

**Delaware Court Of Chancery Gives Important Guidance To
Restructuring Professionals And Other Legal Advisors On The
Value That Special Committees Of Directors Can Add To
Transactions With Controlling Stockholders**

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A recent opinion by the Delaware Court of Chancery potentially marks a major shift in how Delaware courts will analyze going-private transactions involving controlling stockholders. Chancellor Leo E. Strine, Jr.'s May 29, 2013 ruling in *In re MFW Shareholders Litigation* (“*MFW*”), if embraced by the Delaware Supreme Court, provides controlling stockholders with a roadmap to structure such transactions so that they may obtain deferential judicial review under the business judgment standard.

What The *MFW* Opinion Means For Restructuring Professionals

Chancellor Strine's decision in *MFW* offers important guidance for restructuring professionals whose clients may benefit from the applicability of the business judgment rule to a controlling stockholder transaction.

First, the special committee should be formed at the outset of any such potential transaction.

Second, the composition of the special committee matters. Members should be independent of the controlling stockholder, lack any interest in the transaction, and be free of any other factor that would negatively impact their ability to act properly in protecting the interests of the non-controlling stockholders.

Third, the scope of the special committee's authority is important. The special committee must be given real power to negotiate with the controlling stockholder, the authority to shut down and walk away from negotiations, and the ability to hire independent legal and financial advisors.

Fourth, the process employed by the special committee and its advisors is crucial. Not only should the special committee and its advisors develop a specific process, they should adhere to that process as closely as possible and rigorously document their adherence to that process.

Background

In 2011, MacAndrews & Forbes Holdings Inc. (“MacAndrews & Forbes”), the controlling stockholder of M&F Worldwide Corp. (“M&F Worldwide”), proposed a going-private transaction through which MacAndrews & Forbes would acquire all of the equity interest in M&F Worldwide that it did not already own in exchange for cash. At the outset, MacAndrews & Forbes stated that any such transaction would be expressly conditioned on (i) the approval of a special committee of disinterested and independent directors of M&F Worldwide, and (ii) the affirmative vote of a majority of M&F Worldwide’s unaffiliated stockholders. MacAndrews & Forbes stated that it was not interested in selling its shares and would not vote in favor of any alternative sale, merger, or similar third-party transaction.

M&F Worldwide’s board of directors formed a special committee, giving it full power to negotiate the transaction with MacAndrews & Forbes and to say “no” to a transaction. The special committee selected its own legal and financial advisors, met frequently, and negotiated at length to secure a material increase in the price per share. The special committee approved the transaction, which was then approved by 65% of the stockholders unaffiliated with and independent of MacAndrews & Forbes. Plaintiffs pursued a damages case after the transaction closed, claiming that the both the price and the process employed in negotiating the transaction were not entirely fair. After discovery, the defendants moved for summary judgment, arguing that the deferential business judgment rule, and not the onerous entire fairness standard of review, should apply to a going-private transaction with a controlling stockholder that is conditioned on (i) the approval of both a disinterested, independent, and properly-functioning special committee of directors and (ii) a fully-informed and uncoerced vote of a majority of unaffiliated stockholders.

The Ruling

Since at least 1994, it has been generally understood (although not universally accepted) that going-private transactions between Delaware corporations and their controlling stockholders are always subject to the entire fairness standard of review, which requires that such transactions be shown to be entirely fair as to both the price of such transactions and the process by which those transactions were structured. This understanding arose out of the Delaware Supreme Court’s seminal 1994 decision in *Kahn v. Lynch Communications Systems* (“*Lynch*”), in which the Supreme Court held that while approval of a proposed controlling stockholder transaction by either a special committee of disinterested and independent directors or a majority of non-controlling stockholders could shift the burden of proof to the plaintiffs to prove a transaction’s unfairness, “the exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness. . . .”

Despite this language from the Supreme Court’s decision in *Lynch*, and other decisions since that have embraced this language, the Chancellor concluded in *MFV* that he was not

bound to apply entire fairness review to the MacAndrews & Forbes going-private transaction. He reasoned that the Delaware Supreme Court has never been presented with a case where a going-private transaction was conditioned on the approval of *both* a special committee *and* a majority of the non-controlling stockholders, and thus has never actually held that entire fairness is the exclusive method of review for such a dual-approval structure. Considering the issue as a novel and unanswered question of law, the Chancellor held that a going-private transaction with a controlling stockholder that is conditioned from the outset on obtaining both such approvals should be reviewed under the deferential business judgment rule instead of entire fairness.

Importantly, the Chancellor provided specific guidance on what must be shown in order for approvals by a special committee and a majority of non-controlling stockholders to be given business judgment review. As to the approval by a special committee, the following conditions must be met:

- the special committee’s members are independent of the controlling stockholder and disinterested in the transaction;
- the special committee is empowered to select its own independent legal and financial advisors;
- the special committee has the power to negotiate the terms of the transaction and to say “no” to the transaction; and
- the special committee must give due attention and deliberation to the process and otherwise meet its fiduciary duty of due care.

And as to the approval by a majority of unaffiliated stockholders, the following conditions must be met:

- stockholder approval is a non-waivable condition of the transaction;
- the stockholders receive all material information necessary to render their vote a fully-informed one; and
- the stockholders’ vote is uncoerced.

Applying these conditions to the facts before him, the Chancellor ruled that the approvals by the special committee and a majority of the non-controlling stockholders were valid and effective to permit application of the business judgment rule to the MacAndrews & Forbes going-private transaction. The Court entered final judgment in favor of the defendants.