

Recent MFW-Related Developments in Delaware Courts

Contributors

Edward B. Micheletti, Partner

Kathryn Bartolacci, Associate

Matthew P. Majarian, Associate

In 2014, the Delaware Supreme Court's landmark *Kahn v. M&F Worldwide Corp.*¹ (*MFW*) decision established that the deferential business judgment standard of review could apply to controlling stockholder "squeeze-out" mergers under certain circumstances. Six necessary conditions must be satisfied for a transaction to obtain business judgment review under *MFW*: (i) the transaction is conditioned *ab initio*, or "from inception," on the approval of a special committee and a majority-of-the-minority majority vote; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisers 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.

Over the past year, the Delaware Court of Chancery has issued a number of significant decisions that provide further guidance about satisfying *MFW*'s *ab initio* standard, which circumstances are sufficiently coercive as to disable the protective effect of the *MFW* structure, and which rights and responsibilities must be reserved to a special committee of disinterested directors in order to retain the possibility of business judgment review for a controlling-stockholder transaction.

The '*Ab Initio*' Requirement and the Commencement of Substantive Economic Negotiations

In 2018, the Delaware Supreme Court explained in *Flood v. Synutra International, Inc.*,² that in order to satisfy *MFW*'s *ab initio* prong, a controller must condition a transaction on the approval of both an *MFW*-compliant special committee of independent directors and a majority-of-the-minority stockholder vote *before economic negotiations begin*. Two recent cases have provided further clarity and guidance about how the court will examine this aspect of *MFW*.

First, in *Salladay v. Lev*,³ Vice Chancellor Sam Glasscock III considered *MFW*'s *ab initio* prong in the context of a transaction where three members of the Intersections board were alleged to have stood on both sides of its transaction with iSubscribed. On September 27, 2018, a representative of iSubscribed's newly formed merger subsidiary met with Intersections' chairman and CEO, who explained that "the Intersections Board would be receptive to an acquisition offer of \$3.50 to \$4.00 per share." Thereafter, the Intersections board formed a special committee of independent directors and determined that it would not approve any transaction not supported by the committee.

In denying a motion to dismiss, the Court of Chancery explained that the *ab initio* prong of *MFW* "requires the committee's empowerment prior to 'substantive economic negotiations,' which include valuation and price discussions if such discussions 'set the field of play for the economic negotiations to come.'" In this regard, the court focused on the alleged September 27, 2018, meeting — wherein the parties discussed financial parameters of a potential merger offer that "set the stage for future economic negotiations" — and determined that plaintiffs "adequately [pled] the existence of substantive economic negotiations, pre-Committee, that raise[] a pleading-stage inference that these discussions deprived the Committee of the full negotiating power sufficient to invoke the business judgment rule" under *MFW*.

¹ 88 A.3d 635 (Del. 2014).

² 195 A.3d 754 (Del. 2018).

³ 2020 WL 954032 (Del. Ch. Feb. 27, 2020).

Second, in *In re HomeFed Corp. Stockholder Litigation*,⁴ Chancellor Andre G. Bouchard addressed a transaction wherein a controlling stockholder of HomeFed Corporation, acquired all outstanding shares of HomeFed stock by way of a 2:1 share exchange, which closed in July 2019. As early as 2017, the controlling stockholder and HomeFed had discussed a potential take-private transaction, and in December 2017, HomeFed formed a special committee of independent directors to negotiate with the controlling stockholder. The special committee “paused its process” in March 2018, however, when the controlling stockholder informed the committee that it was no longer interested in pursuing a transaction.

Nonetheless, over the following 11 months, the controlling stockholder engaged in direct discussions with HomeFed’s largest minority stockholder, whose support was alleged to be essential to secure minority stockholder approval of any potential transaction. After obtaining such support in early February 2019 for a take-private transaction involving a 2:1 exchange ratio, the controlling stockholder formally proposed the transaction to HomeFed and conditioned its offer on HomeFed’s agreement to the *MFW* structure.

The Court of Chancery denied a motion to dismiss, after holding that the operative complaint adequately alleged that the controlling stockholder “did not commit to the *MFW* protections before engaging in substantive economic discussions concerning the Transaction.” At the earliest, the controlling stockholder had agreed to an *MFW*-compliant transaction structure in a public filing dated February 20, 2019 — but it had received an indication of support for a 2:1 exchange ratio (which the court described as “an important substantive economic term”) from the large minority stockholder before that point. Thus, “by engaging in substantive economic

discussions ... before committing itself to the twin *MFW* protections, [the controlling stockholder] failed to disable and subject itself to the pressures of negotiating with the Special Committee with those protections in place,” rendering *MFW* potentially inapplicable. Of note, the court rejected defendants’ argument that substantive economic negotiations are irrelevant to the *MFW* analysis if conducted “between the controller and a minority stockholder with no authority to bind the company as opposed to an authorized representative of the controlled company.”

