

Entire fairness is operative standard of review for non-*MFW* controlling stockholder transaction

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On January 22 2016 Vice Chancellor Laster of the Delaware Court of Chancery issued a ruling in post-closing damages litigation⁽¹⁾ regarding partial summary judgment in favour of minority stockholder plaintiffs. The court held that the entire fairness review applies when evaluating a two-step transaction with a controlling stockholder where the necessary conditions for obtaining business judgement deference established by the Delaware Supreme Court in *Kahn v M&F Worldwide Corp (MFW)* have not been satisfied.

The court ruled that majority stockholder Danfoss A/S, which owned 75.6% of the shares of subsidiary Sauer-Danfoss, Inc, had failed to "disable" itself in a manner that was sufficiently unambiguous from the outset according to the rubric established by the Delaware Supreme Court in *MFW*. Consequently, the entire fairness standard governed the court's review of the transaction in which the controlling stockholder acquired the remaining shares it did not already own. The vice chancellor held that because it did not at the outset expressly condition the proposed transaction on approval by a special committee the controlling stockholder was not entitled to have the transaction reviewed under the more deferential business judgement standard. He specifically noted that the initial draft of the merger agreement also failed to include a majority-of-the-minority voting provision.

In addition, the court, drawing a parallel to the rule in *Ams Mining Corp v Theiault*,⁽²⁾ under which the burden to demonstrate the entire fairness remains with the defendant throughout the trial if it cannot show in the pre-trial record that it is entitled to shift the burden of persuasion, ruled similarly that if the record does not permit a pre-trial determination that the controller "disabled" itself in accordance with *MFW*, the appropriate standard of review remains entire fairness. This conclusion reinforces the Delaware Supreme Court's suggestion in *MFW* that if triable issues of fact remain after discovery about whether either or both of the dual procedural protections were established, or if established were effective, the ultimate judicial scrutiny of controlling stockholder buyouts will continue to be the entire fairness review.

While the court applied the entire fairness standard, it held that the burden of persuasion had nevertheless shifted to the plaintiffs because the majority of the disinterested stockholders ultimately approved the transaction following a fully informed vote.

Given the particular difficulty of making a pre-trial showing that no triable issue of fact remains with respect to the *MFW* requirement that the special committee meet its duty of care in negotiating a fair price, this opinion highlights the scrutiny that Delaware courts will continue to apply to transactions involving a controlling stockholder, even when they make attempts to employ the dual protections approach suggested by *MFW*. If *MFW* protection is sought, the decision also highlights the importance of creating a clear record at the earliest stages of any such transaction in order to establish clear compliance with the *MFW* criteria at the pretrial stage.

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Endnotes

(1) *In re Sauer-Danfoss Stockholder Litigation*, CA No 8396-VCL (Del Ch January 22 2016).

(2) 51 A 3d 1213, 1243 (Del 2012).

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