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# *Kahn v. M&F Worldwide Corp.*: Risking Too Much on Ab Initio Conditions

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NICHOLAS R. RODRIGUEZ\*

## *Kahn v. M&F Worldwide Corp.*: Risking Too Much on *Ab Initio* Conditions

IN *KAHN V. M&F WORLDWIDE CORP.*,<sup>1</sup> the Delaware Supreme Court considered whether the standard of review for a going-private merger by a controlling stockholder is the business judgment rule, rather than the entire fairness standard, when the merger is conditioned upfront on approval by both (i) an adequately empowered independent special committee that acted with due care to negotiate a fair price, and (ii) an informed, uncoerced majority-of-the-minority vote.<sup>2</sup> Reviewing this novel question of law, the court concluded that the business judgment rule was the appropriate standard when the controlling stockholder conditioned the merger on both of these procedural protections.<sup>3</sup> While the court's decision was properly motivated by the underlying justification in *Kahn v. Lynch Communications Systems, Inc.*,<sup>4</sup> which was to protect the minority stockholder,<sup>5</sup> the Delaware Supreme Court created potential ambiguity by adding a condition that the Court of Chancery did not—that the special committee exercise due care in negotiating a *fair price*.<sup>6</sup> This simple phrase introduces an aspect of entire fairness into what the court fashioned as a business judgment analysis.<sup>7</sup> Moreover, even if

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1. 88 A.3d 635 (Del. 2014).
2. *Id.* at 645.
3. *Id.*
4. 638 A.2d 1110 (Del. 1994).
5. *See infra* Part IV.A.
6. *M&F Worldwide*, 88 A.3d at 645.
7. *See infra* Part IV.C.

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the fair price condition is measured by a gross negligence standard, the transactional risks associated with upfront conditions will likely limit controlling stockholders' use of the *M&F* framework.<sup>8</sup> Finally, though the court had the opportunity to adopt a unified standard of review for going-private transactions, which would have reinforced its commitment to protecting the minority stockholder, the court failed to address this aspect of Chancellor Strine's decision.<sup>9</sup>

I. STATEMENT OF THE CASE

In June 2011, MacAndrews & Forbes—a holding company—made a public offer to purchase the remaining shares of M&F Worldwide (“MFW”) in a one-step going-private merger.<sup>10</sup> At the time of the offer, MacAndrews & Forbes owned 43% of MFW, and offered to pay \$24 per share for the remaining shares.<sup>11</sup> However, MacAndrews & Forbes said it would not proceed with the transaction unless the merger was approved by both an independent special committee and a majority of the stockholders unaffiliated with the controlling stockholder (“controller”).<sup>12</sup>

After the offer was received, the board of directors of MFW met to consider the proposal.<sup>13</sup> Several directors recused themselves before the meeting,<sup>14</sup> and eventually, the board formed an independent special committee comprised of its own legal and financial advisors.<sup>15</sup> The special committee met eight times over three months and ultimately rejected MacAndrews & Forbes' offer of \$24 per share.<sup>16</sup> Once the committee increased the merger price to \$25 per share, and after receiving a fairness opinion from its financial advisor, the committee unanimously recommended the merger to the MFW board of directors.<sup>17</sup> Five members of the board recused themselves from the vote due to conflicting interests, and the

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8. See *infra* Part IV.D.

9. See *infra* Part IV.B.

10. *M&F Worldwide*, 88 A.3d at 640.

11. *Id.* At the time of the offer, MFW shares were trading at \$16.96. *Id.*

12. *Id.* at 640–41.

13. *Id.* The MFW board of directors consisted of thirteen members: Ron Perelman, Barry Schwartz, William Bevins, Bruce Slovin, Charles Dawson, Stephen Taub, John Keane, Theo Folz, Philip Beekman, Martha Byorum, Viet Dinh, Paul Meister, and Carl Webb. *Id.* at 640.

14. Schwartz and Bevins recused themselves from the meeting because they had roles at both MacAndrews & Forbes and MFW, as did Dawson who had previously expressed support of the offer as CEO of Harland Clarke Holding Company, a company that owned three out of four business segments of MFW. *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 641 (Del. 2014). Slovin recused himself at later point because he had a relationship with MacAndrews & Forbes that could raise questions about his independence for the purpose of serving on the special committee. *Id.* at 641–42.

15. *Id.* at 641. The independent special committee consisted of four members: Byorum, Dinh, Meister, and Webb. *Id.*

16. *Id.* at 652–53.

17. *Id.*

remaining eight directors voted unanimously to recommend the offer to the stockholders.<sup>18</sup> Following the recommendation, 65.4% of the shares not owned by MacAndrews & Forbes voted in favor of the transaction.<sup>19</sup>

Prior to the vote, a group of the unaffiliated stockholders sued MacAndrews & Forbes and the board of directors of MFW, alleging that the merger was unfair and requesting an injunction.<sup>20</sup> These plaintiffs withdrew their motion for a preliminary injunction and instead sought damages for breach of fiduciary duty.<sup>21</sup> The defendants then moved for summary judgment.<sup>22</sup>

Examining this novel question of law, the Court of Chancery held that the deferential business judgment rule applies in a one-step going-private merger conditioned on the approval of an independent special committee and the non-waivable approval of a fully informed majority of the minority.<sup>23</sup> Specifically, the court held that the business judgment rule is invoked if:

*([1]) the controller conditions the procession of the transaction on the approval of both a special committee and a 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; ([5]) the vote of the minority is informed; and ([6]) there is no coercion of the minority.*<sup>24</sup>

The Court of Chancery admitted that *Lynch* could, and had been read to suggest that a controller who consented to both procedural protections would receive no additional legal credit and still be subject to entire fairness review.<sup>25</sup> Because this was a novel legal question, however, the court stated that it was still subject to judicial interpretation.<sup>26</sup>

Chancellor Strine (now Chief Justice Strine) examined the merger and found that all six conditions were met.<sup>27</sup> Accordingly, the court reviewed the merger under the business judgment rule<sup>28</sup> and granted the defendant's motion for summary judgment.<sup>29</sup> Though the court was not squarely presented with the question of

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18. *Id.* at 653 n.38.

19. *Kahn v. M&F Worldwide*, 88 A.3d 635, 638 (Del. 2014).

20. *In re MFW S'holders Litig.*, 67 A.3d 496, 499 (Del. Ch. 2013).

21. *Id.*

22. *Id.*

23. *Id.* at 502.

24. *Id.* at 535.

25. *In re MFW S'holders Litig.*, 67 A.3d 496, 500 (Del. Ch. 2013).

26. *Id.*

27. *Id.* at 517.

28. *Id.* at 524.

29. *Id.* at 536.

