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Cases Indicate There Is **Leeway for Controllers** When Determining **'MFW'-Compliance**

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Delaware law has long embraced the concept of expansive judicial deference to the decisions of corporate directors. The seminal *MFW* decision, in 2014, ushered in an era of even further expanded deference.

MFW provides a pathway for early dismissal of challenges to M&A transactions under the business judgment rule standard of review *even* in the context of a transaction between a corporation and its controlling shareholder. Prior to *MFW*, the more stringent entire fairness standard of review has been applicable in this context.

MFW is applicable to a controller transaction *if* the transaction was subjected ab initio (i.e., from the "outset of negotiations") to the unwaivable conditions that the transaction be approved by both (1) an independent special committee and (2) a majority of the minority stockholders (the so-called "ab initio requirement"). In addition, the committee must have been fully authorized (including to definitively "say no" to the transaction) and must have met its duty of care in negotiating the deal price; and the stockholder vote must have been fully-informed and uncoerced. The underlying premise of *MFW* is that these procedural protections, if followed, will circumscribe the controller's influence over the transaction from the outset and thus will replicate the process that would pertain to an arm's-length third party transaction (thus eliminating the need for a higher standard of review).

Whether a controller will determine to structure a transaction to be *MFW*-compliant depends on the specific facts and circumstances. In our survey of public company controller mergers (over $50 million in value) since *MFW*, roughly half appeared to be intended to be *MFW*-compliant (all involved a special committee and about half included in the merger agreement a condition that the transaction be approved by the minority stockholders). While private company merger agreements are not publicly available, in our experience, *MFW* compliance is somewhat less frequent in that context.

Typically, the primary reason for a controller determining to forgo the protections of *MFW* is to avoid subjecting the transaction to the uncertainty of the result of a minority stockholder vote. Another reason is that the "ab initio requirement" (i.e., the requirement that the committee and minority stockholder vote conditions be imposed "from the outset of negotiations") means that the determination whether to structure a deal to be *MFW*-compliant must be made at the very earliest stage of the process, when the controller has the least sense of how things are likely to proceed.


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The *MFW* decision itself emphasizes the need for "strict compliance" with the prescribed procedures (including the ab initio requirement) in order to obtain business judgment review of a controller transaction. Importantly, however, two 2018 decisions—*Olenik v. Lodzinski* (July 2018) and *In re Synutra* (February 2018)—indicate that, notwithstanding the ab initio requirement, depending on the facts and circumstances, there appears to be some leeway for controllers in terms of their timing in determining whether or not to structure a transaction to be *MFW*-compliant—at least when the substantive *MFW* prerequisites (approval by a special committee with independent directors who met their duty of care

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and minority stockholder approval in a fully-informed and uncoerced vote) clearly are satisfied.

In *Olenik*, Vice Chancellor Joseph Slights ruled that *MFW* applied to the challenged controller squeeze-out merger even though there had been "extensive preliminary discussions" before the *MFW*-required conditions were imposed by the buyer. The court emphasized that the ten months of discussions had been "exploratory in nature" and that "negotiations" did not begin until the buyer submitted a "definitive proposal" (in the form of a formal offer letter). We note that there were not meaningful price discussions between the parties until after the offer letter was submitted and that two months of price negotiations ensued after submission of the offer letter. In *Synutra*, Vice Chancellor J. Travis Laster ruled that *MFW* applied even though the buyer did not impose the *MFW*-required conditions until after it had already submitted a proposal to the target company (with a specified price) and the target board had met and formed a special committee. The court pointed out that the *MFW*-required conditions were imposed "promptly" (two weeks) after the initial proposal (in a "follow-up letter" reaffirming the initial proposal) and that "negotiations" did not begin until after the conditions were imposed.

Key Points

• In 'Olenik', the Court of Chancery found that the ab initio requirement was fulfilled (and 'MFW' therefore applied) even though there had been "extensive preliminary discussions" before the buyer imposed the 'MFW'-required conditions. The court held that, notwithstanding ten months of discussions between the controller and the company about the possible squeeze-out merger, for *MFW* purposes, "negotiations" between the parties did not begin until the buyer submitted a "definitive proposal" (in the form of a formal offer letter). The court distinguished (a) "exploratory discussions" (even if "extensive") to determine *whether a proposal would be made* from (b) "negotiations" to reach a definitive agreement *after a proposal has been made*. We note that the factual context included (1) no evidence of significant price discussions having occurred during the ten months of discussions preceding the offer letter; (2) two months of back-and-forth negotiation over pricing following submission of the offer letter; and (3) a special committee that the court viewed as having been independent and having functioned effectively.

• 'Olenik' appears to indicate that the court is not likely to find 'MFW' inapplicable based on the ab initio requirement when the other 'MFW' requirements have been clearly satisfied. The court's discussion of the distinction between "discussions" and "negotiations," while providing helpful guidance, does not establish a clear dividing line between the two. However, we believe that the decision underscores that, in general, the court will tend to disfavor a finding that *MFW* is inapplicable based on the ab initio requirement, at least where (1) the minority stockholders approve the transaction (which, in this case, they did overwhelmingly), (2) the special committee functions effectively in overseeing the process and does not just "rubber-stamp a fully-baked deal," and (3) the initial discussions do not appear to involve a tradeoff where the controller agreed to accept the *MFW* approval conditions in exchange for a lower price.

The 'MFW' approach has been adopted in New York. The New York Court of Appeals adopted the MFW approach in 'Kenneth Cole' (2016).

