

Delaware Law Updates

KAHN V. M&F WORLDWIDE CORP., C.A. NO. 6566 (DEL. MAR. 14, 2014)

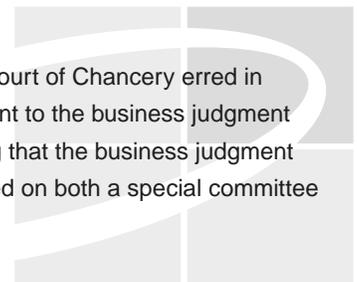
March 14, 2014

In this *en banc* decision, the Delaware Supreme Court affirmed the Court of Chancery's decision to grant summary judgment to the defendants and addressed an issue of first impression: what standard of review will apply where a merger between a controlling stockholder and its subsidiary is conditioned *ab initio* upon the approval of both an independent and adequately-empowered special committee and an uncoerced and informed vote of a majority of the minority stockholders. Distinguishing this case from *Kahn v. Lynch* and its progeny, the Supreme Court held that in controller buyouts the business judgment standard of review will be applied if: (i) the controller conditions the transaction on the approval of both a special committee and a favorable vote of 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 to the transaction; (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. In so holding, the Supreme Court noted that unless both procedural protections are established prior to trial, controller buyouts will be subject to the entire fairness standard of review.

This appeal is from a final judgment entered by the Court of Chancery in a proceeding that arose from a 2011 acquisition by MacAndrews & Forbes Holdings, Inc. ("MacAndrews & Forbes"), a holding company solely owned by Ron Perelman, which owned 43% of M&F Worldwide Corp. ("MFW"). MacAndrews & Forbes offered to purchase the remaining equity of MFW in a going private merger. In its initial letter of intent, MacAndrews & Forbes said it would not proceed with any going private transaction unless it was approved by both an independent committee of the MFW board of directors and by a vote of a majority of MFW's stockholders who were not affiliated with MacAndrews & Forbes. The MFW board of directors established a special committee, which negotiated with MacAndrews & Forbes, achieved an increase in the offer price, and approved the going private merger. In addition, the merger was approved by a vote of 65.4% of MFW's minority stockholders. Plaintiffs, stockholders of MFW, brought suit and claimed MacAndrews & Forbes and the directors of MFW had breached their fiduciary duties in connection with the merger. The defendants brought a motion for summary judgment and argued that, because the merger had been conditioned on the approval of the special committee and the disinterested stockholders, the business judgment standard of review should apply.

The Court of Chancery found that the business judgment standard of review will apply to a merger between a controlling stockholder and its subsidiary where (i) the controlling stockholder, from the outset, indicates it will not proceed without both protections; (ii) the committee is independent; (iii) the committee has the authority to choose its own advisors and to say no definitively; (iv) the committee meets its duty of care; (v) the vote of the minority stockholders is informed; and (vi) the minority stockholders are not coerced. The Court of Chancery held that, on the facts presented in this case, the business judgment standard would apply and granted defendants' motion for summary judgment.

The Delaware Supreme Court addressed two issues on appeal: (1) whether the Court of Chancery erred in concluding that no material disputed facts existed regarding the condition precedent to the business judgment review, and (2) whether the Court of Chancery erred, as a matter of law, in holding that the business judgment standard applies to controller buyouts where the controller's proposal is conditioned on both a special committee and a favorable vote by a majority of the minority stockholders.



First, addressing whether the special committee was independent and effective, the Supreme Court found that the defendants successfully established a record of independent committee effectiveness and process that warranted a grant of summary judgment. The Supreme Court then turned to plaintiffs' allegations that three of the four committee members were not independent by virtue of various business and social relationships between such members and MacAndrews & Forbes. The Supreme Court agreed with the Chancery Court and determined that, because the plaintiffs failed to proffer evidence of the financial circumstances of the committee members whose independence they challenged, there was no triable issue of fact with respect to their independence. The Supreme Court, therefore, concluded that the record supported the Court of Chancery's holding that none of the plaintiffs' claims relating to the independence of the special committee members raised a triable issue of material fact concerning their individual independence or the special committee's collective independence. In addition, the Supreme Court noted that the special committee was empowered to hire its own legal and financial advisors and had the power to report to the board its recommendations about the fairness of the merger.

Moreover, the Supreme Court noted that the special committee exercised due care by insisting that the employees who worked for both MFW and MacAndrews & Forbes be screened from the process, holding a number of meetings during the summer of 2011, asking MFW's management for updated projections, engaging its financial advisor to conduct additional analyses and explore strategic alternatives the might generate more value for MFW's stockholders, seeking its financial advisor's advice about strategic alternatives, and making a counteroffer to the initial offer from MacAndrews & Forbes. The Supreme Court, therefore, agreed with the Court of Chancery and found that the plaintiffs failed to establish a triable issue of fact regarding whether the special committee fulfilled its duty of care.

After finding that no triable issue of fact with respect to the committee's composition and process existed, the Supreme Court examined the vote of the disinterested stockholders of MFW. The Court concluded that the vote was fully informed and not coerced. The Court noted that MFW's stockholders representing over 65% of the minority shares approved the merger following the proxy statement's disclosure of the background of the special committee's work, the valuation ranges provided by the special committee's financial advisor, and the analyses supporting the financial advisor's fairness opinion. The Supreme Court agreed with the Court of Chancery and noted that since the plaintiffs did not allege any disclosure failures or coercion, there was no factual dispute that a majority of the minority stockholders voted in favor of the merger upon full information and without being coerced. For these reasons, the Supreme Court upheld the Court of Chancery's findings that the procedural protections upon which the merger was conditioned had been established prior to trial. The Supreme Court, therefore, found that the Court of Chancery did not err in concluding that no material disputed facts existed regarding the condition precedent to the business judgment review.

Next, the Supreme Court determined that the business judgment standard of review should be applied to this transaction and affirmed the judgment of the Court of Chancery. In deciding that the business judgment standard of review should apply to controller mergers in which dual procedural protections are applied, the Supreme Court noted the following: (1) the entire fairness standard of review is applied in the controller merger context as a substitute for the dual protections of a disinterested board and stockholder approval, but is not needed when, as in this case, there is a special committee and the transaction is conditioned on a majority of the minority vote because the dual procedural protections offset the influence of the controller; (2) a merger that employs the dual procedural protections optimally protects the minority stockholders in controller buyouts; (3) the public policy of Delaware corporate law is to defer to informed decisions of impartial directors, especially when those decisions are approved by informed disinterested stockholders; (4) the dual protections enable stockholders to get the best price, which "may be the preponderant consideration outweighing other features of [a] merger." In addition, the Supreme Court noted that adopting the business judgment standard of review where both an independent committee and a

vote of disinterested stockholders are properly used would benefit minority stockholders because it would give controlling stockholders an incentive to agree to the use of both procedural protections, resulting in the replication of an arm's-length process.

The Supreme Court cautioned that the business judgment standard will only be applied to controller buyouts where it is established pre-trial that the special committee was independent, empowered, and met its duty of care and that the vote of a majority of the minority stockholders was informed and uncoerced. The Court further explained that if a plaintiff were able to plead a plausible set of facts showing that the foregoing conditions were not met, the complaint would state a claim for relief that would entitle the plaintiff to conduct discovery. If after discovery, triable issues of fact remained about whether the dual procedural protections were established and effective, the case would proceed to trial in which the court would apply the entire fairness standard of review. In so holding, the Court noted that the plaintiffs' Verified Consolidated Class Action Complaint would have survived a motion to dismiss under this new standard.

