

JUDICIAL DEVELOPMENTS SHARPENING THE FOCUS OF THE
MFW STANDARD: INDEPENDENCE OF THE SPECIAL
COMMITTEE AND DIRECT NEGOTIATIONS BY THE
CONTROLLER WITH STOCKHOLDERS

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ABSTRACT

Under Delaware corporate law, when a controller intends to acquire its controlled entity, minority stockholders in such entity may challenge such transaction under the high-scrutiny "entire fairness" standard, unless the business judgment rule is restored for the controller by the MFW standard. Under this standard, two procedural devices protect the minority's interest: an independent special negotiation committee and an approval by the majority-of-the-minority stockholders. This article deals with two issues of the MFW standard addressed by the Delaware Court of Chancery in 2020:

First, when considering the independence of a single member of the special committee, a court dealing with the MFW standard may look at precedents in demand-excuse cases which give guidance in the specific case. Different from the demand-excuse cases, the MFW standard likely requires each member of the special committee to be independent. Second, direct negotiations between the controller and certain stockholders without involving the special committee may likely make the protections of MFW unavailable.

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I. INTRODUCTION

After *Weinberger v. UOP*,¹ practitioners increasingly resorted to special negotiating committees to restore the presumptive fairness provided by the business judgment rule.² Delaware courts started accepting the use of special committees of independent directors in the 1980s, but questions abounded both as to the committee's independence and whether an independent committee restored the full presumption of the business judgment rule.³ These uncertainties were ultimately addressed in *Kahn v. M & F Worldwide Corp* ("*MFW*"), when the Delaware Supreme Court affirmed the business judgment rule can be restored for a transaction where a controlling stockholder acquires the controlled company by conditioning the transaction *ab initio* on two procedural devices of

¹Weinberger v. UOP, 457 A.2d 701 (Del. 1983).

²Scott V. Simpson & Katherine Brody, *The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context of Controlling Shareholder Transactions and Other Corporate Transactions Involving Conflicts of Interest*, 69 THE BUS. LAW. 1117, 1118 (2014).

³*Id.*

governance: "(1) the approval of an independent, adequately-empowered special committee that fulfills its duty of care, and (2) the uncoerced, informed vote of a majority of minority stockholders."⁴ According to the court, these procedural protections efficiently protect the interests of the minority because they replicate the results of an arm's length negotiated transaction.⁵

Though *MFW* brought clarity to Delaware law, two inherent uncertainties continued with the standard: what renders the special committee independent and to what extent are direct negotiations between the controller⁶ and minority shareholders still possible. Section II looks back to the *MFW* decision and sets out the basic requirements of the *MFW* standard. Then, Section 0 deals with specific requirements relating to the independence of the members of the special committee brought up in a recent decision. Thereafter, Section 0 illustrates and discusses recent issues regarding direct negotiations between the controller and minority stockholders.

II. *MFW*-DOCTRINE FOR CONTROLLER BUYOUT-TRANSACTIONS

A. *Standard of Review – Restoring the Business Judgment Rule*

In *MFW*, the Delaware Supreme Court dealt with the question of which standard of review applies to a merger between a controlling stockholder and its controlled entity.⁷ Before the transaction, Mac Andrews & Forbes Holdings, Inc. was a 43% stockholder in M&F Worldwide Corp.⁸ Mac Andrews & Forbes Holdings, Inc. acquired the remaining 57% of stock in M&F Worldwide Corp. in the transaction which Mac Andrews & Forbes Holdings, Inc. conditioned from the outset on the approval of a special committee of directors and the majority vote of the minority shareholders.⁹ The plaintiffs sued for post-closing relief for breach of fiduciary duties of directors.¹⁰ The Court of Chancery, however, granted the motion to dismiss to the defendants, which was affirmed by the Delaware Supreme Court.¹¹

⁴Kahn v. M&F Worldwide Corp., (MFW) 88 A.3d 635, 642 (Del. 2014).

⁵*Id.* at 642; see Simpson & Brody, *supra* note 3, at 1126.

⁶Regarding the term "controller," see *In re KKR Fin. Holdings. LLC S'holder Litig.*, 101 A.3d 980, 991 (Del. Ch. 2014).

⁷*MFW*, 88 A.3d at 643.

⁸*Id.* at 638.

