Mergers and Acquisitions Alert:

Controlling Stockholder Squeeze-Outs May Be Structured to Achieve Deferential "Business Judgment Rule" Under Delaware Law

APRIL 14, 2014

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Overview

In *Kahn v. M&F Worldwide Corp. (Del. Mar. 14, 2014)*, the Delaware Supreme Court recently decided that a going private transaction sponsored by the controlling stockholder of a Delaware corporation may, under certain circumstances, be reviewed under the most deferential standard of review under Delaware law — the business judgment rule.

M&F Worldwide presented the question of the appropriate standard of review for a merger between a controlling stockholder and its non-wholly owned subsidiary where the merger is conditioned, at the outset, upon the approval of both (1) an independent, adequately-empowered special committee that fulfills its duty of care and (2) the uncoerced, informed vote of a majority-of-the minority stockholders.

The issue is important because, given the high likelihood of litigation challenging M&A transactions involving publicly-traded targets — particularly those involving controlling stockholders seeking to "squeeze out" the minority, the procedural issues regarding the standard of review and whether the plaintiff or defendant has the burden of proof often have a direct and meaningful impact on the ability of the plaintiff-stockholders to delay or prevent the closing of the deal and the settlement value associated with the litigation.

Background and the Court of Chancery Decision

M&F Worldwide involved the 2011 acquisition by MacAndrews & Forbes Holdings, Inc. (**"M&F"**) — a 43% stockholder in M&F Worldwide Corp. (**"MFW"**) — of the remaining common stock of publicly-traded MFW.

M&F's proposal to take MFW private was contractually contingent upon two procedural conditions that were approved by MFW's board of directors at the outset of the transaction: (1) the merger would be negotiated and approved by a special committee of independent members of the MFW board; and (2) the merger would be subject to the non-waivable approval by a majority of MFW stockholders unaffiliated with M&F.

Kahn, along with certain other MFW stockholders, initially sought to enjoin the merger but later amended their complaint to seek post-closing damages against M&F, MFW's directors and Ronald Perelman, the 100% owner of M&F, for breach of fiduciary duty. Following extensive discovery, the defendants moved for dismissal on a motion summary judgment.

The Delaware Chancery Court held that the business judgment review, rather than the more stringent entire fairness standard, should apply to a limited category of controller mergers where the controller voluntarily relinquishes its control such that the negotiation and approval process replicate those that characterize an arm's length third-party merger. The Court of Chancery found that all of those conditions were met in the MFW transaction, reviewed the transaction under the business judgment standard and dismissed the case by granting the defendants' motion for summary judgment.

The Delaware Supreme Court's Decision

The Delaware Supreme Court affirmed the Chancery Court decision, and held that, in "controller buyouts", the business judgment standard of review will apply if and only if all of the following conditions are met: (1) at its outset, the controller conditions the transaction on the approval of both a special committee and majority of the minority stockholders; (2) the special committee is independent; (3) the special committee is empowered to freely select its own advisors and to say "no" definitively; (4) the special committee meets its duty of care in negotiating a fair price; (5) the vote of the minority is informed; and (6) there is no coercion of the minority.

The Court reasoned that a properly-functioning special committee serves to cleanse the board of any conflict it would otherwise have in determining whether to approve a transaction in which one or more directors is specially interested, and the non-coerced majority-of-the-minority stockholder approval condition serves to cleanse an otherwise tainted full stockholder approval. Together, these protections mimic "the shareholder-protective characteristics of

third-party, arms'-length mergers, which are reviewed under the business judgment standard."

By contrast, the Delaware Supreme Court emphasized that a transaction in which the controller employs only one of the two key procedural safeguards — that is, either a properly functioning special committee or a non-waivable condition of approval by a non-coerced majority-of-the minority — would be reviewed under the entire fairness standard of review; the benefit of utilizing one (but not both) of those safeguards would be to shift the burden of proof from the defendant (in cases where neither safeguard is used) to the plaintiff (where one but not both of those safeguards are used).

Key Take-Aways

The near-certainty of litigation in the context of the sale of a publicly-traded company is well-understood. Going private transactions (as well as other types of "interested party" transactions where one or more members of a target company's board or its controlling stockholder has interests on both sides of the same transaction) add a substantial element of exposure and, accordingly, present a variety of corporate governance and tactical challenges. The extent to which a target company anticipates corporate governance challenges, and engineers and executes — at the outset of the transaction — a well-considered corporate governance strategy can make the difference in getting the deal closed without delay and preventing, or at least mitigating the leverage of, a plaintiff-stockholder's fiduciary duty claims and related settlement value.

M&F Worldwide has meaningful implications for how a controlling stockholder or group can best structure a transaction to acquire the remaining equity of a publicly-traded Delaware corporation while mitigating potential fiduciary duty claims from minority stockholders challenging the transaction. In particular, the decision is useful in guiding a private equity sponsor who, either alone or acting as a group with other like-minded stockholders, own a controlling position in a publicly-traded company and desires to fund a take-out of the remaining equity.

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