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whether the business judgment rule would apply to a tender offer if the same conditions were met, the court hinted that if the equitable duties of a controller were consistent, an “across-the-board incentive system would be created to ensure fair treatment of minority stockholders” regardless of the transaction structure.<sup>30</sup>

### II. LEGAL BACKGROUND

In Delaware, going-private transactions by controlling stockholders (also known as a “freeze-out” transaction) are typically accomplished by one of four methods: (1) a reverse stock split; (2) an asset sale; (3) a negotiated merger; or (4) a tender offer.<sup>31</sup> The use of methods (1) and (2) are rare;<sup>32</sup> reliance on the latter two methods, however, has provided for a vast amount of Delaware case law evaluating the validity of these types of transactions.<sup>33</sup>

The third method, a negotiated one-step merger (also known as a “long-form merger,” “cash-out merger,” or “one-step freeze-out,” all of which are hereinafter “negotiated merger”), is a “bargaining transaction, the terms of which are negotiated by the management of the merging firms”—in the case of a freeze-out, between the controlling stockholder and the target corporation.<sup>34</sup> To go private via a negotiated merger, the controlling stockholder will propose merging the target corporation into itself or one of its subsidiaries, and then the target board and the stockholders of the target company (both of which are dominated by the controller) will approve the merger.<sup>35</sup> Once approved, the controlling stockholder will issue the unaffiliated stockholders cash or shares in the newly privatized company in exchange for their stock in the target.<sup>36</sup> Following this process, the controller will execute the transaction as a statutory merger under Section 251 of the Delaware General Corporation Law (“DGCL”).<sup>37</sup>

Unlike the negotiated merger, the fourth method, a two-step merger (also known as a “tender offer”), involves either a unilateral tender offer or a negotiated tender offer by a controlling stockholder at step one, followed by (in most cases) a

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30. *In re MFW S'holders Litig.*, 67 A.3d 496, 503–04, 536 (Del. Ch. 2013).

31. Marco Ventoruzzo, *Freeze-Outs: Transcontinental Analysis and Reform Proposals*, 50 VA. J. INT'L L. 842, 851 (2010).

32. There are many reasons why controlling stockholders avoid these two methods; mainly, because they have adverse tax consequences, they are expensive, time-consuming and cumbersome, and they may not always result in acquiring all of the equity. See Joshua M. Koenig, *A Brief Road Map to Going Private*, 2004 COLUM. BUS. L. REV. 533, 537–39 (2004).

33. See *infra* Parts II.A–B.

34. David W. Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153, 179 (1986).

35. Priya Gupta, *Freezeouts in Delaware: An Exploration of the Appropriate Standard of Review*, 2012 COLUM. BUS. L. REV. 707, 713–14 (2012).

36. Koenig, *supra* note 32, at 533.

37. Gupta, *supra* note 35, at 713; DEL. CODE ANN. tit. 8 § 251 (2014).

“short-form” merger or a long-form merger at step two.<sup>38</sup> The controller, making proper disclosures and adhering to the Securities and Exchange Commission’s (“SEC”) timeframes, sends a direct tender offer to the targeted stockholders to purchase their stocks.<sup>39</sup> These timeframes are much faster than those of the one-step merger.<sup>40</sup> If the controlling stockholder gains 90% of the shares, the controlling stockholder will be able to complete a “short-form” merger, which does not require approval from the minority stockholders and creates a private company.<sup>41</sup>

If the controller does not gain the 90%, but the tender offer has been negotiated, the controller may be able to exercise a “top-up” option—meaning that the controller would be able to reach the 90% threshold by acquiring newly issued shares from the target company, and the controller would be able to complete the transaction as a short-form merger.<sup>42</sup> If certain conditions are established, but the 90% threshold is not met, Section 251(h) of the DGCL provides that the target company may eliminate the need for a stockholder vote at the second step.<sup>43</sup> If the 90% cannot be met by any method, the controlling stockholder will likely have to resort to using either a “long-form” merger, which will abide by the “long-form” process discussed *supra*,<sup>44</sup> or they can use a “back-end” merger, which will “squeeze out” stockholders who have not tendered their shares by having the remaining stockholders give their written consent.<sup>45</sup>

These transactions are reviewed under one of two standards of review: the business judgment rule or the entire fairness standard. The business judgment rule “is a presumption that in making a business decision[,] the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>46</sup> So long as there exists “a business decision, disinterestedness and independence, due care, good faith, and, according to some, the absence of abuse of discretion,” and the challenged decision does not constitute “fraud, illegality, ultra vires conduct or waste,” the business judgment rule shields directors from liability.<sup>47</sup>

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38. *Id.* at 718.

39. *Id.*

40. David Offenberg & Christo Prinsky, How do Acquirers Choose between Mergers and Tender Offers 8 (Sept. 28, 2013) (unpublished manuscript), available at <http://mason.gmu.edu/~aphilipo/seminars/papers/Tenders.pdf>.

41. Gupta, *supra* note 35, at 718.

42. Symposium, *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 PENN. ST. L. REV. 615, 666–67 (2012).

43. DEL. CODE ANN. tit. 8 § 251(h) (2014).

44. See *supra* notes 34–37 and accompanying text.

45. Symposium, *supra* note 42, at 621.

46. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

47. STEPHEN A. RADIN ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES FOR CORPORATE DIRECTORS* 25 (6th ed. 2008).

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On the other hand, the more onerous entire fairness standard requires a court to evaluate the transaction for fair dealing and fair price.<sup>48</sup> As the Delaware Supreme Court explained:

*[Fair dealing] embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. [Fair price] relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.*<sup>49</sup>

While both the negotiated merger and the tender offer ultimately create a private company, the standard of review used to evaluate these transactions varies; in certain circumstances, tender offers are reviewed under the business judgment rule, whereas negotiated mergers are subject to entire fairness review.<sup>50</sup> Part II.A explains the development of going-private jurisprudence in Delaware as well as the Delaware Supreme Court's adherence to making entire fairness the exclusive standard of review.<sup>51</sup> Part II.B discusses the evolution of this jurisprudence after *Lynch* as the Court of Chancery developed seemingly divergent lines of case law that it later retreated from in favor of a more unified doctrine.<sup>52</sup>

A. *The Delaware Supreme Court has Consistently Held that the Standard of Review that Best Protects the Minority Stockholder in a Going-Private Transaction Involving a Controlling Stockholder is the Entire Fairness Standard*

In 1983, the Delaware Supreme Court first explored the use of entire fairness review to protect the minority stockholder.<sup>53</sup> In *Weinberger v. UOP, Inc.*, the controlling stockholder, who owned 50.5% of UOP shares, froze-out UOP's minority shareholders at \$21 per share.<sup>54</sup> Soon thereafter, the minority shareholders sued the controlling stockholder, alleging, among other things, that the price of the merger was unfair.<sup>55</sup> Holding that entire fairness review applied to cash-out mergers by controlling stockholders, the Delaware Supreme Court found that the "business purpose requirement" (i.e., the business judgment rule) did not provide "any

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48. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

49. *Id.* at 711 (citations omitted).

50. *See infra* Parts II.A–B.

51. *See infra* Part II.A.

52. *See infra* Part II.B.

53. *Weinberger*, 457 A.2d at 710.

54. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 704, 708 (Del. 1983).

