

M&A Update

Delaware Supreme Court Upholds Business Judgment Rule Review for Certain Controlling Stockholder Transactions with Dual Minority Protections

March 17, 2014

On March 14, 2014, the Delaware Supreme Court upheld the Court of Chancery's 2013 decision in *In re MFW Shareholders Litigation*, holding that in going-private mergers where there is a controlling stockholder, the use of **both** a truly independent special committee **and** a majority of the minority stockholder vote, allows for judicial review under the deferential business judgment standard.

Background

In mid-2011, Ronald Perelman's wholly-owned holding company, MacAndrews & Forbes, a 43% stockholder of M&F Worldwide (MFW), made a proposal to take MFW private by acquiring the minority shares at \$24 per share. In its initial proposal, MacAndrews & Forbes indicated that it "would not move forward" without approval from both an independent special committee and a majority of MFW's unaffiliated minority stockholders, and that it had no interest in selling to a third party bidder. In response to this proposal, the MFW board formed a special committee consisting solely of independent directors. The special committee ultimately recommended that the board approve and the minority stockholders accept a deal that paid \$25 per share, and 65% of the non-controlling stockholders thereafter voted in favor of the transaction.

After closing, MFW stockholders sued MFW, Perelman, and several MFW directors for damages based on allegations of breach of fiduciary duty. On May 29, 2013, the Delaware Chancery Court granted summary judgment in favor of defendants. Significantly, in doing so, then-Chancellor (now Chief Judge) Strine determined that the transaction was subject to deferential review under the business judgment rule notwithstanding that controlling stockholder transactions typically are subject to the more rigorous entire fairness standard. The Delaware Supreme Court affirmed both the reasoning employed and outcome reached by the lower court.

Takeaways

The Supreme Court opinion confirms the availability of a procedural option for controlling stockholders to use in Delaware for structuring controlling stockholder merger transactions to

obtain the benefit of deferential review of the transaction under the business judgment rule. Adopting the *MFW* “dual minority protection” structure, however, also entails downsides, risks and costs, which need to be evaluated given the specific facts of each transaction.

1. Special Committee Independence and Empowerment. Much of the Court’s factual analysis focused on whether the committee was independent and sufficiently empowered. While the Court applied well-settled Delaware law in determining that the special committee was independent, rejecting typically used arguments about the directors’ personal and professional relationships with the controlling stockholder, it elaborated on when a committee is sufficiently empowered. Importantly, to the Court, the committee had authority to retain independent advisors, negotiate transaction terms and say no to the controlling stockholder. The Court appeared to discount the fact that the committee did not have authority “to say yes” to a third party offer (or pursue other strategic options) on the ground that MacAndrews & Forbes indicated at the outset its unwillingness to sell and it had no duty to do so, which effectively precluded a third party acquisition. The Court noted, however, that the committee, with the help of its financial advisor, did consider, as part of its analysis of whether to accept or reject the proposed buy out, whether there were other potential buyers and what other options were available that might generate more value than the *MFW* proposal. Where a controlling stockholder’s holdings do not amount to a veto right over an acquisition by a third party or where the controlling stockholder does not clearly state at the outset that it is unwilling to sell to a third party, consideration should be given to empowering the committee to pursue other transactions and “say yes” to a third party proposal.
2. Conduct of Committee. The Court also found that the committee did its work properly. The Court cited evidence that the committee met eight times; “screened off” MacAndrews & Forbes employees from the committee’s process; had up-to-date projections prepared by *MFW*’s business segments (which reflected deteriorating results); actively negotiated price and obtained another \$1 per share; investigated the possibility of other buyers notwithstanding MacAndrews & Forbes’ stated unwillingness to sell; and obtained an opinion from its financial advisor that the transaction was fair and within the range of value estimated for the minority stock. Ultimately, this holding is consistent with Delaware’s general respect for the informed decisions of impartial directors. However, as this and other recent cases make clear, courts will carefully review the committee’s actual conduct and decision-making. If the court concludes that directors are not fully informed or sufficiently proactive in obtaining the best available deal for stockholders, the court will not show deference to the committee’s decisions.
3. Minority Vote. The Court concluded (and plaintiffs did not contest) that the minority stockholders voting to approve the transaction were fully informed and uncoerced. The Court observed that the proxy statement accurately disclosed the committee’s work and negotiation efforts, information about the projections prepared by management, and five separate price ranges for the value of *MFW* stock generated by the committee’s financial advisor and

supporting its fairness opinion. Again, however, it is not enough just to obtain the requisite percentage of minority votes. *MFW* and other recent decisions are clear that courts will not give weight to stockholder votes that are procured by misleading or incomplete information in the proxy statement.

4. Timing. As did the lower court, the Delaware Supreme Court emphasized that the controlling stockholder made clear in its initial proposal and before commencing negotiations that it would only proceed upon receiving approval of an independent special committee and a majority vote of minority stockholders. In controlling stockholder situations, prospective acquirers and the board both must be cognizant that this timing is quite important. If the controlling stockholder is willing to agree to these conditions, it should do so at the outset in order to maximize the possibility of deferential business judgment review of the resulting transaction. Alternatively, the board should insist on and obtain the controlling stockholder's consent to these conditions before engaging with the controlling stockholder and commencing negotiations.
5. Execution Risks. There are practical disadvantages to following the "dual protection" approach. For example, a non-waivable majority-of-the-minority provision can present execution risks that could prevent the deal from receiving stockholder approval. Dell's recent going-private transaction encountered this problem. Dell initially conditioned the transaction on approval from a special committee and a majority of outstanding minority shares. As voting proceeded, however, it became apparent that approval of a majority of the outstanding minority shares would not be obtained. The controlling stockholder ultimately increased its price in exchange for loosening the minority vote condition such that it would be approved so long as a majority of minority shares actually voted were in favor. While amending the transaction approval terms in this way could have potentially foreclosed business judgment review, it enabled the deal to proceed. Under the unique facts of the Dell transaction, the court was not troubled by this change; however, the outcome in Dell may not serve as a precedent in other transactions. Accordingly, potential acquirers, directors and their advisors need to weigh the importance of obtaining a favorable after-the-fact standard of review against offering veto power over the transaction to minority stockholders.
6. Need To Go Through Discovery. The Court explained that it may still be difficult to obtain dismissal of a plaintiff's complaint challenging a going-private transaction without discovery to determine if the transaction meets the *MFW* criteria. The Court observed that the complaint in this case would have survived a motion to dismiss because it pled "a reasonably conceivable set of facts" calling into question the sufficiency of the price offered and thus the committee's negotiations. Therefore, companies and their controlling stockholders may have to go through potentially protracted and costly discovery on whether the *MFW* criteria are met, as well as on the merits, in order to prevail pre-trial at the summary judgment stage. If triable factual issues remain after discovery and summary judgment about whether "either or both of the dual

procedural protections were established” or were effective, then the case will be tried and the transaction will be subject to entire fairness review.

For a copy of the full opinion, click [here](#).

* * * * *

If you have any questions, please contact any of the following attorneys or your Cadwalader contact:

Jason M. Halper	+1 212 504 6605	jason.halper@cwt.com
Greg Markel	+ 1 212 504 6112	greg.markel@cwt.com
William P. Mills	+1 212 504 6436	william.mills@cwt.com
Martin L. Seidel	+1 212 504 5643	martin.seidel@cwt.com
Joshua A. Apfelroth	+1 212 504 6391	joshua.apfelroth@cwt.com