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Delaware Supreme Court Rejects "MFW Creep" Argument: All Controlling Stockholder Transactions Require Dual MFW Protections to Receive Deferential Business Judgment Review

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April 11, 2024 - On April 4, 2024, the Delaware Supreme Court (the "Court"), in an opinion decided *en banc* and delivered by Chief Justice Seitz, held that where a controlling stockholder stood on both sides of a transaction with the controlled corporation and received a non-ratable benefit, "entire fairness" was the presumptive standard of review, and that if the controlling stockholder wanted to secure the benefits of deferential "business judgment" review, it had to properly employ both a special committee of independent directors and an unaffiliated stockholder vote.[1]

Importantly, the opinion clarifies that a corporation must employ both the independent committee and minority vote procedural devices to secure business judgment review of such transactions, whether or not they constitute "freeze-out mergers" by which the controller cashes out the minority stockholders (*i.e.,* the stockholders not affiliated with the controller), and that the special committee must be entirely independent.

Background

The case arose out of a restructuring of Match Group, Inc.'s ("Match") assets in a way that stockholder plaintiffs alleged unfairly benefited the controlling stockholder at the expense of the minority. The transaction was approved by both a separation committee composed of three members of the board of directors and a majority of the minority stockholders of Match.

The Delaware Court of Chancery (the "Chancery Court") dismissed the case, holding that the transaction satisfied the requirements of *Kahn v. M & F Worldwide Corp.* ("*MFW*").[2] Under *MFW*, the court will review a transaction involving a

controlling stockholder under the deferential business judgment standard if it was approved by both a properly functioning committee of directors independent from the controlling stockholder and a fully informed vote of the majority of the minority stockholders, among other requirements. Notably, the Chancery Court found that plaintiffs failed to plead a reasonably conceivable set of facts showing that at least two of the three separation committee members lacked independence or that disclosure in the proxy statement related to possible conflicts was inadequate.

Plaintiffs appealed, arguing that (i) the separation committee lacked independence because one of its members was beholden to the controlling stockholder, and (ii) the stockholder vote was not fully informed because the facts constituting the member's lack of independence were not properly disclosed in the proxy statement. Defendants argued that the Chancery Court's judgment should be affirmed because (i) none of the members of the separation committee was beholden to the controlling stockholder and even if that were the case, it was sufficient that the separation committee's other two members were independent and (ii) the stockholder vote was therefore fully informed. In supplemental briefing requested by the Court, defendants further argued that since the case at hand did not constitute a freeze-out merger, *MFW* did not apply and therefore it was sufficient for Match to employ either the independent committee or the minority vote procedural device to obtain business judgment deference, and not both.

The Court's Opinion

The Court confirmed the Chancery Court's analysis that the presumptive standard of review for the transaction at hand was entire fairness unless the defendants could satisfy all of *MFW*'s requirements to change the standard of review to business judgment.

However, the Court reversed the Chancery Court's decision to apply the business judgment rule and dismiss the plaintiffs' claims, ruling that in order to fulfill the requirements of *MFW*, all (not just the majority) of the members of the special committee must be independent from the controller. The Court found that plaintiffs pled facts sufficient to infer that one of the members lacked such independence because of "personal ties of respect, loyalty, and affection," citing that the person (i) had been the Chief Financial Officer of the controller for a period of seven years, (ii) upon his departure, was "more than grateful to [the controller] for the opportunities he . . . gave me," and (iii) served as a director of various affiliates of the controller earning significant compensation.

The Court remanded the case to the Chancery Court, which will determine whether the director in question was not in fact independent and whether the transaction was entirely fair.

Takeaways

- Delaware courts will review transactions between a corporation and its controlling stockholder, or between a corporation and a third party in which the controlling stockholder receives a non-ratable benefit, for whether they are entirely fair to the minority stockholders. They will apply the more deferential business judgment standard of review when "(i) a controlling stockholder conditions a transaction from the start 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 fully empowered; (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." [3]
- However, derivative claims against controlling stockholders, such as may arise from board decisions approving compensation for a controlling stockholder in her capacity as an officer, [4] remain subject to Court of Chancery Rule 23.1 and demand review precedent. These require plaintiffs to either make a demand on the board to pursue such claims or prove to the court that the majority of the board members could not independently consider such demand (which would be the case if they lacked independence from the controlling stockholder receiving the compensation).
- Delaware's rigid review of controlling stockholder transactions has been the subject of public debate [5] and practitioners have argued that the double *MFW* protection was no longer necessary, given the proven assertiveness of independent directors (whom Delaware courts trust to even bring suit against management and other

fiduciaries) [6] and of institutional shareholders. [7] It therefore remains to be seen whether Delaware will respond to this decision by amending in one way or another its General Corporation Law to limit equitable review of controller transactions that were approved by either a special committee or the majority of the minority stockholders.

For more information on these issues, please contact Alexander Rahn, Chuck Samuelson, or Shahzeb Lari.

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1. In re Match Grp., Inc. Derivative Litig., No. 368, 2022 CONSOLIDATED, 2024 WL 1449815 (Del. Apr. 4, 2024), aff'g in part, rev'g in part and remanding, CONSOLIDATED C.A. No. 2020-0505-MTZ, 2022 WL 3970159 (Del. Ch. Sept. 1, 2022). ↩
2. See generally In re Match Grp., Inc. Derivative Litig., CONSOLIDATED C.A. No. 2020-0505-MTZ, 2022 WL 3970159 (citing Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014), overruled on other grounds by Flood v. Synutra Int'l, Inc., 195 A.3d 754 (Del. 2018)). ↩
3. In re Match Grp., Inc. Derivative Litig., No. 368, 2022 CONSOLIDATED, 2024 WL 1449815, at *10 (citing Kahn, 88 A.3d at 639). ↩
4. See Tornetta v. Musk, 310 A.3d 430 (Del. Ch. 2024). ↩
5. See, e.g., T. Francis & E. Mulvaney, Elon Musk Isn't the Only Billionaire Fighting Delaware, WALL ST. J. (Feb. 11, 2024), https://www.wsj.com/business/elon-musk-isnt-the-only-billionaire-fighting-delawares-grip-on-u-s-business-e9fe299a. ↩
6. See United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034 (Del. 2021). ↩
7. See L. Hamermesh et al., Optimizing The World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead (Fac. Scholarship at Penn Carey Law, 2021). ↩

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