SIMPSON THACHER MEMORANDUM

Delaware Chancery Court Applies Business Judgment Rule to Controlling Stockholder Merger Transaction

June 3, 2013

On May 29, Chancellor Strine issued an important decision in the *In re MFW Shareholders Litigation* case, dismissing challenges to a going-private merger with a controlling stockholder based on a business judgment rule standard of review. For decades, going-private mergers with controlling stockholders have been subject to review under Delaware's rigorous "entire fairness" standard, which requires the court to make its own determination as to the procedural and substantive fairness of a transaction. In this regime, defendants could shift the burden of proof to the plaintiffs by obtaining approval of either a special committee or a majority of the unaffiliated stockholders, but generally would not be able to obtain a resolution of the case without a full evidentiary hearing or trial. In *MFW*, where the merger was subject to both special committee approval and approval of the unaffiliated stockholders, Chancellor Strine distinguished prior case law and concluded 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."

Although the decision remains subject to appeal, the case may provide a template for future controlling stockholder merger transactions and could significantly reduce the cost from the litigation that typically accompanies such transactions.

Background

MacAndrews & Forbes, which owned 43% of M&F Worldwide, proposed to take the company private for $24 per share in cash. In its offer letter, MacAndrews & Forbes indicated that it would not proceed with a transaction unless it was both approved by an independent special committee and by a majority of the unaffiliated stockholders. The letter also stated that MacAndrews & Forbes was not interested in selling any of its shares or supporting any alternative transaction for the company. The M&F Worldwide board formed an independent special committee to evaluate and negotiate with MacAndrews & Forbes, including clear authority for the committee to decide *not* to pursue the proposed merger. The committee ultimately achieved a price increase of $1 per share, and 65% of the shares held by stockholders unaffiliated with MacAndrews & Forbes voted in favor of the merger.

Plaintiff stockholders initially sought to enjoin the transaction but, following discovery, elected instead to pursue a post-closing damages remedy. The defendants moved for summary judgment. Chancellor Strine resolved the "novel question of law" (*i.e.*, the appropriate standard

of judicial review) in favor of the defendants, concluding that the business judgment standard rather than entire fairness applied to the case. Reviewing the transaction under the business judgment rule, he dismissed the case and expressly declined to review the substantive fairness of the merger or the choices of the special committee in negotiating the deal.

Six-Part Test

Chancellor Strine's decision laid out a six-part test for determining whether a going-private transaction can be reviewed under the business judgment rule:

- the controlling stockholder conditions the transaction on approval by both a special committee and a majority of the unaffiliated stockholders
- the special committee is independent
- the special committee is empowered to freely select its own advisors and to say no definitively
- the special committee meets its duty of care
- the stockholder vote is fully informed
- there is no coercion of the unaffiliated stockholders.

MacAndrews & Forbes' commitment not to "go around" the special committee was an especially important factor underpinning the decision.

Key Points

- The *MFW* blueprint may present interesting choices for practitioners structuring controlling stockholder merger transactions: seeking to structure a deal that falls within the Chancellor's six-part test, with a fully empowered special committee and a non-waiveable majority-of-the-minority vote requirement (and the expectation – but not guarantee – of business judgment review), could increase the risk the transaction is not completed. Alternatively, following the pre-*MFW* regime, and having either (but not necessarily both) special committee approval or majority approval of the unaffiliated stockholders and burden shifting might increase the likelihood of completing the transaction, but choosing that path, where entire fairness is expected to apply, would bring with it greater litigation risk and cost than a transaction tested under the business judgment rule.
- The special committee was given only limited powers in its authorizing resolutions – to evaluate and negotiate a transaction (but not execute a definitive agreement, which authority was reserved for the full board); recommend to the board whether to approve a transaction; to retain independent legal and financial advisors; and to determine not to pursue a transaction. It was given the authority to study other alternatives for the company but did not have authority to market the company to third party buyers. Chancellor Strine noted that MacAndrews & Forbes had no legal obligation to sell its 43% block, "which was large enough, as a practical matter, to preclude any other buyer from succeeding" over MacAndrews & Forbes' opposition. Likewise, the special

committee did not have authority to adopt a poison pill (a tool which the Chancellor had suggested in a prior case might be useful for a special committee to have), presumably because of MacAndrews & Forbes' commitment not proceed with an offer without the special committee's approval.

- The court expressly declined to review the "effectiveness" of the special committee (whether it was substantively effective in its negotiations with MacAndrews & Forbes). Chancellor Strine observed that to do so would be inconsistent with the principles of the business judgment rule, which require a court not to second-guess the actions of an independent committee acting on an informed basis. He also noted that by reviewing the transaction under the business judgment rule standard, heightened forms of judicial scrutiny, including *Unocal* and *Revlon*, would not be applicable. This does produce the somewhat anomalous result that a board considering an all cash bid from an unaffiliated third party will be subject to heightened *Revlon* duties while a board considering a similar bid from an affiliated stockholder could potentially be subject to the lowest level of judicial review. In *MFW* at least, that difference may reflect the Chancellor's view that in light of its 43% ownership position and stated unwillingness to sell, MacAndrews & Forbes already had control of the company and negotiations for a control premium and the highest available price were not relevant.

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You can download a copy of the *MFW* opinion by clicking here.

For more information about the *MFW* case or related matters, please contact any of the members of our Mergers and Acquisition Practice, including those listed below.

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