⁹*Id.*

¹⁰*Id.*

¹¹*MFW*, 88 A.3d at 654.

Principally, a merger between the controlling stockholder and its controlled entity would be reviewed under the highest standard of review, entire fairness, because of the influence of the controller.¹² However, in *MFW*, the court affirmed that the presumption of the business judgment rule was restored because the dual protections of 1) a special negotiation committee and 2) an approval of a majority of the uninterested stockholders (minority plebiscite) were employed.¹³

The Supreme Court justified applying the business judgment rule because the special committee can act as an independent agent to the stockholders.¹⁴ These agents try to get the best price for the minority stockholders or can say "no" to the transaction.¹⁵ Additionally, the minority plebiscite allows the minority stockholders to have an effective say on a transaction recommended by the special negotiations committee.¹⁶

That structure, it is important to note, is critically different than a structure that uses only one of the procedural protections. The "or" structure does not replicate the protections of a third-party merger under the DGCL approval process, because it only requires that one, and not both, of the statutory requirements of director and stockholder approval be accomplished by impartial decisionmakers. The "both" structure, by contrast, replicates the arm's length merger steps of the DGCL by "requir[ing] two independent approvals, which it is fair to say serve independent integrity-enforcing functions."¹⁷

Under the business judgment rule, plaintiffs had to demonstrate no rational basis existed to believe the merger was favorable to *MFW*'s minority stockholders.¹⁸ The court concluded the plaintiffs failed this showing because it was impossible to argue that no rational person could have found the transaction favorable to the minority stockholders.¹⁹

¹²*Id.* at 644; *see also* Weinberger v. UOP Inc, 457 A.2d 701, 703 (Del. 1983).

¹³*MFW*, 88 A.3d at 645.

¹⁴*Id.* at 644.

¹⁵*Id.*

¹⁶*Id.*

¹⁷*MFW*, 88 A.3d at 643.

¹⁸*Id.* at 645.

¹⁹*Id.* at 654.

B. Requirements on Special Negotiation Committee and Minority Plebiscite

The Delaware Supreme Court held, in order for the business judgment standard of review to apply to a controller buyout, the following six conditions must be satisfied:

- (i) the controller conditions the procession of the transaction 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 empowered to freely select its own advisors and to say no definitively;
- (iv) the Special Committee meets its duty of care in negotiating a fair price;
- (v) the vote of the minority is informed; and
- (vi) there is no coercion of the minority.²⁰

Additionally, the Delaware Supreme Court makes clear that the controller must agree *ab initio* (from the beginning) to employ these protections.²¹

Recent jurisprudence of the Court of Chancery reveals that defendants claiming the *MFW* standard applies, appear to fail on one or more of the six conditions.²² Two aspects of this jurisprudence are discussed in the next sections.

III. INDEPENDENCE OF COMMITTEE MEMBERS

The second prong of the *MFW* standard requires the Committee to be independent from the controller.²³ Two aspects on how to determine independence should be considered: First, there are bright-line tests to determine whether a specific director is independent or not, like those provided in the NASDAQ Rules.²⁴ Second, similar issues regarding

²⁰*Id.* at 645 (tabulation added).

²¹*MFW*, 88 A.3d at 646.

²²See *In re Dell Technologies Inc. Class V S'holders Litig.*, C.A. 2018-0816-JTL, 2020 WL 3096748 (Del. Ch. 2020); see also *In re HomeFed Corp. S'holder Litig.*, C.A. 2019-0592-AGB, 2020 WL 3960335 (Del. Ch. 2020).

²³*MFW*, 88 A.3d at 645.

²⁴NASDAQ, *Corporate Governance Requirements*, NASDAQ LISTING CENTER, (last visited May 1, 2021) <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series>. (According to NASDAQ Rule 5605(a)(2)(B), a director is dependent of a company if she accepted a compensation of the company exceeding \$120,000 per year during the last three years, other than her compensation for board or committee services.).

independence arise in the context of excusing demand in derivative proceedings as well as related special litigation committees.²⁵ However, when personal and/or business relationships become entangled, courts apply further criteria as illustrated in the cases set out below.

