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Delaware Supreme Court affirms that the business judgment rule applies to a going-private merger proposed by a controlling stockholder

In *Kahn v. M&F Worldwide*, C.A. No. 6566 (Del. Mar. 14, 2014), the Delaware Supreme Court ruled for the first time that a going-private merger with a controlling stockholder is not always subject to the entire fairness standard (which is Delaware's most rigorous standard of review). Instead, a controlling stockholder going-private transaction can be subject to Delaware's most forgiving standard of review, which is the business judgment standard, when the merger is conditioned up-front on both approval by an independent special committee and a majority-of-the-minority stockholder vote, and both of those protective devices subsequently are properly and effectively implemented. As we discuss below, although the route to business judgment review approved by the Court doubtless will be followed in many future controlling stockholder going-private transactions, it will not always be the best approach.

Background

MacAndrews & Forbes owned 43% of M&F Worldwide ("MFW") and offered to purchase the remaining shares of MFW in a going-private merger. In the letter to the MFW board of directors proposing the transaction, MacAndrews & Forbes said it would not proceed with the going-private transaction unless it was approved by a special committee of MFW's independent directors and was conditioned on receipt of affirmative votes in favor of the merger by the holders of a majority of the MFW common stock not owned by MacAndrews & Forbes or its affiliates. MacAndrews & Forbes confirmed in its letter that it would not sell its stock or support any alternative sale, merger or similar transaction involving MFW. MFW's board of directors established a special committee and empowered it to, among other things, negotiate any element of the proposal and any agreement related thereto, report to the board as to whether the proposal was fair, and decide not to pursue the proposal. The special committee retained its own legal and financial advisors and negotiated with MacAndrews & Forbes. Although the special committee's financial advisor opined that the $24 per share price offered was fair, the special committee negotiated for a higher price, and MacAndrews & Forbes eventually agreed to $25 per share. After stockholder approval (including a majority-of-the-minority approval), the merger was completed. Plaintiff stockholders sued, alleging breach of fiduciary duty by the MFW directors and by MacAndrews & Forbes.

Supreme Court Decision

As discussed in our June 2013 client briefing, in *In re MFW Shareholders Litigation*, 67 A.3d 496 (Del. Ch. 2013), the Delaware Chancery Court ruled that because of the dual procedural protections agreed upon at the outset of negotiations, the transaction should receive business judgment review.

The Supreme Court affirmed, holding that "business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders." The Court explained that entire fairness is ordinarily the standard in a controlling stockholder merger because the controller's influence might undermine the normal statutory protections of approval by a disinterested board and stockholder vote. But in this case, where the controller "irrevocably and publicly disable[d] itself from using its control to dictate the outcome of the negotiations and the stockholder vote, the controlled merger then acquires the stockholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard."

The Court emphasized that the business judgment standard will apply **if and only if** six requirements are satisfied, as follows: "(i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a 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 in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority." The Supreme Court held that, because there was no factual dispute as to the satisfaction of each of these conditions in the case before it, the MFW merger was subject to business judgment review. Because the business judgment standard applied, the plaintiffs could prevail only if they could establish that "no rational person could have believed the merger was favorable to MFW's minority stockholders." Applying this deferential standard, the Court affirmed summary judgment for the defendants.

Notably, the Court explained that to survive a pre-discovery motion to dismiss (as opposed to the post-discovery motion for summary judgment before the Court), a plaintiff need only allege a reasonably conceivable set of facts showing that any of the conditions referred to above is not present. Here, the Court stated (in a footnote) that the complaint would have survived a motion to dismiss because it contained well-pleaded allegations that the price was unfair, which raised inferences as to whether the special committee had functioned correctly that could only be resolved on a factual record after discovery.

Take-aways

- Following the route to business judgment review endorsed by the Delaware Supreme Court in this decision does not guarantee a pain free stockholder litigation process for a controlling stockholder pursuing a going-private transaction. Even when that route is taken, it normally will be possible to get rid of stockholder challenges only after discovery, pursuant to a summary judgment motion. Disposing of stockholder challenges will still take time and money. And if plaintiffs with the aid of discovery can find plausible bases to allege that any of the six conditions enumerated by the Court was not satisfied, for example by calling into question the special committee's effectiveness or the quality of disclosures made to stockholders, their complaints apparently will survive summary judgment.
- The Supreme Court left no doubt that committing up front to approvals by a special committee and a majority-of-the-minority stockholder vote will be of no help if the controlling stockholder then improperly influences the committee, withholds information or otherwise misbehaves.
- A controlling stockholder considering a going-private transaction should not automatically presume that it must follow the approach taken by McAndrews & Forbes in this case. Independent directors who sit on special committees sometimes have

unrealistic views of value or other motivations to resist a going-private proposal. And a majority-of-the-minority vote can be difficult to obtain, even for transactions on attractive terms. A controlling stockholder that "irrevocably" commits to both protective devices can find itself in a bind if either (or both) the special committee or majority-of-the-minority approvals proves unavailable. Accordingly, the facts of each situation should be carefully considered in advance before the controlling stockholder decides which approach to take.

Contacts

Gary Boss
Partner
T: +1 212 878 8063
E: gary.boss@cliffordchance.com

David Brinton
Partner
T: +1 212 878 8276
E: david.brinton@cliffordchance.com

Joseph Cosentino
Partner
T: +1 212 878 3149
E: joseph.cosentino@cliffordchance.com

John Graham
Partner
T: +1 212 878 4955
E: john.graham@cliffordchance.com

John Healy
Partner
T: +1 212 878 8281
E: john.healy@cliffordchance.com

Sarah Jones
Partner
T: +1 212 878 3321
E: sarah.jones@cliffordchance.com

Robert Masella
Partner
T: +1 212 878 8076
E: robert.masella@cliffordchance.com

Craig Medwick
Partner
T: +1 212 878 8168
E: craig.medwick@cliffordchance.com

Ivan Presant
Partner
T: +1 212 818 3154
E: ivan.presant@cliffordchance.com

Benjamin Sibbett
Partner
T: +1 212 878 8491
E: benjamin.sibbett@cliffordchance.com

Nicholas Williams
Partner
T: +1 212 878 8010
E: nicholas.williams@cliffordchance.com

Robert Myers
Senior Counsel
T: +1 212 878 3425
E: robert.myers@cliffordchance.com

Erika Bucci
Counsel
T: +1 212 878 8142
E: erika.bucci@cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

www.cliffordchance.com