The Existence of Coercion Sufficient To Disable the *MFW* Protections

To comply with *MFW*, a conflicted transaction also must be free of coercion affecting the special committee process or the majority-of-the-minority stockholder vote. This issue was a significant focus of *In re Dell Technologies, Inc. Class V Stockholders Litigation*,⁵ which provides guidance as to the types of coercion that courts can identify as impacting the *MFW* analysis.

Dell involved a transaction whereby Dell Technologies, Inc. redeemed its outstanding Series V tracking stock in exchange for either alternative Dell stock or cash. The transaction was conditioned *ab initio* on use of the *MFW* standards. Importantly, however, Dell reserved the right at all times to engage in a “Forced Conversion” of the Series V stock into Dell Class C stock (as permitted by the company’s charter) pursuant to a pricing formula purportedly unattractive to existing stockholders. In denying a motion to dismiss, the Court of Chancery found that Dell’s reservation of the right to bypass the special committee and majority-of-the-minority stockholder vote and instead engage in a Forced Conversion made it reasonably conceivable that *MFW* would not apply.

⁴ 2020 WL 3960335 (Del. Ch. Jul. 13, 2020).

⁵ 2020 WL 3096748 (Del. Ch. Jun. 11, 2020).

After rejecting the argument that because the Forced Conversion right appeared in Dell's charter, it could not have led to coercion, the court held that *MFW* may not apply where "a controller's explicit or implicit threats ... prevent a committee from fulfilling its function." Because the special committee's mandate excluded the ability to control whether or not the Forced Conversion could occur, Dell "deprived the Special Committee of the full power to say 'no'" because Dell "reserved the right to engage in a Forced Conversion and threatened both the Special Committee and the Company's stockholders with that alternative." In addition, the court found it reasonably conceivable that "the specter of a Forced Conversion" impacted the majority-of-the-minority vote by causing Dell's Class V stockholders to approve the transaction for reasons other than its merits and deprived them of a vote "free of the sword of Damocles that the Conversion Right presented."

For *MFW* To Apply, the Special Committee Must Do the Negotiating

The *Dell* opinion also expanded on a core *MFW* prong that requires a conflicted transaction to be negotiated by a disinterested and independent special committee. Specifically, in *Dell*, the court held that when other parties (such as minority stockholders) engage in negotiations with a controller in place of a special committee, *MFW*'s protections will not apply.

The redemption transaction in *Dell* that stockholders ultimately approved was initially negotiated between the company and a special committee of independent directors. After the deal was announced, but before the stockholders were scheduled to vote on the transaction, certain large Class V stockholders objected to the value of the committee-negotiated redemption transaction, allegedly prompting Dell to negotiate

directly with such stockholders to improve the financial terms of the transaction for the minority. These terms were ultimately approved by both the special committee and the minority stockholders. Although the special committee approved the final transaction, it was alleged to have "abandoned the field and stopped acting as the negotiating agent for the Class V stockholders" during the time when Dell was engaging stockholders directly.

The court found that the special committee's actions gave rise to reasonable inferences that, if true, would disable *MFW* and require entire fairness review. According to the court, "*MFW*'s dual protections contemplate that the Special Committee will act as the bargaining agent for the minority stockholders, with the minority stockholders rendering an up-or-down verdict on the committee's work." Thus, "if the committee's initial work is rejected by the stockholders, that does not mean the committee's role is over." Instead, "the committee must return to the bargaining table, continue to act in its fiduciary capacity, and seek to extract the best transaction available." It can "receive input from stockholders," but must be the primary negotiator throughout the deal process for *MFW* to apply.

* * *

The contours and nuances of the *MFW* doctrine continue to develop. The above cases make clear that careful consideration of each of the *MFW* prongs at the outset and throughout any applicable transaction process is paramount. There are lessons to be learned from each of these cases, and how to identify and potentially avoid certain pitfalls that could render *MFW* inapplicable in certain circumstances. Consultation with outside counsel, as early as possible, regarding these and other *MFW*-related issues is critical to best position a controlling stockholder or conflict transaction to comply with *MFW*.

Contacts

Litigation

Cliff C. Gardner

302.651.3260
cgardner@skadden.com

Paul J. Lockwood

302.651.3210
paul.lockwood@skadden.com

Edward B. Micheletti*

302.651.3220
edward.micheletti@skadden.com

Jenness E. Parker

302.651.3183
jenness.parker@skadden.com

Robert S. Saunders

302.651.3170
rob.saunders@skadden.com

Jennifer C. Voss

302.651.3230
jennifer.voss@skadden.com

Mergers & Acquisitions

Faiz Ahmad

302.651.3045
faiz.ahmad@skadden.com

Steven J. Daniels

302.651.3240
steven.daniels@skadden.com

Allison L. Land

302.651.3180
allison.land@skadden.com

Corporate Restructuring

Anthony W. Clark

302.651.3080
anthony.clark@skadden.com

Joseph O. Larkin

302.651.3124
joseph.larkin@skadden.com

*Editor

Special thanks to **Stephen F. Arcano**

This communication is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This communication is considered advertising under applicable state laws.

One Rodney Square / 920 N. King St. / Wilmington, Delaware 19801 / 302.651.3000

One Manhattan West / New York, NY 10001 / 212.735.3000