'MFW' Just Turned 10, but Is It Worth the Candle?

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In 2014, the Delaware Supreme Court held in *Kahn v. M&F Worldwide* (*MFW*) that the business judgment rule applies to a transaction that would otherwise be subject to the exacting entire fairness standard of review due to the presence of a conflicted controlling stockholder so long as the parties condition the transaction at the outset (the "ab initio requirement") on approval by a fully empowered committee of disinterested and independent directors who comply with their duty of care (the "committee requirement") and approval by a majority of disinterested stockholders voting on a fully informed and uncoerced basis (the "majority-of-the-minority requirement"). At the time, practitioners generally lauded *MFW* as a welcome development that rebalanced the litigation risk landscape in a manner that enabled controlled companies to pursue a greater range of value-maximizing transactions. And in the decade that followed, many companies have taken advantage of the *MFW* framework to do just that.

While running an *MFW*-compliant process has potential litigation benefits, it is not a cost-free exercise. The corporation will incur significant costs associated with forming a special committee that in turn must hire and solicit advice from its own independent legal and financial advisers. Delays are also likely to occur because the special committee will need sufficient time to get up to speed and evaluate the transaction, and because the company will need to take the necessary steps to hold a meeting and solicit votes of minority stockholders in favor of the transaction. The majority-of-the-minority requirement may encourage controlling stockholders to offer higher prices than would be available in a non-*MFW*-compliant transaction, but also introduces execution risks in light of the recent rise of passive retail stockholders who are less likely to cast votes at all and gives opportunistic and activist stockholders a greater opportunity to block what may otherwise be a value-maximizing transaction for all stockholders.

Despite all of these up-front costs, there is no guarantee that following *MFW* will actually result in business judgment review because a reviewing court can—and often does—find that one of the *MFW* requirements has not been satisfied. And in several recent cases, the Delaware Court of Chancery found *MFW* satisfied and dismissed a complaint under the business judgment rule, but the Delaware Supreme Court subsequently reversed on appeal and arguably made the requirements of *MFW* more difficult to satisfy. See *In re Match Group Derivative Litigation* (holding that the committee requirement was not satisfied where stockholder-plaintiffs sufficiently pleaded that one of three members of the committee was not independent); *City of Dearborn Police and Fire Revised Retirement System v. Brookfield Asset Management* (holding majority-of-the-minority requirement was not satisfied due to the failure to disclose granular details about potential conflicts of legal and financial advisors); *City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings* (same).

There have been at least 26 Delaware cases (including published opinions and transcript opinions made available to us) addressing an *MFW* defense, and the 10-year anniversary of the decision presents a good opportunity to review the outcomes of those cases and general trends that have developed over time in *MFW* cases. For purposes of the statistics set forth in this article, a trial court decision and any opinion on appeal from such a decision is considered to be one "case."

Early *MFW* Decisions. During the first five years after the Delaware Supreme Court issued the *MFW* opinion (early 2014 to mid-2019), *MFW* defenses succeeded in six of 11 cases for a success rate of 54.5%. In the five cases in which

the *MFW* defense failed, Delaware courts held that the ab initio requirement failed in four cases and the majority-of-the-minority requirement failed in one. Both of the Delaware Supreme Court cases handed down in this era—*Flood v. Synutra International* and *Olenik v. Lodzinski*—provided guidance on the ab initio requirement, confirming that the *MFW* conditions must be in place "early and before substantive economic negotiation [takes] place" so that the controller cannot use imposition of the *MFW* conditions as a bargaining chip to extract concessions late in the process.

More Recent *MFW* Decisions. During the next five years (mid-2019 to the present), *MFW* defenses succeeded in only four of 15 cases for a success rate of 26.7%. In the eleven cases in which the *MFW* defense failed, Delaware courts held that the majority-of-the-minority requirement failed in six, the committee requirement failed in four, and the ab initio requirement failed in four (these amounts do not sum to eleven because multiple *MFW* factors failed in some cases). In this more recent era of *MFW* decisions, plaintiffs often challenged the effectiveness of the majority-of-the-minority requirement by alleging that the stockholder vote was not fully informed due to one or more material misstatements or omissions. Disclosure violations were the basis of the majority-of-the-minority requirement's failure in five of the six cases in which that requirement failed.

Overall *MFW* Defense Statistics. Overall, during *MFW*'s 10-year history, *MFW* defenses succeeded in 10 of 26 cases for an aggregate success rate of 38.5%. In the first nine and a half years after *MFW*, the Delaware Supreme Court reversed a lower court dismissal under *MFW* only once, but it has done so three times in the last three months. Causes of *MFW* defenses' failure, listed in decreasing order of frequency, were the ab initio requirement (eight cases), the majority-of-the-minority requirement (seven cases), and the committee requirement (four cases) (again, these amounts do not sum to sixteen because multiple *MFW* factors failed in some cases). Thus, whereas plaintiffs successfully challenged the first two factors with roughly comparable success rates, corporate defendants generally had the most success satisfying the committee requirement, as that component was either not challenged or held satisfied in 84.6% of litigated cases. With that said, plaintiffs have successfully challenged every factor and almost every sub-factor of the *MFW* test. Comparatively obscure grounds for the *MFW* defenses' failure include that the special committee was not fully empowered or fully functioning (two cases), coercion of the special committee or disinterested stockholders (three cases), and wrongful inclusion of certain stockholders in the majority-of-the-minority stockholder vote tabulation (two cases).

We close by offering the following general takeaways from these findings:

- Despite early challenges, the ab initio requirement has not failed in roughly three years. Nonetheless, it should remain a key point of focus when advising either side of a prospective *MFW* transaction, particularly in fluid scenarios where a potential conflict may manifest later in the process.
- Recent *MFW* defenses are failing more often than not and this trend appears to be particularly noticeable at the appellate level, where three *MFW* dismissals have been reversed in the last three months.
- The special committee requirement tends to be the most difficult to challenge of the three primary *MFW* conditions. While Delaware courts will likely continue to respect the decisions of an independent, disinterested, and well-functioning committee, recent decisions by the Supreme Court are likely to increase the focus on whether the independence of any single member of the committee can be called into question (and thereby result in a failure of the committee requirement) and on the disclosure of potential conflicts of the committee's advisers. Practitioners should focus in particular on legal developments in *Brookfield* addressing disclosure of legal counsel's potential conflicts to both stockholders and the special committee itself.

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