55. *Id.* at 703.

additional meaningful protection [to] minority shareholders.”<sup>56</sup> The court noted: “the requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.”<sup>57</sup> Had UOP “appointed an independent negotiating committee of . . . outside directors” and had “each of the contending parties . . . in fact exerted its bargaining power against the other at arm’s length,” there would have been strong evidence that the transaction met entire fairness.<sup>58</sup>

Two years later, the Delaware Supreme Court in *Rosenblatt v. Getty Oil*<sup>59</sup> examined what impact, if any, a majority-of-the-minority vote would have on the standard of review in a going-private merger.<sup>60</sup> *Rosenblatt* involved a one-step merger where 58% of minority shares voted in favor of the proposed transaction.<sup>61</sup> The Delaware Supreme Court found that the defendant, Getty Oil, who owned a majority of the target company’s stock, dealt fairly with the oil company’s minority shareholders.<sup>62</sup> The court held that the approval of a merger by “an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs[;]” it does not, however, change the standard of review to the business judgment rule.<sup>63</sup>

While the Delaware Supreme Court would give no extra legal credit to the controlling stockholder if the transaction was approved by a majority of the minority shareholders, an open question still existed as to whether the use of a special committee would trigger the business judgment rule. This issue was addressed in *Kahn v. Lynch Communications Systems, Inc.*,<sup>64</sup> where the Delaware Supreme Court held that a one-step going-private merger by a controlling stockholder is subject to entire fairness review, even when the merger is negotiated by an independent special committee.<sup>65</sup>

In *Lynch*, the board of directors of the target company formed a special committee of independent directors to negotiate with the controlling stockholder.<sup>66</sup> During negotiations, the controller threatened to propose a tender offer directly to the minority shareholders if the special committee did not recommend the merger

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56. *Id.* at 715.

57. *Id.* at 710 (citations omitted).

58. *Id.* at 709–10 n.7 (citations omitted).

59. 493 A.2d 929 (Del. 1985).

60. *Id.* at 937.

61. *Id.* at 936.

62. *Id.* at 937.

63. *Id.*

64. 638 A.2d 1110 (Del. 1994).

65. *Id.* at 1117.

66. *Id.* at 1113.



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at the price offered.<sup>67</sup> The special committee subsequently recommended the transaction, and the minority stockholders filed suit.<sup>68</sup> Applying the entire fairness standard, the court held that because the special committee did not have the ability to negotiate or “the power to say no,” the merger was unfair.<sup>69</sup> The court explained that entire fairness review was “one way to provide [procedural] protections” to minority stockholders.<sup>70</sup> Although the controlling stockholder was still subject to heightened judicial scrutiny, the court acknowledged that the initial burden of proof would shift to the plaintiffs if the merger was subject to *either* approval by a properly informed independent special committee or a majority of the stockholders who were unaffiliated with the controller.<sup>71</sup> The court reiterated that in a merger between a controlling stockholder and a corporation, a court could not be certain that “the transaction terms fully approximate[d] what truly independent parties would have achieved in an arm’s length negotiation.”<sup>72</sup> According to the court, protections “beyond those afforded by full disclosure of all material facts,” such as entire fairness review, should be provided to minority shareholders.<sup>73</sup>

*B. Following Lynch, the Standard of Review Evolved as the Court of Chancery Created a Divergent Strand of Case Law that It Later Retreated From in Favor of a More Unified Doctrine*

Two years after deciding *Lynch*, the Delaware Supreme Court provided ammunition to lower courts seeking to minimize *Weinberger* and its progeny. In *Solomon v. Pathe Communications Corp.*,<sup>74</sup> the Delaware Supreme Court held that, absent coercion or disclosure violations, the maker of a tender offer had no duty to offer a fair price.<sup>75</sup> *Solomon* was not binding on freeze-out case law because the tender offer was for less than all of the minority shares.<sup>76</sup> Nevertheless, this decision began a movement by the Court of Chancery to treat tender offers and negotiated mergers differently.<sup>77</sup> *Lynch* and the entire fairness standard would still govern negotiated mergers, whereas tender offers would be reviewed under the deferential business judgment rule absent coercion or disclosure violations.<sup>78</sup> Beginning in

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67. *Id.*

68. *Id.*

69. *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1119–20 (Del. 1994).

70. *Id.* at 1117 (citations omitted).

71. *Id.*

72. *Id.* at 1116 (citing *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 502 (Del. Ch. 1990)).

73. *Id.* at 1117 (citations omitted).

74. 672 A.2d 35 (Del. 1996).

75. *Id.* at 40.

76. *See id.* at 37.

77. *See infra* Part II.B.1.

78. *See infra* Part II.B.1.

2005, however, the Court of Chancery retreated from this dichotomy and advocated for a unified standard of review.<sup>79</sup>

1. *Cutting Controller Freeze-Outs in Two: The Rise of the Business Judgment Rule in Tender Offers*

Following *Solomon*, the Court of Chancery began to narrowly apply *Lynch*.<sup>80</sup> In *In re Siliconix Inc. Shareholders Litigation*,<sup>81</sup> the Court of Chancery rejected entire fairness as the default standard of review for going-private transactions structured as tender offers.<sup>82</sup> Here, the court held that the entire fairness standard would only be applied to the first step (the actual tendering of the shares) of a two-step freeze-out if the tender offer: (1) was coercive; or (2) contained disclosure violations.<sup>83</sup> Thus, outside of coercion or disclosure violations, the default standard of review for the first step of a tender offer would be the business judgment rule.<sup>84</sup> “[A]s long as the tender offer is pursued properly, the free choice of the minority shareholders to reject the tender offer provides sufficient protection.”<sup>85</sup> The court offered three reasons why tender offers and negotiated mergers should be treated differently.<sup>86</sup> First, the acceptance or rejection of a tender offer is the individual stockholder’s decision.<sup>87</sup> Second, in negotiated mergers, the target company enters into the merger agreement with the controlling stockholder; but in the tender offer context, the target company does not confront a comparable corporate decision because the target of the tender offer is the stockholder, not the corporation.<sup>88</sup> Third, directors of corporations have a statutory duty of care when entering into merger agreements, while controlling stockholders do not have such a duty when making a tender offer.<sup>89</sup>

Only a month later, the Delaware Supreme Court in *Glassman v. Unocal Exploration Corp.*<sup>90</sup> addressed the standard of review for the second step—the short-form merger component—of a two-step freeze-out transaction.<sup>91</sup> Unocal, the parent

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79. See *infra* Part II.B.2.

80. See generally *In re Siliconix Inc. S’holders Litig.*, No. CIV. A. 18700, 2001 WL 716787 (Del. Ch. June 21, 2001); *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421 (Del Ch. 2002).

81. No. CIV. A. 18700, 2001 WL 716787 (Del. Ch. June 21, 2001).

82. *Id.* at \*6.

83. *Id.*

84. *Id.*

85. *Id.*

86. *In re Siliconix Inc. S’holders Litig.*, No. CIV. A. 18700, 2001 WL 716787, at \*7 (Del. Ch. June 21, 2001).

87. *Id.*

88. *Id.*

89. *Id.* at \*8.

90. 777 A.2d 242 (Del. 2001).

91. *Id.* at 243.

