# CLIENT UPDATE

# DELAWARE COURT APPLIES BUSINESS JUDGMENT REVIEW TO GOING PRIVATE MERGER

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In a significant decision yesterday, Chancellor Strine of the Delaware Court of Chancery held that a going private merger with a controlling stockholder was subject to the business judgment rule, rather than the far more rigorous test of entire fairness, where the transaction was conditioned from its inception on approval by (1) a special committee of independent directors and (2) a vote of a majority of the shares unaffiliated with the controlling stockholder.

The case, *In re MFW Shareholders Litigation* (C.A. No. 6566-CS; May 29, 2013), arose from a transaction in which MacAndrews & Forbes, owner of 43% of M&F Worldwide ("MFW"), offered to buy the rest of MFW's equity for $24 per share. In its initial proposal, MacAndrews & Forbes said it would not proceed with any going private transaction that was not approved by a special committee and by a majority-of-the-minority vote. The special committee negotiated a $1 per share price increase, and the merger was approved by holders of 65% of the shares not owned by MacAndrews & Forbes. Chancellor Strine, finding that the special committee was independent and functioned properly and that the unaffiliated stockholders were fully informed, granted defendants' motion for summary judgment, applying business judgment review.

Although Chancellor Strine found that the case presented an unresolved question of Delaware law, it is a question that judges, practitioners and academics have discussed for many years: namely, whether *all* going private mergers with controlling stockholders must be subject to the test of entire fairness (which reviews fairness of process and fairness of price, and is a much tougher test for defendants to satisfy), or whether some combination of procedural protections could cause such a merger to be subject to business judgment review (which would respect a decision of independent and informed directors unless it was irrational). The Delaware Supreme Court, in *Kahn v. Lynch*, held that going private mergers with controlling stockholders were subject to entire fairness review, but that the burden would shift to the plaintiff to show that the merger was *not* entirely fair if the transaction was approved *either* by a special committee of independent directors *or* a majority-of-the-minority stockholder vote. That holding has invited the question of whether entire fairness should be the test where both procedural protections are present. Chancellor Strine found that despite broad language contained in *Kahn v. Lynch*, it was not controlling because both protections were not present in that case and thus the issue had not been decided by the Delaware Supreme Court.

The logic underlying the Chancellor's decision is persuasive, particularly the court's focus on incentivizing transaction planners to include both protections by applying the business judgment standard, compared to the modest benefit resulting from merely shifting the burden of proof under the entire fairness standard. But it is not clear whether it will be embraced by the Delaware Supreme Court if the decision is appealed. As recently as last summer, that court, in its *Southern Peru* decision, called entire fairness "the only proper standard of review" for an interested cash-out merger and stated that because fair process usually results in fair price, it has "no doubt" that the use of special committees and majority-of-the-minority conditions will continue to be "integral parts of the best practices that are used to establish a fair dealing process." However, as Chancellor Strine acknowledged, "rational minds can disagree about this question."

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