Interestingly, in a footnote to a demand-excuse case in 2004, *Beam v. Martha Stewart*, the Delaware Supreme Court mentioned the independence of a special committee in a merger case "has its own special procedural characteristics."²⁶ The court noted the analysis requires a finding that the special committee in a merger case objectively considered the proposed transaction and "the committee members *in fact* functioned independently."²⁷

A. *MFW*

The standard mentioned in *Beam v. Stewart* was repeated in *MFW*.²⁸ The court provided guidance on which facts do not make a special committee member dependent on the controller.²⁹ To render a committee member dependent, plaintiffs would have to show the controller's influence on the member must be of a quality that sterilizes the member's discretion.³⁰ Bare allegations a committee member and a representative of the controller belong to the same social circles are not sufficient.³¹

A special committee member, Webb, engaged in "lucrative" business dealings with the controller nine years earlier, but the prior association did not render Webb dependent.³² Dinh, another committee member, was also determined independent, even though Dinh's law firm provided advisory services to the controller prior to the merger proposal.³³ Plaintiffs failed to proffer evidence that the fees earned by the law firm arose to a level which influenced Dinh's decision making.³⁴ Byorum, another member of the committee, was held independent as well.³⁵ She was a senior executive at Citibank, where a board member of the controller was

²⁵JAMES D. COX & MELVIN A. EISENBERG, BUSINESS ORGANIZATIONS, CASES AND MATERIALS, UNABRIDGED 1229 (12th ed. 2019).

²⁶845 A.2d 1040, 1055 n.45 (Del. 2004).

²⁷*Id.* (citing *Kahn v. Tremont Corp.*, 694 A.2d 422, 429–30 (Del. 1997)).

²⁸*MFW*, 88 A.3d at 646.

²⁹*Id.* at 647.

³⁰*Id.* at 648–49.

³¹*Id.* at 648.

³²*MFW*, 88 A.3d at 647.

³³*Id.*

³⁴*Id.*

³⁵*Id.* at 648.

a client.³⁶ The court found, despite these dealings, there were no triable issues of fact concerning the independence of Webb, Dinh, and Byorum.³⁷

Since none of the four committee members were dependent in *MFW*,³⁸ two questions require clarification: First, what particular facts make a committee member dependent? Second, is the committee still independent for *MFW* purposes if only a minority of the members are dependent? Both questions are partly informed by *In re Dell* and discussed in more detail below.

B. *In re Dell*

In *In re Dell*, the Court of Chancery dealt with a motion to dismiss involving allegations that both members of the special committee, were dependent on the controllers, Mr. Dell and Silver Lake.³⁹ The court affirmed they were dependent for the reasons discussed below and denied the motion to dismiss.⁴⁰

1. Special Committee

Mr. Dell controlled 73% and Silver Lake controlled 23% of the outstanding voting power in Dell Technologies, Inc. ("Dell").⁴¹ Mr. Dell had seven board-level votes himself in the six-member board.⁴² One director, Mr. Durban, was appointed by Silver Lake.⁴³ Three other directors—Kullman, Dorman, and Green—were elected by stockholder vote.⁴⁴

In January 2018, Mr. Dell presented to the board three alternative transactions for consolidating the company's ownership of VMware: (i) acquiring the remaining shares of Dell's majority-owned subsidiary VMware, (ii) negotiate a redemption of Class V stock in Dell, or (iii) list Dell's Class C stock and thereby force the Class V stock to convert into Class C stock.⁴⁵ Dell intended to rely on the *MFW* protections.⁴⁶ Therefore, it charged a special committee to negotiate and possibly approve

³⁶*MFW*, 88 A.3d at 648.

³⁷*Id.*

³⁸*Id.* at 650.

³⁹*In re Dell*, C.A. 2018-0816-JTL, 2020 WL 3096748 at *2 (Del. Ch. June 11, 2020).

⁴⁰*Id.* at *44.

⁴¹*Id.* at *3.

⁴²*Id.* at *4.

⁴³*In re Dell*, 2020 WL 3096748, at *4.

⁴⁴*Id.*

⁴⁵*Id.* at *5-6.