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company, owned 96% of its subsidiary, Unocal Exploration Corp (“UXC”).<sup>92</sup> Since Unocal owned greater than 90% of UXC, the transaction was being executed as a short-form merger.<sup>93</sup> The court held that “absent fraud or illegality, appraisal is the exclusive remedy available to a minority shareholder who objects to a short-form merger.”<sup>94</sup> The court reasoned that speed was the key motivation for creating Section 253 of the DGCL,<sup>95</sup> and that the application of entire fairness review would be inappropriate given that it requires significant time.<sup>96</sup>

Continuing down the path of treating negotiated mergers and tender offers differently, the Court of Chancery in *In re Pure Resources Inc., Shareholders Litigation*<sup>97</sup> outlined the test to determine whether a tender offer was coercive.<sup>98</sup> While the court affirmed the *Solomon* line of reasoning,<sup>99</sup> then-Vice Chancellor Strine acknowledged that this area of Delaware law was “fraught with doctrinal tension.”<sup>100</sup> In attempt to alleviate this tension, the court held that a tender offer would only be considered non-coercive if: (1) the offer was subject to a non-waivable majority-of-the-minority vote; (2) the controlling stockholder guaranteed the consummation of a prompt short-form merger at the same price as the tender offer if it obtained 90% or more of the shares; and (3) the controlling stockholder made no “retributive threats” in its negotiations with the special committee.<sup>101</sup> This decision, although allowing for business judgment review of tender offers, revived the underlying justification of *Lynch* and opened the door for a unified standard of review.

## 2. *The Retreat: A Recent Movement Towards a Unified Standard of Review*

In *In re Cox Communications, Inc. Shareholders Litigation*,<sup>102</sup> the Court of Chancery saw the opportunity to reconcile seemingly divergent strands of case law in favor of a unified standard of review post-*Pure Resources*.<sup>103</sup> In dicta, *Cox* suggested that the standard governing going-private transactions by controlling stockholders could be

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92. *Id.*

93. *Id.* at 243–44.

94. *Id.* at 248.

95. *See id.* at 247–48. Section 253 allows a controller to use a short-form merger if the controlling stockholder owns more than 90% of the shares of its subsidiary. DEL. CODE ANN. tit. 8 § 253 (2014).

96. *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 248 (Del. 2001).

97. 808 A.2d 421 (Del Ch. 2002).

98. *Id.* at 445 (applying the test only to tender offers).

99. *Id.* at 444.

100. *Id.* at 433–34.

101. *Id.* at 445.

102. 879 A.2d 604 (Del. Ch. 2005).

103. *Id.* at 607.

“sensibly unified through an extension of . . . [a] reformed *Lynch*[;]”<sup>104</sup> meaning, “if a controller proposed a merger, subject from inception to negotiation and approval of the merger by an independent special committee *and* a Minority Approval Condition,” the business judgment rule should apply.<sup>105</sup>

Five years after *Cox*, the Court of Chancery finally had the opportunity to apply the unified standard of review to controller freeze-outs.<sup>106</sup> In *In re CNX Gas*, a special committee was authorized to recommend to minority stockholders whether, in its opinion, the tender offer by the controlling stockholder was fair.<sup>107</sup> After an unaffiliated financial advisor gave its opinion to the special committee that the tender offer was indeed fair, several minority stockholders filed lawsuits requesting that the court enjoin the transaction before the tender offer could be sent out.<sup>108</sup> Vice Chancellor Laster rejected the controlling stockholder’s argument that the business judgment rule should apply, and explained that two-step going-private transactions are subject to entire fairness review unless the tender offer is both: (1) negotiated and recommended by an informed special committee of disinterested directors with the power to negotiate with the controlling stockholder, and (2) subject to a “majority of the minority” tender or vote requirement.<sup>109</sup> Only if both of these conditions are met will the tender offer be protected by the business judgment rule.<sup>110</sup> In dicta, the court indicated that in the context of a one-step going-private merger by a controlling stockholder, the business judgment rule would apply under the same conditions; however, that question was not squarely presented to the court.<sup>111</sup>

### III. THE COURT’S REASONING

In *Kahn v. M&F Worldwide Corp.*, the Delaware Supreme Court held that business judgment is the standard of review that governs going-private mergers by controlling stockholders, when the merger is conditioned “*ab initio*” upon both: (1) the approval of an independent, adequately-empowered special committee that

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104. *Id.*

105. *Id.* at 643–44 (footnotes omitted).

106. *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 400 (Del. Ch. 2010).

107. *Id.* at 404.

108. *Id.* at 399–400, 405.

109. *Id.* at 413.

110. *Id.*

111. See *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 414 (Del. Ch. 2010); *but see In re Cox Radio, Inc. S’holders Litig.*, C.A. No. 4461-VCP, 2010 WL 1806616, at \*11 (Del. Ch. May 6, 2010) (rejecting the unified standard), *aff’d*, 9 A.3d 475 (Del. 2010) (noting that the court did “not express any view as to the proper standard by which the underlying transaction should be reviewed”).

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fulfills its duty of care to negotiate a fair price; and (2) the uncoerced, informed vote of a majority of the minority stockholders.<sup>112</sup>

The court provided four justifications for its holding.<sup>113</sup> First, entire fairness review in a controller merger is a substitute for the dual protections of a disinterested board and stockholder approval since the controller has an influence on both of these components.<sup>114</sup> By employing these protections upfront, however, the controller is no longer an influencing force, and the merger acquires the “shareholder-protective characteristics of third-party, arm’s-length mergers, which are viewed under the business judgment standard.”<sup>115</sup> Second, the dual protections “optimally protect[] the minority stockholders in controller buyouts[,]” by preventing the controlling stockholder from dictating the outcome of the negotiation and dangling the majority-of-the-minority vote before the special committee.<sup>116</sup> “[The structure] will provide a strong incentive for controlling stockholders to accord minority investors the transactional structure that respected scholars believe will provide them the best protection,” since the minority stockholders get the benefit of “independent, empowered negotiating agents to bargain for the best price and say no . . . [and] the critical ability to determine for themselves whether to accept any deal.”<sup>117</sup> Third, the dual protection structure “is consistent with the central traditions of Delaware law, which defers to the informed decisions of impartial directors.”<sup>118</sup> Fourth, the underlying purpose of the dual protection merger utilized by MacAndrews & Forbes and the entire fairness standard converged “at the same critical point: price.”<sup>119</sup> The dual protection structure:

*requires two price-related pretrial determinations: first, that a fair price was achieved by an empowered, independent committee that acted with care; and, second, that a fully-informed, uncoerced majority of the minority stockholders voted in favor of the price that was recommended by the independent committee.*<sup>120</sup>

Summarizing its holding, the court made clear that the business judgment rule will only be applied if:

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112. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).

113. *Id.* at 644–45.

114. *Id.* at 644.

115. *Id.*

116. *Id.*

117. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) (quoting *In re MFW S’holders Litig.*, 67 A.3d 496 (Del. Ch. 2013)).

118. *M&F Worldwide*, 88 A.3d at 644.

119. *Id.* at 644–45.

120. *Id.* at 645 (footnotes omitted).

