The Standard of Review in Going Private Transactions: Delaware’s Long Awaited Clarification

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Due to a jigsaw puzzle of judicial decisions, companies and controlling shareholders have had to deal with continuing uncertainty as to the standard of review that a Delaware court would apply to a going private transaction with a controlling shareholder. Without certainty as to the applicable standard of review, deal professionals have been left to structure key elements of these transactions based on intuition and “feel” for what will pass scrutiny under the circumstances. In late May, however, Chancellor Strine provided welcome clarity on this process in his decision in the In re: MFW Shareholders Litigation action.

The MFW case arose from the proposed acquisition of M&F Worldwide by its 43% shareholder, MacAndrews & Forbes. In making its initial proposal, the shareholder made clear that it expected the company to establish a special committee of M&F’s independent directors, that it would not proceed with the transaction unless it was approved by a majority of M&F’s minority shareholders and that it would not bypass the special committee (i.e., the committee had the authority to “just say no”). After negotiating with the special committee, the controlling shareholder raised its price by approximately 4%, ultimately agreeing to pay a 47% premium to M&F’s price before announcement of the offer. Holders of 65% of the shares held by the minority shareholders voted to approve the transaction.

In the MFW decision, Chancellor Strine applied the business judgment rule, rather than the higher-scrutiny “entire fairness” standard, to his review of the transaction. In applying this lower-level scrutiny to the transaction, the Court granted the defendants’ motion for summary judgment and dismissed the plaintiff shareholder claims.

In his decision, Chancellor Strine announced that the following six specific conditions would need to be met in order for the business judgment rule to apply to a controlling shareholder transaction: “(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.”

The clarity of Chancellor Strine’s holding is refreshing. However, in the law of going private transactions, like in skydiving, an eye always needs to be kept on the horizon. First, the MFW decision has been appealed to the Delaware Supreme Court, and that Court could obviously take a different view. Second, since MFW did not involve a tender offer, the case does not decide whether a special committee recommendation is now required in order to obtain the benefits of the business judgment rule in the case of a tender offer structure. Chancellor Strine did not impose such a requirement in the context of a tender offer in his 2002 In re Pure Resources decision. Third, even if the “six point test” survives Supreme Court review, there is certain to continue to be litigation as to, among other things, the proper mandate that a special committee must have in these circumstances, whether the members of the special committee are appropriately independent, and whether the minority vote is fully informed.

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