

Wachtell on Controlling Shareholders and the Business Judgment Rule in Going Private Merger Transactions

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The Delaware Court of Chancery this week held that the use of both an independent special committee and a majority-of-the-minority vote condition in a go-private merger between a controlled company and its controlling stockholder will result in application of the deferential business judgment rule standard of review rather than the onerous entire fairness standard. *In re MFW S'holders Litig., C.A. No. 6566-CS (Del. Ch. May 29, 2013)*.

The case arose out of a stockholder challenge to a merger in which MacAndrews & Forbes acquired the 57% of M&F Worldwide it did not already own. The transaction was subject to the approval of both an independent special committee and the majority of stockholders unaffiliated with MacAndrews. The plaintiffs contended that the presence of a controller on both sides of the transaction mandated entire fairness review, and argued that the use of “procedural devices” like the special committee and the vote condition should at most have the modest effect of shifting the burden of proof on the issue of entire fairness.

After determining that the special committee was independent, properly empowered, and acted with due care and that the shareholder vote was fully informed and uncoerced, the Court turned to the appropriate standard of review. The Chancellor acknowledged that the Delaware Supreme Court has generally stated that a controlling stockholder’s presence on both sides of a merger leads to entire fairness review and that use of *either* a special committee *or* a majority-of-the-minority vote could result in a burden shift. Nonetheless, the Chancellor concluded that the Supreme Court has never been directly asked whether use of *both* devices should result in business judgment rule review. The Chancellor answered in the affirmative, noting the benefits provided by these combined procedural devices and the powerful incentive to use both of them that would result from such a rule. The Court viewed favorably

that MacAndrews promised not to pursue a transaction without approval of the special committee, thus empowering the special committee to more effectively “say no.” The Chancellor also noted that to obtain that benefit, the controlling stockholder “cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move,” but would have to accept it at the outset of negotiations.

With its *MFW* opinion, the Court of Chancery has laid out a cogent rule of law to govern an unsettled issue of practical importance to transaction planners. If the case is appealed, the plaintiffs can be expected to argue that Chancery’s decision conflicts with existing Supreme Court precedent. Until the Supreme Court rules, transaction planners will need to be alert to this important development.