⁴⁶*Id.* at *1.

transactions (i) or (ii).⁴⁷ The directors Dorman and Green served on this committee.⁴⁸

2. Mr. Dorman held Dependent

Two sets of facts led the court to find Mr. Dorman dependent at the motion to dismiss stage.⁴⁹

First, Mr. Dorman was one of three partners at Centerview Capital, a venture and growth capital investment firm.⁵⁰ Centerview and its affiliates had long standing relationships with Mr. Dell and Silver Lake.⁵¹ Dorman used the relationship to raise capital and attract investment opportunities, benefitting Centerview Capital.⁵² Further, Centerview Capital's parent, Centerview Partners, advised Mr. Dell and Silver Lake in previous transactions.⁵³

Second, Mr. Durban, the managing partner of Silver Lake, had close social ties with Mr. Dorman.⁵⁴ They both belonged to the "world's most exclusive and secretive private clubs," played golf together, and were "platinum" donors to the University of Georgia.⁵⁵

Looking at these facts "holistically," the court held Mr. Dorman's relationships with Mr. Dell and Mr. Durban went beyond what "naturally develops among directors."⁵⁶ Mr. Dorman had reason to remain on good terms with Mr. Dell and Mr. Durban, comprising Mr. Dorman's ability to engage in hard negotiations.⁵⁷

3. Mr. Green held Dependent

Mr. Green had a thirty-year friendship with Mr. Tucci, who was one of Mr. Dell's closest friends.⁵⁸ Mr. Green and Mr. Tucci served together on boards, founded an investment company together, and traded on their relationship to Mr. Dell.⁵⁹ For the transaction in question, Mr. Tucci acted

⁴⁷*In re Dell*, 2020 WL 3096748, at *7-8.

⁴⁸*Id.* at *7.

⁴⁹*Id.* at *36.

⁵⁰*Id.*

⁵¹*In re Dell*, 2020 WL 3096748, at *36.

⁵²*Id.*

⁵³*Id.*

⁵⁴*Id.* at *37.

⁵⁵*In re Dell*, 2020 WL 3096748, at *36-37.

⁵⁶*Id.*

⁵⁷*Id.* at *36.

⁵⁸*Id.* at *37.

⁵⁹*In re Dell*, 2020 WL 3096748, at *37.

as the controller's advisor and agent, while Mr. Green's duty was to represent Dell's minority stockholders.⁶⁰

Further, Mr. Green was a director of Dell's subsidiary which went public in the same timeframe.⁶¹ This subsidiary used Goldman Sachs as lead underwriter.⁶² In the transaction at hand, Goldman Sachs advised the controllers, the party Mr. Green had to negotiate with.⁶³

Again, looking at these facts as a whole, the court held it as "reasonably conceivable for pleading purposes that" Mr. Green was too compromised to negotiate independently.⁶⁴

C. Discussion

1. Standard to Determine Independence of Each Member

Even though the *Beam* court stated in 2004 that "special procedural characteristics" apply for the independence of a special committee in a merger case, these merger cases use authority from demand-excuse cases, such as *Beam*, to support their reasonings.⁶⁵ This makes sense, as the both circumstances apply the same principles: mere friendships or simple business relationships do not render directors dependent.⁶⁶ Friendships and business relationships have to be of a certain quality, making the particular director not acting impartially, to change a director's status from independent to dependent under both circumstances.⁶⁷ Contrary to the statement of the *Beam* court mentioned above, the *MFW* and *In re Dell* opinions do not reveal a distinction on how to evaluate dependence for either *MFW* purposes or demand-excuse cases.

⁶⁰*Id.*

⁶¹*Id.* at 38.

⁶²*Id.*

⁶³*In re Dell*, 2020 WL 3096748, at *38.

⁶⁴*Id.*

⁶⁵*MFW*, 88 A.3d at 646 n.18 (citing *Beam v. Stewart*, 845 A.2d 1040, 1055 n.45 (Del. 2004)); see also *In re Dell*, 2020 WL 3096748 at *34 (citing *Beam*, 845 A.2d at 1046 n.8); *Beneville v. York*, 769 A.2d 80, 85–87 (Del. Ch. 2000); and *Del. City. Emp. Ret. Fund v. Sanchez*, 124 A.3d 1017, 1023 (Del. 2015).

⁶⁶*Sanchez*, 124 A.3d at 1022; *MFW*, 88 A.3d at 648-49.

⁶⁷*Sanchez*, 124 A.3d at 1023; *MFW*, 88 A.3d at 648-49.