(i) the controller conditions the procession of the transaction on the approval of both a Special Committee and 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 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.<sup>121</sup>

In a footnote, the court noted that the complaint against the defendants would have survived a motion to dismiss because the “allegations about the sufficiency of the price call[ed] into question the adequacy of the Special Committee’s negotiations, thereby necessitating discovery on all of the new prerequisites . . . .”<sup>122</sup> The court explained that, if after discovery, triable issues of fact remain about whether all of the conditions were established, the case would proceed to trial where the court would review the conduct under entire fairness.<sup>123</sup>

After announcing this new standard, the court concluded that all six of the prerequisites had been met.<sup>124</sup> Specifically, the court held that: (1) the MFW board agreed *ab initio* to both procedural protections;<sup>125</sup> (2) the evidence failed to show an economic relationship between members of the Special Committee and Ron Perelman sufficient to compromise the independence of the committee;<sup>126</sup> (3) the Special Committee, with the help of its financial advisors that it chose itself, had the right to say no definitively and to solicit offers from other potential buyers;<sup>127</sup> (4) the Special Committee met its duty of care in negotiating a fair price where its financial advisor, Evercore, opined that \$25 per share was a fair price based on generally accepted valuation methodologies, and where the plaintiffs had failed to provide evidence to the contrary;<sup>128</sup> (5) the vote of the minority was informed where a proxy statement sent out to all stockholders disclosed the background of the Special Committee’s work, of Evercore’s valuation ranges, and of the analyses supporting Evercore’s fairness opinion;<sup>129</sup> and (6) there was no coercion of the minority.<sup>130</sup>

As a result of these findings, the court determined that the Court of Chancery had properly held that the business judgment rule applied.<sup>131</sup> Finding that the

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121. *Id.*

122. *Id.* at 645 n.14.

123. *Id.* at 645–46.

124. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 654 (Del. 2014).

125. *Id.* at 646.

126. *Id.* at 650.

127. *Id.* at 650–51.

128. *Id.* at 652–53.

129. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 653–54 (Del. 2014).

130. *Id.* at 654.

131. *Id.*

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plaintiffs had not rebutted this deferential standard, the court affirmed the judgment of the Court of Chancery in favor of the defendants.<sup>132</sup>

IV. ANALYSIS

In *M&F Worldwide*, the Delaware Supreme Court held that a going-private merger by a controlling stockholder is reviewed under the business judgment rule when the merger is conditioned upfront upon the approval of both an independent, adequately-empowered special committee that acted with due care to negotiate a fair price, and an informed, uncoerced majority of the minority stockholders.<sup>133</sup> While the court's holding was properly motivated by the underlying principle of *Lynch*, protecting the unaffiliated stockholder,<sup>134</sup> the court missed an opportunity to adopt a unified standard of review for going-private transactions.<sup>135</sup> Moreover, the court created potential ambiguity by adding a condition that the Court of Chancery did not—that the special committee must meet its duty of care in negotiating a *fair price*—thereby introducing a component of entire fairness review into the analysis.<sup>136</sup> Even assuming that the fair price condition does not change the roadmap laid out by Chancellor Strine, the *M&F* transaction structure is unlikely to be used by controlling stockholders because considerations other than the benefits of the business judgment rule will encourage controllers to use tender offers.<sup>137</sup>

A. *The M&F Worldwide Court was Properly Motivated by the Core Objective of Lynch: Protecting the Unaffiliated Stockholder*

In *Weinberger*, the Delaware Supreme Court first noted the difference between a merger where a party stands on both sides of the transaction, and a merger where parties negotiate at arm's length.<sup>138</sup> Similarly, in *Lynch*, the fear was that a court could not be certain that a transaction by a parent-subsidary could “fully approximate” what independent parties would have done in an arm's length transaction.<sup>139</sup> The goal, therefore, has very clearly been to replicate the protections that are afforded to shareholders who negotiate at arm's length.<sup>140</sup> Post-*Lynch*, courts have continued to follow this jurisprudence by reviewing going-private

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132. *Id.*

133. *Id.* at 645.

134. *See infra* Part IV.A.

135. *See infra* Part IV.B.

136. *See infra* Part IV.C.

137. *See infra* Part IV.D.

138. *See Weinberger v. UOP, Inc.*, 457 A.2d 701, 709 n.7 (Del. 1983) (“Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with [the controlling stockholder] at arm's length.”).

139. *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) (citations omitted).

140. *See supra* notes 138–39 and accompanying text.

mergers under the entire fairness standard to make sure that the same result would have been achieved had the parties negotiated at arm's length.<sup>141</sup> Because courts have rarely pursued alternative methods to mimic the protections of an arm's length transaction, entire fairness (until *M&F*) has been deemed the best judicial tool to protect the minority shareholders from bad deals.<sup>142</sup> The *M&F Worldwide* court, by employing the business judgment rule when the merger is conditioned upfront on the approval of both an independent special committee and a majority of the minority stockholders, has found a proper alternative to entire fairness: a pseudo arm's length transaction.<sup>143</sup> Thus, the court, finding its roots in *Lynch*, was properly motivated by a desire to protect the minority stockholder.

An arm's length transaction requires both an unconflicted negotiating agent and approval by disinterested stockholders.<sup>144</sup> A special committee and a majority-of-the-minority vote similarly create a structure that provides "procedural protections beyond those afforded by full disclosure of facts."<sup>145</sup> While an arm's-length merger is not perfect, it does seem to provide for a much fairer transaction.

Having an independent special committee with the power to say no is enormously beneficial to minority stockholders and is not a procedural protection that is often missing from freeze-out transactions.<sup>146</sup> The special committee replicates the unconflicted bargaining agent, whose job it is to negotiate without bias.<sup>147</sup> Like the bargaining agent, the special committee negotiates with the controller to increase the price per share for the minority stockholder.<sup>148</sup> Contrary to

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141. See, e.g., *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 445 (Del. Ch. 2002) (requiring a non-waivable majority of the minority tender condition, among other things, to establish that a tender offer was non-coercive); *In re CNX Gas Corp. S'holders Litig.*, 4 A.3d 397, 413 (Del. Ch. 2010) (applying the business judgment rule to the first-step of a tender offer that is negotiated by a special committee and conditioned on the affirmative tender of a majority of the minority shares); *In re MFW S'holders Litig.*, 67 A.3d 496, 535 (Del. Ch. 2013) (using the business judgment rule to encourage controlling stockholders to employ the independent special committee and majority-of-the-minority vote prerequisites).

142. See *Lynch*, 638 A.2d at 1117 ("One way to provide [procedural] protections would be adhere to the more stringent entire fairness standard of judicial review.").

143. See *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (noting that upfront approval by both a majority of the minority stockholders and a special committee provides similar protections as those of a third-party arm's length transaction).

144. *In re MFW S'holders Litig.*, 67 A.3d at 500.

145. *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994).

146. See Fernán Restrepo, *Do Different Standards of Judicial Review Affect the Gains of Minority Shareholders in Freeze-out Transactions? A Re-Examination of Siliconix*, 3 HARV. BUS. L. REV. 321, 342 (2013) (finding that post-*Siliconix*, companies formed a special committee of independent directors 94.47% of the time for tender offers and 84.61% of the time for mergers).

147. See *supra* notes 140–41 and accompanying text.

148. See Kevin Parrish, *Michael Dell, Special Committee Reach Agreement; Dell Sued*, TOM'S HARDWARE (Aug. 3, 2013, 5:00 PM), <http://www.tomshardware.com/news/Dell-Buyout-special-Committee-Carl-Icahn-Complaint,23775.html> (reporting that the special committee had negotiated an increased price in the Dell going-private transaction).



