review applies in cases where a going-private transaction has been conditioned on *both* the approval of a special committee comprised of independent directors with the absolute authority to reject the deal and a fully informed, uncoerced majority-of-the-minority stockholder vote.¹ In this case, Chancellor Leo E. Strine, Jr. answered the question that practitioners have been asking for years, which is whether a going-private merger with a controlling stockholder can be structured to be subject to the business judgment rule, a lower standard of judicial review.

Background

On June 13, 2011, MacAndrews & Forbes, then the 43.4 percent stockholder of M&F Worldwide ("MFW"), offered to purchase the remaining shares of MFW's equity in a going-private merger for US\$24 per share in cash. MacAndrews & Forbes conditioned such merger on the approval by an independent special committee of the board of directors and by an affirmative vote of a majority of the minority stockholders.² The MFW board formed a special committee of independent directors, which had the ability to and did employ its own legal and financial advisors, and was empowered to negotiate the merger and definitively say no to the transaction. In addition, MacAndrews & Forbes promised that it would not proceed with any transaction that was not supported by the special committee, including a tender offer directly to the minority stockholders. The special committee met eight times during the course of three months and negotiated with MacAndrews & Forbes, which resulted in MacAndrews & Forbes raising its bid approximately 5 percent to US\$25 per share in cash.³ Once the higher bid was approved by the special committee, the merger was submitted to a vote of the MFW stockholders, with 65 percent of the minority stockholders approving the transaction.⁴

MacAndrews & Forbes and the directors of MFW were sued by stockholders alleging the unfairness of the merger.⁵ The plaintiffs initially sought a preliminary injunction, but later dropped their injunction motion in favor of a post-closing damages remedy for breach of fiduciary duty.⁶ After expedited discovery, the defendants moved for summary judgment.⁷

¹ C.A. No. 6566-CS, slip op. at 7 (Del. Ch. May 29, 2013).

² *Id.* at 14.

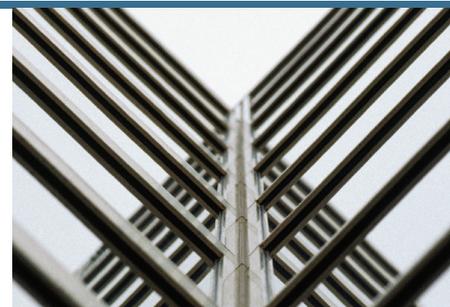
³ *Id.* at 1, 15-16.

⁴ *Id.* at 1.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*



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The Court's Analysis

The Court reviewed prior decisions by the Delaware Supreme Court involving a merger with a controlling stockholder, and concluded that the question presented in this case was a novel question of law.⁸ The Court noted that, in 1994, the Delaware Supreme Court held in *Kahn v. Lynch Commc'n Sys. (Lynch I)*⁹ that the approval of a merger with a controlling stockholder by *either* a special committee *or* the majority of the minority stockholders would shift the burden of proof under the entire fairness standard from the defendant to the plaintiff, but the question of what the correct standard of review should be when the merger is conditioned on the approval of *both* an independent, adequately empowered special committee *and* the majority of the minority stockholders had not been previously presented to the Delaware courts.¹⁰

The Court highlighted a critical difference between a scenario where *either* of the two procedural protection mechanisms is used (special committee *or* majority-of-the-minority vote) and a scenario where *both* procedural protection mechanisms are used.¹¹ Chancellor Strine stressed that, in contrast to the latter scenario, the former scenario does not replicate the protections of a third-party merger under Section 251 of the Delaware General Corporation Law ("DGCL") approval process, because the former scenario requires that only one of the statutory requirements of director and stockholder approval be fulfilled by impartial decision makers.¹² Emphasizing that each of the two procedural protections is "incomplete and [that they are] not substitutes, but are complementary and effective in tandem," Chancellor Strine noted that, on the one hand, a "special committee alone ensures only that there is a bargaining agent who can negotiate price and address the collective action problem facing stockholders, but it does not provide stockholders any chance to protect themselves" and, on the other hand, a majority-of-the-minority vote alone provides stockholders "a chance to vote on a merger proposed by a controller-dominated board, but with no chance to have an independent bargaining agent work on their behalf to negotiate the merger price...."¹³

