Delaware Supreme Court Establishes Standard of Review for Controlling Stockholder Transactions

On March 14, the Delaware Supreme Court issued its much anticipated opinion in *Kahn v. M&F Worldwide Corp.*, affirming the Delaware Court of Chancery's holding in *In re MFW Shareholders Litigation*. The decision adopts the approach taken by then-Chancellor Strine and provides guidance on steps that controlling stockholders and other deal participants can take to avail themselves of the more favorable business judgment standard of judicial review in stockholder litigation involving squeeze-out transactions where there is a controlling stockholder.

The Delaware Supreme Court affirms that if a transaction between a company and its controlling stockholder is initially conditioned on both (i) the approval of an independent, adequately-empowered and well-functioning special committee, and (ii) the uncoerced, informed vote of a majority of minority stockholders, then the deferential business judgment standard of judicial review will apply. Otherwise, the entire fairness standard of judicial review will apply.

BACKGROUND

The decision involves a 2011 acquisition by MacAndrews & Forbes Holdings, Inc. ("M&F"), a 43% stockholder in M&F Worldwide Corp. ("MFW"), of the remaining common stock of MFW. M&F's take-private of MFW was conditioned at the outset on the transaction being (i) negotiated and approved by a special committee of independent MFW directors, and (ii) approved by a majority of stockholders unaffiliated with M&F. In this case, M&F also made clear that it had "no interest" in participating in any alternative sale transaction. Ultimately, the transaction was approved by a vote of 65.4% of MFW's minority stockholders and closed in December 2011.

Various stockholder plaintiffs then brought lawsuits asserting breach of fiduciary duty claims in the Delaware Court of Chancery against M&F and certain of MFW's directors, alleging that the transaction and related process was unfair to MFW's minority stockholders. Summary judgment was granted in the defendants' favor, and the Court of Chancery's conclusion that business judgment review was the appropriate judicial standard of review was appealed to the Delaware Supreme Court.

KEY TAKEAWAYS

Standards of judicial review. The decision makes clear that the business judgment standard of review will be applied to a squeeze-out transaction involving a controlling stockholder if and only if (i) the controlling stockholder conditions the procession of the transaction on the approval of both a special committee and a majority of minority stockholders, (ii) the special committee is independent, (iii) the special committee is empowered to freely select its own advisors and say no definitively, (iv) the special committee fulfills its duty of care in negotiating a fair price, (v) the vote of the minority stockholders is informed, and (vi) there is no coercion of the minority stockholders. If any of these conditions are not satisfied, instead of a business judgment standard of review, the transaction will be reviewed under the more exacting "entire fairness" standard, with the potential of shifting the burden of proving entire fairness to the plaintiffs if it can be shown that the transaction was either approved by a well-functioning committee of independent directors or approved by an informed and uncoerced vote of a majority of the minority stockholders.

Unifying standards. Under Delaware law, business judgment review is afforded to non-coercive squeeze-out transactions by controlling stockholders structured as tender offers that (i) are negotiated and recommended by a well-functioning and independent special committee, (ii) contain a majority of the minority tender condition and (iii) contain a commitment from the controlling stockholder to consummate a short-form merger at the same price promptly after obtaining 90% of the outstanding shares of stock, whereas any such tender offer that does not meet these conditions is subject to entire fairness review. However, prior to the MFW decision, squeeze-out transactions involving one-step mergers were evaluated under the entire fairness standard, and under no circumstance received business judgment level review. As a result of MFW, the standards by which Delaware courts will evaluate a squeeze-out transaction by a controlling stockholder are now closely aligned, irrespective of whether the transaction is structured as a tender offer or a long-form merger.

Potential for prolonged litigation still exists for transactions between a company and its controlling stockholder. While adherence to the process set forth in MFW will ultimately lead to a controlling stockholder transaction being reviewed under the more deferential business judgment standard, it may not result in the dismissal of litigation challenging the transaction in the pre-discovery stage and, as a result, the benefits in following this framework should not be overstated. A plaintiff may still survive a motion to dismiss challenging the transaction if its complaint adequately pleads facts challenging the independence, empowerment, or effectiveness of the special committee, or coercion or lack of information affecting the majority-of-the-minority vote. This may not be a particularly high threshold as, for example, in a footnote to the MFW opinion, the Delaware Supreme Court suggested that the MFW plaintiffs would have survived a motion to dismiss under the new MFW framework given their allegations of inadequate price alone.