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minority stockholder arguments, the special committee frequently says “no” to low offers or walks away from the table if the price is not right.<sup>149</sup> It is therefore generally accepted that special committees play a role in going-private transactions in the controller context.<sup>150</sup>

What is more important and generally less accepted is the majority-of-the-minority condition.<sup>151</sup> Working in tandem with the special committee, the majority-of-the-minority vote is a way for stockholders to express whether they agree with the price per share that the special committee has negotiated.<sup>152</sup> Since the majority-of-the-minority vote is an upfront condition, it properly replicates the disinterested stockholder vote required in an arm’s length negotiation.<sup>153</sup> Without this approval, the transaction will fail. Moreover, activist investors’ involvement as minority shareholders enhances the protective characteristics of the majority-of-the-minority vote.<sup>154</sup> Thus, outside of outright coercion, fraud, or illegality,<sup>155</sup> an upfront majority-of-the-minority vote, together with a special committee condition, sufficiently replicates the characteristics (and protections) of a third-party arm’s-length transaction. Accordingly, the objectives that the *Lynch* court sought to achieve by requiring entire fairness review are met by this structure.<sup>156</sup>

But why would a controller ever choose to employ both of these procedural protections? This new structure creates a doctrinal incentive for the controlling stockholder.<sup>157</sup> The Delaware Supreme Court in *Rosenblatt* similarly incentivized the use of a majority-of-the-minority vote by shifting the burden of proof from the

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149. See Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L. J. 2, 39 (2005) (finding that between June 2001 and April 2005, 18 out of 80 freeze-out merger negotiations resulted in no deals after a special committee and a controlling stockholder could not reach an agreement).

150. See Restrepo, *supra* note 146, at 342 (noting that approximately 86.66% of transactions have special committees).

151. See *id.* (reporting that a majority-of-the-minority vote was present in 32.5% of pre-*Siliconix* mergers and 38.46% of post-*Siliconix* mergers).

152. See *In re John Q. Hammons Hotels Inc. S’holder Litig.*, CA No. 758-CC, 2009 WL 3165613, at \*12 (Del. Ch. Oct. 2, 2009) (“[T]he majority of the minority vote serves as a complement to, and a check on, the special committee . . . [and] provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests.”).

153. See *In re MFW S’holders Litig.*, 67 A.3d 496, 500 (Del. Ch. 2013).

154. See Leonard Chazen, *Did the Dell Majority-of-the-Minority Clause Go Too Far?*, LAW360 (July 22, 2013, 6:41 PM), <http://www.law360.com/articles/459110> (discussing the obstacles that the unaffiliated stockholders, who were activist investors, created in the Dell Corporation going-private transaction by Michael Dell).

155. The business judgment rule would not shield a controller from liability if they acted illegally, fraudulently, or coercively. See *Solomon v. Pathe Commc’ns Corp.*, 672 A.2d 35, 39–40 (Del. 1996) (holding that although the majority stockholder has no obligation to pay a fair price in a tender offer, a majority stockholder may not coerce a minority stockholder without being subject to liability); RADIN, *supra* note 47, at 25 (noting that the business judgment rule does not protect against fraud and illegality).

156. See *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1116–17 (Del. 1994).

157. See *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014) (receiving business judgment review by employing both procedural protections).

defendant to the plaintiff.<sup>158</sup> The *Lynch* court incentivized the use of *either* protection by giving controlling stockholders the benefit of not having to prove entire fairness.<sup>159</sup> Here, like *Lynch* and *Rosenblatt*, the *M&F* court was correctly motivated by tradition, providing an additional incentive to use *both* procedural protections.<sup>160</sup>

*B. Adopting a Unified Standard of Review for Going-Private Transactions Would Have Reinforced the Court's Commitment to Protecting the Minority Stockholder*

Following the *Siliconix* and *Glassman* decisions, the Court of Chancery recognized how inconsistent controller freeze-out doctrine had become.<sup>161</sup> Two transaction structures, which ultimately had the same result, were being reviewed under different standards.<sup>162</sup> Pre-*MFW*, the tender offer was reviewed under the business judgment rule so long as it was not coercive and did not contain disclosure violations, whereas the negotiated merger, regardless of the conditions, was subject to entire fairness review.<sup>163</sup> Observing a prime opportunity to shift away from treating these structures differently, Chancellor Strine explained that freeze-outs that were conditioned upon the approval of both an independent special committee and a majority of the minority stockholders would be subject to the business judgment rule regardless of the transactional method.<sup>164</sup> The Delaware Supreme Court, however, was silent on the issue, which suggests that the *M&F* framework only applies to negotiated mergers.

Since the *Solomon* line of cases confused freeze-out doctrine, clarity has been at the forefront of Chancery Court decisions.<sup>165</sup> Chancellor Strine continued down this path by providing a clear standard. The business judgment rule would apply so long as the *MFW* conditions were met, notwithstanding the transaction structure.<sup>166</sup> While the Delaware Supreme Court was similarly clear as to the conditions needed to achieve deferential review,<sup>167</sup> the court failed to address an important aspect of Chancellor Strine's opinion: the unified standard.

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158. See *Rosenblatt v. Getty Oil*, 493 A.2d 929, 937 (Del. 1985).

159. See *Lynch*, 638 A.2d at 1117.

160. See *supra* note 157–59 and accompanying text.

161. See *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 433–34 (Del. Ch. 2002) (acknowledging that freeze-out jurisprudence was “fraught with doctrinal tension”).

162. See *supra* Part II.B.1 (discussing the doctrinal dichotomy).

163. See *supra* Part II.B.1.

164. *In re MFW S'holders Litig.*, 67 A.3d 496, 503–04 (Del. Ch. 2013).

165. See, e.g., *In re CNX Gas Corp. S'holders Litig.*, 4 A.3d 397, 414 (Del. Ch. 2010) (discussing a unified standard in controller freeze-outs); *In re Cox Comm'ns, Inc. S'holders Litig.*, 879 A.2d 604, 607 (Del. Ch. 2005) (same); see also *supra* Part II.B.2.

166. *In re MFW S'holders Litig.*, 67 A.3d at 503–04.

167. See *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014) (listing six prerequisites to gain business judgment review).

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Though the decision to go private comes to the same end—a private company—these two transaction structures and their standards of review continue to be inconsistent and confusing.<sup>168</sup> A single standard of review would alleviate this issue. By unifying the doctrines, the Delaware Supreme Court could have made the default standard entire fairness for both tender offers and negotiated mergers, while only invoking the business judgment rule when the *M&F* prerequisites were met. Consistent with Delaware tradition, this unified standard would have provided for an enhanced level of predictability in the judicial arena.<sup>169</sup> Ultimately, however, the Delaware Supreme Court failed to address *M&F*'s applicability to tender offers, which provides little incentive for controllers to use the dual protections when the going-private transaction is structured as a tender offer.<sup>170</sup>

C. *The Court Created Potential Ambiguity by Adding a Condition that the Chancery Court did Not—that the Special Committee Must Meet Its Duty of Care in Negotiating a Fair Price—Thereby Introducing an Aspect of Entire Fairness into the Analysis*

While the Delaware Supreme Court affirmed the Court of Chancery's decision to grant the defendant's motion for summary judgment, the court altered the fourth prerequisite of the *MFW* framework.<sup>171</sup> As a result of this modification, a court will likely be required to make a fact-intensive pretrial determination before applying the business judgment rule, which limits the litigation benefit that Chancellor Strine sought to achieve.<sup>172</sup>

Unlike Chancellor Strine's opinion, the Delaware Supreme Court's framework requires (in addition to the other five prerequisites) that "the Special Committee meet[] its duty of care in negotiating a *fair* price."<sup>173</sup> Although due care is a component of the business judgment rule and was a part of Chancellor Strine's opinion, fair price is absent in both of these.<sup>174</sup> Instead, fair price is an element of

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168. See *supra* Part II.B.