In contrast, the Court stated that when both procedural protections are in place, such structure replicates the arm's-length merger steps of the DGCL.¹⁴ The Court

noted that, when the two protections are established from inception, the controlling stockholder knows that it cannot bypass the special committee's ability to say no and it knows it cannot offer to condition the transaction on a majority-of-the-minority vote late in the process in order to avoid having to increase its price. Additionally, the Court noted that the special committee will be incentivized to negotiate vigorously on behalf of the minority stockholders because the minority stockholders will vote on any deal approved by the special committee and express whether or not they think the special committee did an adequate job.¹⁵

After considering the public policy arguments of the plaintiffs, the Court concluded that the rule of equitable common law that best protects minority investors is not to subject every controlling stockholder transaction to entire fairness review, but to encourage controlling stockholders to accord the minority this combination of procedural protections.¹⁶

The Court held that "when a controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors, the business judgment rule standard of review applies."¹⁷ Chancellor Strine further explained that the business judgment rule is only invoked in a controlling stockholder merger if all the following conditions are met: "(i) the controller conditions the procession of the transaction on the approval of both a special committee and majority of the minority stockholders; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisors and to say no definitively; (iv) the special committee meets its duty of care; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."¹⁸

The Court concluded that all of the foregoing conditions were met in the case at hand, and granted the defendants' motion for summary judgment based on the business judgment rule.¹⁹ If the plaintiffs appeal this decision, then the Delaware Supreme Court will have the opportunity to provide definitive guidance on the question presented in this case, which has not been previously presented to the Delaware Supreme Court for its consideration.

⁸ *Id.* at 1, 11.

⁹ *Kahn v. Lynch Commc'n Sys. (Lynch I)*, 638 A.2d 1110, 1117 (Del. 1994).

¹⁰ *In re MFW S'holders Litig.*, C.A. No. 6566-CS, slip op. at 3-7.

¹¹ *Id.* at 8.

¹² *Id.* at 53 (citing 8 Del. Code § 251(b)-(c)).

¹³ *In re MFW S'holders Litig.*, C.A. No. 6566-CS, slip op. at 8.

¹⁴ *Id.* at 53.

¹⁵ *Id.*

¹⁶ *Id.* at 50.

¹⁷ *Id.* at 7.

¹⁸ *Id.* at 65. If triable issues of fact about the above listed conditions remain after discovery, the Court stated that the plaintiff can go to trial and if the Court does not find that all those conditions are satisfied, the Court will conduct a substantive fairness review.

¹⁹ *Id.* Under the business judgment rule, a court may not second-guess the substantive fairness of the merger, and instead must dismiss a challenge to a merger unless its terms were "so disparate that no rational person acting in good faith could have thought the merger was fair to the minority." *Id.* at 2. The Court noted that since the final bid offered to MFW was a 47 percent premium to the stock price before the initial offer was made, the merger could not be deemed to constitute "waste." *Id.*

Takeaways

- Controlling stockholders intending to take a company private should consider benefiting from the business judgment standard of review by conditioning their proposals upfront on approval of *both* (i) a special committee comprised of independent directors that is empowered to freely select its own advisors and has the authority to say no definitively; and (ii) a fully informed and uncoerced vote of the majority-of-the-minority stockholders. Such protections should include a controlling stockholder's promise that it will not proceed with the transaction in any manner unless the special committee assents, ensuring that the committee's approval will not be bypassed through a tender offer directly to the minority stockholders.
- The opportunity to have a going-private merger with a controlling stockholder reviewed under the business judgment rule standard could provide a sufficiently strong incentive for the controlling stockholder such that the procedural protections provided to the MFW stockholders may become increasingly common.

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