• Notably, in 'Olenik', the court did not find it problematic that the lead negotiator for the buyer had significant ties to the controller. The factual context included a nine-person board, seven of whom had been appointed by the controller and five of whom were senior executives of the company and/or were serving on boards of or membership unit holders in the controller or its affiliates. The lead negotiator for the company throughout the process was "L," who was the CEO and a director of the company and had a financial interest in and significant connections with the controller. The court stated that, given L's track record and expertise in the industry, it was unsurprising that he would be selected as the lead negotiator (notwithstanding his conflicts of interest based on his ties to the controller). We note that the court (in our view, importantly) considered the special committee to have functioned effectively in actively overseeing the process and considered the two directors who comprised the committee to have been independent and disinterested.

• 'Synutra' provides another example of the Court of Chancery granting some leeway with respect to the ab initio requirement. In *Synutra*, the court ruled that the ab initio requirement was satisfied (and therefore *MFW* applied) even though the buyer did not impose the *MFW*-required conditions until after the buyer had already submitted a proposal (with a specified price) to the target company. Further, after the proposal was submitted and before the *MFW* conditions were imposed, the target board had met and had formed a special committee. The court pointed out that the *MFW*-required conditions were imposed in a "follow-up letter" that reaffirmed the initial proposal, which was delivered "promptly" (two weeks) after the initial proposal. The court ruled that

actual "negotiations" with respect to the proposal did not begin until *after* the conditions had been imposed. The court emphasized that nothing "substantive" had occurred between the time the buyer first approached the target and when the MFW conditions were imposed. Specifically, the court noted, before the follow-up letter was submitted, there was no evaluation of the submitted proposal by the board; although the special committee had been formed, it had not met; and, "the prompt sending of the Follow-up Letter prevented the [Buyer] form using the [*MFW*] conditions as bargaining chips" in the negotiation process.

• **As in 'Olenik', the factual context in 'Synutra' was not "optimal."** In *Synutra*, after the company waived the conflict of interest, the company's regular counsel "switched" to representing the buyer—and even after the switch advised the company's directors about their fiduciary duties and the formation of a special committee. Also, the special committee's banker presented the committee with a valuation of the company that provided an unusually wide range of values (from $1.70 to $20.03). The court concluded that these facts, while not "optimal," did not establish that the committee had been grossly negligent. The court observed that the committee met 15 times over 10 months; retained "undeniably independent" advisors; conducted a market check that included contacting 13 potential strategic buyers and 12 potential financial buyers; negotiated a price increase (that represented only a 2 percent increase over the buyer's initial offer, but represented a 58 percent premium to the company's unaffected stock price and a 31 percent and 20 percent premium, respectively, to the 30-day and 60-day averages); and negotiated certain revised deal terms, including a reduced termination fee and the inclusion of a go-shop provision.

These decisions appear to indicate that, depending on the facts and circumstances, there is some leeway for controllers in terms of their timing in determining whether or not to structure a transaction to be *MFW*-compliant. At the same time, however, as noted above, in most cases the critical factor for a controller in determining whether to structure a transaction to be *MFW*-compliant is not related to the strictures of the ab initio requirement but to the uncertainty for the transaction created by the minority stockholder approval condition.

Practice Points

• **A controller who is considering structuring a transaction to be 'MFW'-compliant should seek to ensure that the "preliminary discussions" do not constitute "negotiations."** In *Olenik*, the court reasoned that "negotiations" began following the buyer's submission of a "definitive proposal" (in the form of a formal offer letter). With respect to the court's view of the period preceding submission of the buyer's offer letter as "preliminary discussions," (1) it appears that significant back-and-forth price-related discussions did not occur during this period (although the court did not specifically articulate this as a basis for its finding); (2) meaningful back-and-forth pricing negotiations did occur for two months after submission of the offer letter; (3) there was no indication of a tradeoff between imposition of the *MFW* approval conditions and pricing; and (4) in the court's view, after the special committee was formed toward the end of the preliminary discussions, the committee functioned well to oversee the process through the signing of the merger agreement. In *Synutra*, the court viewed "negotiations" as not having commenced even after a formal offer letter was submitted because nothing "substantive" occurred before the *MFW*-required conditions were "promptly" added in a follow-up letter.

• **Earlier rather than later imposition of the 'MFW'-required conditions is still the safest course.** As discussed, these decisions appear to indicate that the court is likely to view a well-functioning special committee and fully-informed approval by the minority stockholders as outweighing potential foot-faults relating to the ab initio Nonetheless, a buyer seeking to structure a transaction to be *MFW*-compliant should consider that the dividing line between "preliminary discussions" and "negotiations" for *MFW* purposes is still less than certain and, therefore, the *earliest* possible imposition of the required conditions is still the safest course for ensuring *MFW* compliance.

• **The application of 'MFW' has been extended beyond mergers to controller transactions generally.** While the *MFW* case itself and both *Olenik* and *Synutra* involved controller squeeze-out mergers, the Court of Chancery has applied *MFW* also to consulting arrangements between a controller and the controlled company (*EZCORP*, 2016); to allegedly disparate consideration received by a controller in connection with a merger of the controlled company with an unrelated third party (*Martha Stewart Omnimedia*, 2017); and to an arguably pro rata share reclassification which the court viewed as a conflicted transaction (because it created a class of stock for use for capital raises while preserving the controller's control position) (*Crane*, 2017). In *Crane*, Chancellor Bouchard wrote that there is "no principled basis on which to conclude that the … protections in the *MFW* framework should apply to squeeze-out mergers but not to other forms of controller transactions."

• **The 'MFW' approach has been adopted in New York.** The New York Court of Appeals adopted the *MFW* approach in *Kenneth Cole* (2016).

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