169. See William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1314 (2001) (arguing that the Delaware courts have emphasized predictability and certainty in corporate law).

170. See *In re MFW S'holders Litig.*, 67 A.3d 496, 502–03 (Del. Ch. 2013) (finding that the dual protections of a minority vote and approval by a special committee best protects the minority stockholder in going-private mergers).

171. See *infra* note 179 and accompanying text.

172. See *infra* note 177 and accompanying text.

173. *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014) (emphasis added).

174. See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (explaining that the business judgment rule is "a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company"); *In re MFW S'holders Litig.*, 67 A.3d at 535 (providing that the business judgment will be invoked only if: "(i) the controller conditions the procession of the transaction on the approval of both a special committee and a majority of the

entire fairness review.<sup>175</sup> The *M&F* court, explaining its reasoning, stated that the dual-protection structure requires two price-related pretrial determinations, one of which is “that a *fair price was achieved* by an empowered, independent committee that acted with care.”<sup>176</sup> However, “whether an independent committee was effective in negotiating a price is a process so fact-intensive and inextricably intertwined with the merits of an entire fairness review (fair dealing and fair price) that a pretrial determination . . . is often impossible.”<sup>177</sup> The court failed to provide further guidance on this prong, which will leave the fourth condition open to interpretation, the most reasonable interpretation of which is that a court is required to make a fact-intensive fair price inquiry.<sup>178</sup>

Accordingly, though on its face, the Delaware Supreme Court’s test seems to affirm the lower court’s decision, the need to establish that the special committee acted with due care to negotiate a *fair price* changes the analysis. Instead of deference, the standard appears to create an onerous fairness inquiry at step four, similar to the fair price prong of entire fairness.<sup>179</sup> Effectively, an element of entire fairness is now one of the prerequisites to achieve business judgment, albeit in an arguably less scrutinous manner.<sup>180</sup> The language used by the court may be more deferential than a fair price inquiry because it appears to require some combination of fair price and the duty of care.<sup>181</sup> Nevertheless, reading the condition together with the detailed fair price discussion by the *M&F* court suggests that a quick win for a controlling stockholder is doubtful.<sup>182</sup> A plaintiff should easily be able to challenge the “fair price” condition to avoid a motion to dismiss, or, with sufficient

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minority stockholders; (ii) the special committee is independent (iii) the special committee is empowered to freely select its own advisors and to say no definitively; (iv) the special committee meets its duty of care; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority”).

175. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

176. *M&F Worldwide*, 88 A.3d at 645.

177. *See id.* at 646 (citing *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012)).

178. *See infra* note 179 and accompanying text.

179. *Compare Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014) (“[T]he business judgment standard of review will be applied *if and only if*: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and 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 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.”) with *In re MFW S’holders Litig.*, 67 A.3d 496, 535 (Del. Ch. 2013) (“The business judgment rule is only invoked if: (i) the controller conditions the procession of the transaction on the approval of both a special committee and 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 definitively; (iv) *the special committee meets its duty of care*; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.”).

180. *See M&F Worldwide*, 88 A.3d at 645.

181. *See id.*

182. *See id.* at 651–53; *but see Swomley v. Schlecht*, C.A. No. 9355-VCL, at 11 (Del. Ch. Aug. 27, 2014) (Transcript) (interpreting the fourth prong of *M&F Worldwide* to require a showing of gross negligence).

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affidavits, a motion for summary judgment.<sup>183</sup> With the Delaware court's rejection of the federal pleading standard announced in *Twombly-Iqbal*, plaintiffs need only satisfy the lower pleading standard of "reasonable conceivability" to survive a motion to dismiss.<sup>184</sup> Unfortunately, a plaintiff's recognition that the fair price condition requires a fact-intensive inquiry will "allow plaintiffs to extract settlement value out of non-meritorious claims."<sup>185</sup> These claims could be combated with a more deferential analysis.<sup>186</sup>

Even the allegations made in the complaint in *M&F Worldwide* would have survived a motion to dismiss and required discovery on all of the prerequisites listed by the court.<sup>187</sup> Only with "100,000 pages" of discovery was the court able to conclusively establish that the fair price condition had been met.<sup>188</sup> The high cost of discovery is one reason that defendants seek to settle,<sup>189</sup> and is a reason why the application of *M&F Worldwide* at the motion to dismiss stage is so essential.<sup>190</sup> Moreover, this type of fact-intensive review is not the hands-off approach that Delaware courts traditionally take.<sup>191</sup> How does a court measure a special

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183. See *M&F Worldwide*, 88 A.3d at 645 n.14 (explaining that under the new prerequisites in *M&F*, the complaint would have survived a motion to dismiss because it adequately called into question the sufficiency of the price that the special committee negotiated); *Id.* at 649 (noting that the defendant's failed to submit expert affidavits to call into question factual issues, including the fairness of the price, in response to the motion for summary judgment).

184. See *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 536–37 (Del. 2011).

185. See Gupta, *supra* note 35, at 742; see also Michael J. McGuinness & Timo Rehbock, *Going Private Transactions: A Practitioner's Guide*, 30 DEL. J. CORP. L. 437, 459 (2005) ("A transaction that is subject to the entire fairness standard of review may attract more stockholder litigation than a transaction subject to a lower standard of review.").

186. See Matthew G. Laver, *Western Investment Hedged Partners LP v. Sunset Financial Resources, Inc.: Exercising Control of Corporate Machinery Through a Manipulative Democracy*, 3 J. BUS. & TECH. L. 469, 471 (2008) (explaining that the business judgment rule shields directors from frivolous claims filed by shareholders).

187. *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 n.14 (Del. 2014).

188. See *id.* at 654 n.40.

189. See Corinne L. Giacobbe, *Allocating Discovery Costs in the Computer Age: Deciding Who Should Bear the Costs of Discovery of Electronically Stored Data*, 57 WASH. & LEE L. REV. 257, 268 (2000) (finding that the high cost of "discovery requests forces many defendants to settle rather than incur such tremendous costs at a very early stage of the litigation process").

190. See Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. PA. L. REV. 755, 775 (2009) (reporting that "settlement discussions almost never take place until after the motion [to dismiss] is filed, and that settlement discussions typically do not take place until after the class action has survived the motion to dismiss").

191. See Bradley R. Aronstam et al., *Delaware's Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of Siliconix and Unocal Exploration*, 58 BUS. LAW. 519, 522 (2003) ("Delaware's jurisprudence rests upon the fundamental premise that directors have the power and obligation to direct and oversee the business and affairs of Delaware corporations.").

committee's duty of care to negotiate a fair price? This will be a question that the Delaware Supreme Court may have to answer in the near future.

