

[Securities Regulation Daily Wrap Up, TOP STORY—Del. Ch.: Structuring combination using MFW framework pays off for Earthstone Energy board, \(Jul. 23, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

By carefully structuring an "Up-C" combination with Bold Energy to conform to the framework laid out in Kahn v. M&F Worldwide Corp. (Del. 2014), Earthstone Energy fiduciaries secured the benefit of the business judgment presumption and shook off a stockholder lawsuit. The Delaware Court of Chancery did not need to determine whether Earthstone's largest stockholder was a controller because business judgment deference applied, even at the pleadings stage on the motion to dismiss ([Olenik v. Lodzinski](#), July 20, 2018, Slight, J.).

The plaintiff stockholder and the D&O defendants appeared poised to litigate whether the transaction was cleansed, under Corwin, by the approval of 99.7 percent of the non-affiliated shares outstanding. The plaintiffs argued that Corwin did not apply because the transaction involved a conflicted controlling stockholder, but the defendants disputed that Earthstone's 41-percent owner, the holding company Oak Valley Resources, was a controller. As their back-up argument, the defendants maintained that even if Oak Valley was a controller, the business judgment rule applied because the transaction was structured to comply with the six conditions set forth in MFW. The court ran with this fallback argument and did not reach the issue of Corwin cleansing or whether Oak Valley was a controlling stockholder.

MFW factors. The six [MFW](#) elements that earn a transaction business judgment review are:

1. The merger is conditioned ab initio on the approval of both a special committee and a majority of the minority stockholders;
2. The special committee is independent;
3. The committee is empowered to freely select its own advisors and say no definitively;
4. The committee meets its duty of care in negotiating a fair price;
5. The vote of the minority is informed; and
6. The minority is uncoerced.

Conditions were stated upfront. The plaintiff argued that the ab initio requirement was not satisfied because deal negotiations preceded the announcement of the special committee and the voting conditions, but the court found that these conditions were present in the first proposal that Earthstone directed to Bold. Although there may have been discussions prior to that proposal, the law distinguishes between discussions about the possibility of a deal and negotiations of a transaction after those discussions lead to a deal.

Committee was independent and empowered and acted with due care. The plaintiff also challenged the independence of the special committee, but the court found that it was well-functioning. Neither the fact that several directors may have been elected by an interested party nor that they may have had interests in Oak Valley sufficed to disqualify them. The special committee was also empowered and acted with due care. In the decisionmaking context, this means process due care, and the standard of review required the plaintiff to plead facts from which the court could infer gross negligence.

On the contrary, the special committee met eight times and actively engaged with its independent advisers, including its financial advisor, Stephens, which provided a fairness opinion when the deal terms were finalized. When viewing the fairness opinion, the court wrote, "one cannot help but be struck by what is missing in the Complaint—there are no allegations of banker conflicts, no allegations of misaligned incentives, either in Stephens' fee structure or otherwise, and no allegations of a lack of diligence or commitment to the engagement.

Rather, it appears that Plaintiff simply does not like, or agree with, what Stephens had to say about the Transaction."

Stockholder vote was informed and uncoerced. Finally, the court determined that the stockholder vote was informed and that none of the allegedly misleading proxy statement disclosures stated a claim or undermined confidence in the stockholder vote. The proxy statement adequately apprised Earthstone stockholders of the material facts they needed to know about the transaction so they could cast informed votes. Accordingly, the business judgment rule applied and the court deferred to the fiduciaries' judgment, dismissing the complaint with prejudice.

The case is [No. 2017-0414-JRS](#).

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Companies: Earthstone Energy, Inc.; Bold Energy Holdings, LLC; Oak Valley Resources, LLC

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