# Securities Regulation Daily Wrap Up, MERGERS AND ACQUISITIONS—Del. Ch.: Business judgment rule applied to controller buyout with dual protections, (Mar. 14, 2014)

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By Mark S. Nelson, J.D.

The Delaware Supreme Court, in a case of first impression, upheld a chancery court ruling applying the business judgment rule to a controlling shareholder buyout. The chancery court had ruled on "novel" issues regarding the deal's dual protection structure, which it likened to an arms-length transaction, thus refusing to apply the entire fairness standard. In affirming, the court said there was no credible claim that no rational person would find the deal favored the target company's minority shareholders (*Kahn v. MF Worldwide Corp.*, March 14, 2014, Holland, R.).

The appeal in this case was submitted to the Delaware Supreme Court on December 18, 2013, after former Chief Justice Myron T. Steele had retired, and prior to former Delaware chancellor, Leo E. Strine, Jr., being sworn-in as chief justice. Former Chancellor Strine decided the case below. Delaware Superior Court Judge Jan R. Jurden sat by designation for the court's decision.

**Background.** MacAndrews & Forbes Holdings, Inc. (MacAndrews) acquired M&F Worldwide Corp. (MFW) with plans to take MFW private afterwards. The deal was conditioned on both MFW's special committee of independent directors negotiating and approving the deal and on approval by a majority of shareholders who were not associated with MacAndrews. The merger closed in December 2011 with the blessing of 65.4 percent of MFW's minority shareholders.

After Allen Kahn and others (Kahn) withdrew their request for injunctive relief from the deal, they moved ahead with breach of fiduciary duty claims against MacAndrews, Ronald O. Perelman, and MFW's directors plus MFW's special committee (defendants). The defendants then asked the Delaware Chancery Court to grant summary judgment, which it did, because the deal met the business judgment rule (*In re MFW Shareholders Litigation*, May 29, 2013, Strine, L.).

The chancery court characterized the issue here as a "novel" one: "what standard of review should apply to a going private merger conditioned upfront by the controlling stockholder on approval by both a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote."

The chancery court noted that only a sliver of "controller mergers" are held to the lower business judgment rule, instead of the higher entire fairness standard. The court then listed six factors that, "if, *but only if*" they were met, would allow use of the business judgment rule. The chancery court found those factors met here and upheld the merger under the business judgment rule.

**Business judgment rule.** The court noted that the question here, presented to the court for the first time, offered a chance to mull the court's prior cases in which it held that the entire fairness standard applies to deals that are challenged because of the involvement of a self-dealing, controlling shareholder. The defendant in these cases, however, can shift the burden of persuasion to the plaintiff by showing the deal had the approval of a well-functioning, independent directors' committee, or that a majority of the minority shareholders approved.

This case presented a situation where a deal was conditioned on the conjunctive (both criteria), while prior Delaware cases focused on the disjunctive (either criteria). The disjunctive version is exemplified by the Delaware Supreme Court's nearly 20-year old opinion in *Kahn* (*Kahn v. Lynch Communication Sys., Inc.,* 638 A.2d 1110 (Del. 1994), Walsh, J.).

The court held that the business judgment rule, not the entire fairness standard, applies when a controlling shareholder and its subsidiary merge based on conditions stated at the beginning of the deal that approval must be had from both an independent, adequately empowered special committee that meets its duty of care and from an un-coerced, informed majority of the minority shareholders.

The court first reasoned that there was no chance the controlling shareholder could undermine the deal's procedural safeguards in cases like this one. Said the court, "The simultaneous deployment of the procedural protections employed here create a countervailing, offsetting influence of equal—if not greater—force." Using language akin to the chancery court's, the court determined that the controlling shareholder had "disabled itself" to the extent that the deal mirrored an arms-length transaction.

The court gave three more reasons for using the business judgment rule here. The dual protection structure hobbles the controlling shareholder from making an end-run around the special committee and from using the prospect of majority-of-the-minority approval to dodge last-minute price changes. The business judgment rule in this case gels with Delaware corporate law principles that favor decisions taken by impartial directors and disinterested, un-coerced shareholders. Lastly, the dual protection structure mitigates price worries that often arise in the entire fairness setting because the twin protections "converge" on price.

**Controller buyout contests.** Having concluded that the business judgment rule applies in controller buyout mergers using a dual protection structure, the court outlined the procedural stance of these cases. As a result, a party contesting a dually protected controller buyout deal must leap several hurdles in order to get a case to the discovery and trial stages.

The court said the business judgment rule applies if, and only if, six criteria are met: (1) the controller conditions the deal on approval by both a special committee and a majority of the minority shareholders; (2) the special committee is independent; (3) the special committee is empowered to hire its own advisers and to definitively say no to a deal; (4) the special committee satisfies its duty of care by seeking a fair price; (5) the minority's vote is an informed one; and (6) the minority was not coerced.

The court also said that a challenger who can plead "reasonably conceivable" facts showing that at least one of the six criteria was unmet could go ahead with discovery. Any issues left after discovery may then go to trial. At the trial stage, however, the deal is to be judged under the entire fairness standard.

**Controller buyout test applied.** The court upheld the chancery court's findings regarding the several criteria for the controller merger at issue here. The merger was conditioned on approval by both a special committee and a majority of the minority shareholders.

With respect to director independence, the court noted that there must be some material relationship between one director and another alleged to have a controlling influence. Here the court found that the independence of three directors challenged by Kahn could not be undermined by their prior business and social ties to another director. The court noted that Kahn never submitted Rule 56 affidavits to show the directors' bias. The court also said it was appropriate for the chancery court to decide these issues at the summary judgment stage.

The special committee here was empowered to reject a deal. The committee hired one of four financial advisers it interviewed and retained a large, prominent law firm to advise it on legal matters. The committee had a broad mandate beyond merely evaluating a deal. The court also agreed with the chancery court that, although the special committee's ability to say no was tempered by its limited power to seek other buyers, it did mull the existence of other buyers and of higher value alternatives in its talks with its financial advisers.

The court found the special committee met its duty of care. MacAndrews and dual MacAndrews-MFW employees were shut out of the special committee's proceedings. The committee met eight times, asked for and got the latest MFW financial projections, and engaged in price negotiations with MacAndrews. Ultimately, having explored many options, including a sale to another buyer (despite the defendants' urging not to), and having made a "very aggressive" counteroffer to MacAndrews, the committee unanimously recommended selling to MacAndrews for $1 per share more than MacAndrews originally offered. The special committee's financial adviser said this was a fair price.

As for the minority shareholders, the court said they were adequately informed of the deal. They had a proxy statement, which recited the special committee's negotiations with MacAndrews (including the counteroffer), and detailed the updated financial projections and the financial adviser's analysis. Over 65 percent of the minority shareholders approved the deal.

The case is No. 334, 2013.

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Companies: M&F Worldwide Corp.; MacAndrews & Forbes Holdings, Inc.

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