*D. Even if the Fair Price Condition Added by the Delaware Supreme Court is Measured by Gross Negligence, the M&F Worldwide Decision will Likely Not Yield a Significant Change in Transaction Structure Choice Taken by Controlling Stockholders Because Transactional Risks of Upfront Conditions are Too Great and Tender Offers are a Preferable Mechanism*

Even assuming, *arguendo*, that the special committee's need to exercise a duty of care to negotiate a fair price is measured by a gross negligence standard,<sup>192</sup> the structure announced in *M&F Worldwide* is unlikely to be used by controlling stockholders because considerations other than the benefits of the business judgment rule will encourage controllers to use tender offers.<sup>193</sup> Stated differently, the business judgment rule incentive, from a controller's perspective, is not enough to gamble on upfront conditions.<sup>194</sup> Instead, controlling stockholders will seek a quicker transaction structure, which makes the tender offer the preferable mechanism.<sup>195</sup>

The *ab initio* conditions that the Delaware Supreme Court has placed on the controlling stockholder make it unlikely that there will be a large use of the *M&F* framework. To receive the deferential business judgment rule, the approval by a majority of the minority stockholders and a special committee must be upfront.<sup>196</sup> An upfront majority-of-the-minority condition is not a tool that controlling stockholders frequently use in going-private transactions,<sup>197</sup> since conditioning the merger on approval by a group of stockholders, some of whom may be institutional investors, is risky.<sup>198</sup> These are risks that a controller is likely to avoid.<sup>199</sup> For example, if a controller is unsure that a majority-of-the-minority vote will go favorably, he may be much more willing to roll the dice on *Lynch's* entire fairness

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192. See *Smith v. Van Gorkom*, 488 A.2d 858, 872–73 (Del. 1985) (discussing that the failure to exercise a duty of care requires a showing of gross negligence or recklessness).

193. See *infra* notes 202–11 and accompanying text.

194. See *infra* notes 196–201 and accompanying text.

195. Liz Hoffman, *Is the One-Step Merger Dead?*, LAW360 (Aug. 27, 2013), <http://www.law360.com/articles/464051> (explaining that choosing between one-step and two-step mergers transaction structures is based significantly on whether it will create anti-trust violations, national security problems, and the speed of the transaction).

196. *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 642 (Del. 2014).

197. See Restrepo, *supra* note 146, at 342 (finding that a majority of the minority condition was present in negotiated mergers 32.5% of the time pre-*Siliconix* and 38.46% of the time post-*Siliconix*).

198. See *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 618 (Del. Ch. 2005) (noting that a majority of the minority condition creates a substantial transactional risk for a controlling stockholder).

199. See *infra* note 206 and accompanying text.

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RISKING TOO MUCH ON *AB INITIO* CONDITIONS

with burden shifting, rather than being rejected by a majority-of-the-minority vote from the start.<sup>200</sup> Furthermore, the controller must meet five additional prerequisites to receive the business judgment rule, which makes it very difficult for the controlling stockholder to satisfy the *M&F* framework on a motion to dismiss, or, as mentioned *supra*, a motion for summary judgment.<sup>201</sup> While a litigation incentive exists to abide by the *M&F* structure, a cost-benefit analysis reveals that the benefits of the business judgment rule are not worth the risks.

Instead of the business judgment rule incentive, a controller's choice of transaction structure likely will be motivated by the speed of the transaction, which makes the tender offer the superior method.<sup>202</sup> If another bidder is in the picture, which may be likely if the initial offer is low, the controller will want to quickly take the company private via tender offer.<sup>203</sup> On average, mergers take 75 days longer than tender offers to complete.<sup>204</sup> Negotiated mergers are also expensive, due particularly to the need to prepare, file, and mail proxy statements and hold stockholder meetings.<sup>205</sup> One would assume that most controlling stockholders want transactions that are less risky, cost-effective, and quick.<sup>206</sup> The tender offer is therefore the preferable mechanism.

Moreover, federal agencies are indirectly encouraging tender offers through faster filing requirements. The SEC allows tender offers to be filed on the same day that the tender offer begins, while requiring mergers to be subjected to at least ten days of review before the proxy is sent out.<sup>207</sup> This, again, contributes to longer timeframes for mergers as compared to tender offers.<sup>208</sup>

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200. See Suneela Jain et al., *Examining Data Points in Minority Buy-Outs: A Practitioners Report*, 36 DEL. J. CORP. L. 939, 950 (2011) (finding that 70% of controlling stockholders "felt that the benefits of the *Pure Resources* safe harbor from 'entire fairness' were not worth the costs of pursuing it").

201. See *supra* notes 182–86 and accompanying text; Linda S. Mullenix, *Summary Judgment: Taming the Beast of Burdens*, 10 AM. J. TRIAL ADVOC. 433, 433–34 (1987) (discussing how a motion for summary judgment is "difficult to present, rarely granted, and subject to a disproportionately high rate of reversal").

202. See Offenber & Prinsky, *supra* note 40, at 9 (finding that in the 2007 tender offer for Biosite Inc., the Offer to Purchase filed with the SEC stated, "Biosite's advisors indicated on multiple occasions Biosite's board of directors' strong preference for a two-step tender offer structure, which would take a shorter period of time to deliver the consideration to Biosite's shareholders that elected to tender in the tender offer than would a one-step merger structure").

203. See *id.*

204. *Id.* at 21.

205. Allison L. Land, *Amendments to Delaware General Corporation Law to Facilitate Short-Form Mergers in Two-Step Transactions*, SKADDEN (July 26, 2013), [www.skadden.com/insights/amendments-delaware-general-corporation-law-facilitate-short-form-mergers-two-step-transact](http://www.skadden.com/insights/amendments-delaware-general-corporation-law-facilitate-short-form-mergers-two-step-transact).

206. See generally THE MOFO GUIDE TO U.S. PRIVATIZATIONS (Morrison & Foerster, 2012), available at <http://www.mofo.com/files/Uploads/Images/121119-The-MoFo-Guide-to-US-Privatizations.pdf> (providing various factors that companies should consider prior to choosing a suitable going-private transaction structure).

207. See Offenber & Prinsky, *supra* note 40, at 6–7.

208. *Id.*

Even the Delaware legislature has expedited the tender offer process.<sup>209</sup> Section 251(h) of the DGCL was recently amended to allow for controlling stockholders to benefit from an “opt-in” program that eliminates the need for stockholder approval during the second-step of a two-step merger.<sup>210</sup> This permits controlling stockholders to avoid a long and cumbersome vote at the second step.<sup>211</sup> While the Delaware General Assembly has streamlined the tender offer process, legislation in one-step negotiated mergers has stayed dormant. Accordingly, it will not be until legislative initiatives better encourage controlling stockholders to use negotiated mergers instead of the more coercive tender offer that we will see a significant change in transaction structure.

## V. CONCLUSION

*M&F Worldwide* provides an incentive for controllers to adopt a transaction structure that best protects the minority stockholder.<sup>212</sup> Still, the conditions and risks that this structure creates will likely prevent most controlling stockholders from using the *M&F* framework.<sup>213</sup> The fair price condition likewise delivers a hurdle that may restrain a controlling stockholder from implementing this structure.<sup>214</sup> Nevertheless, a path has been made for controllers to reduce the impact of post-merger lawsuits that are bound to occur.

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209. See H.B. 329, 147th Gen. Assemb., Reg. Sess. (Del. 2014).

210. *Id.*

211. *Id.*; DEL. CODE ANN. tit. 8 § 251(h) (2014).

212. See *supra* Part IV.A.

213. See *supra* Part IV.D.

214. See *supra* Part IV.C.



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