



Understanding Delaware's MFW Process

It's about ensuring a fair process, not establishing value.

BY ODERAH NWAEEZE AND DOUG RAYMOND

It is common for company managers to enter into a transaction with people or entities they know or with whom they have a close relationship. There are many reasons for this: trust, familiarity with the business or industry, or a track record of success. But as corporate directors know, transactions involving a controlling stock-

holder or control group come with unique risks. Key among them is the potential that the controller could use its leverage to force through a transaction value that is materially unfair to the company and its minority equity holders. Thus, when challenged in court, corporate transactions involving controlling stockholders must be evaluated

under the heightened “entire fairness” standard. That standard burdens the board and management with demonstrating that the deal was entirely fair — in price and process — to the company and its minority stockholders. As *Kahn v. M&F Worldwide Corp.* (*MFW*) establishes, however, corporations can receive the benefit of the business judgment rule if the deal is conditioned upon the approval of an independent special committee, which satisfied its duty of care, and the uncoerced, informed vote

of a majority of the minority shareholders.

The purpose of the *MFW* process is to minimize the opportunity for interests other than those of the company and its stockholders to infect the transaction. The reasoning is that a sanitized and fair process is more likely to result in a fair price. Recently, however, parties have begun to contest whether the *MFW* process has been accurately or properly implemented when it does not result in the “best” deal as far as price is concerned. On this issue, the Del-

aware Court of Chancery has held that companies that have employed the *MFW* process are still entitled to the benefit of the business judgment rule — even where the price achieved misses the mark.

In a recent Delaware Court of Chancery decision, Vice Chancellor Paul A. Fioravanti Jr. dismissed claims brought by a minority stockholder, who alleged that the controlling stockholder and director defendants breached their fiduciary duties in connection with the controlling stockholder's acquisition of the minority stockholders' shares. The court held that the plaintiff was not entitled to entire fairness review of a merger that followed the *MFW* framework simply because another, better deal surfaced that was rejected by the controller and not considered by the board. As that opinion explained, while the *MFW* process is intended to get the best value for the company, that is not guaranteed, and a board's inability

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to achieve the highest value is not indicative of wrongdoing. In other words, as long as the *MFW* process results in a reasonable deal, courts will not overly scrutinize the value of the transaction.

But minority stockholders are not the only ones misunderstanding the reach of *MFW*. Some boards have argued that when the *MFW* process is deployed, the deal price is the ceiling for any minority stockholder that seeks to challenge the per-stock price in a merger. The Court of Chancery recently disagreed with that conclusion in an appraisal action. In that case, the court refused to permit the defendant and its board to cap the company's per-share value at \$15 per share simply because that

was the value assigned after the *MFW* process. According to the chancellor, structuring a transaction according to *MFW* does not create a cap on fair value because there is no presumption, under Delaware law, that a merger price is equal to fair value. Appraisal matters have long been considered a safety valve for protecting minority stockholders from the worst-case scenarios of applying the business judgment rule to controller squeeze-outs. Accepting the argument that deploying the *MFW* process caps a company's per-share value would prevent appraisal rights from serving their intended function. The court and minority stockholders must still be satisfied that the short-form merger utilized reasonable

valuation models or methods.

The holding demonstrates that adhering to the *MFW* framework for deals involving controlling stockholders will avail a company's board of the protections of the business judgment rule, even when the transaction approved is inferior to others that had been considered and rejected. But the company cannot rely on the use of the *MFW* process to cap their corporation's per-share price in an appraisal action. ■

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