2. Independence of Each Member Likely Required

The second prong of the *MFW* standard does not tell us whether each member of the committee, or only a majority of the members, must be independent to satisfy the *MFW* requirements.⁶⁸ In *MFW*, all four members of the committee were held independent.⁶⁹ Dell only engaged a two-member committee. Thus, a single dependent member makes the *MFW* standard inapplicable since no independent majority could exist.⁷⁰ The *In re Dell* decision cites *Beam* for the proposition that only the majority, not each member, must be independent.⁷¹ As such, it is questionable whether looking at the demand-excuse cases is controlling for *MFW* purposes.

Allowing the *MFW* standard to apply when a minority of the members of a special committee is dependent on the controller would potentially thwart the rights of the minority stockholders. To support this statement, one can consider that it is not always possible, or practical, to have all members of the special committee present during negotiations. For example, negotiations may not be at arm's length if the entire delegation of the special committee negotiating with the controller or its advisors is dependent on the controller. The special committee's purpose is to negotiate with the controller as an agent of the minority stockholders by using real bargaining power.⁷²

There is a significant difference between activities of a special committee and what the independent majority of the board looks at in demand-excuse cases.⁷³ In the latter, the usual question is whether the board decides on the demand impartially.⁷⁴ Thus, the focus of the activity is not on negotiations, but on the decision. The influence of dependent directors' votes is better traceable in decisions than in negotiations. This is not to say that the influence of a dependent director is not critical in the deliberations and the decision itself. However, such influence is of another quality compared to the situation where this dependent director leads negotiations, as it may be the case for a special committee member in *MFW* situations.

⁶⁸*MFW*, 88 A.3d at 647-50.

⁶⁹*Id.* at 650.

⁷⁰*In re Dell*, 2020 WL 3096748 at *35.

⁷¹*Id.* (citing *Beam*, 845 A.2d at 1046, n.8); *see also* Salladay v. Lev., C.A. 2019-0048-SG, 2020 WL 954032, at *9 n.120 (Del. Ch. Feb. 27, 2020). The court in *Dell* used the same approach without deciding on the initially asked question.

⁷²*MFW*, 88 A.3d at 647.

⁷³*Beam*, 845 A.2d at 1055 n.45.

⁷⁴COX & EISENBERG, *supra* note 27, at 1212.

One such special committee which requires each member to be independent is the audit committee.⁷⁵ Independence makes the audit committee more likely to hire the best independent auditor, to examine the auditor's work, to better catch inflated numbers, to reduce the risk the auditor becomes influenced by management, and to bolster public credence.⁷⁶ In *MFW* circumstances, a completely independent special committee is also more likely to hire independent consultants, better assess consultants' work, challenge the numbers leading to the valuation, and increase credibility in the eyes of the public.

The notion each member of the special committee is required to be independent for the *MFW* standard to apply is supported by the risk a single dependent member may thwart the special committee's role as agent of the stockholders, the different activities of the board in the demand-excuse case, and the analogy of the benefits of the audit. Even though this question seems not to be decided by courts, it is clearly advisable to avoid any member of a special committee being dependent on the controller.⁷⁷ In some circumstances, it may even be necessary to appoint new members to the board to create a truly independent special committee.⁷⁸

IV. DIRECT NEGOTIATIONS BETWEEN CONTROLLER AND STOCKHOLDERS

Another issue of direct negotiations by the controller with significant minority stockholders in the controlled entity appeared in both the *In re Dell* and the *In re HomeFed* decisions. Three questions arise regarding such direct negotiations: 1) Do such direct negotiations make the *MFW* protections unavailable because the controller bypasses the special committee? 2) Is the answer different for direct negotiations before or after the *MFW* protections are put in place? 3) What kind of discussions between the controller and shareholders make the *MFW* protections available? For questions one and three, a key issue is what constitutes "negotiations" and when did such negotiations commence. This is illustrated by the facts of *In re Dell* and *In re HomeFed*.

⁷⁵15 U.S.C. § 78j-1(m)(3)(A) (2010).

⁷⁶Jody K. Upham, *Audit Committees: The Policemen of Corporate Responsibility*, 39 TEX. J. BUS. L. 537, 543-44 (2004).

⁷⁷Simpson & Brody, *supra* note 3, at 1137-1138.

⁷⁸Simpson & Brody, *supra* note 3, at 1137-1138.

A. *In re Dell*

1. Facts

Dell's special committee was charged with the negotiations in January 2018.⁷⁹ In the end of June 2018, the special committee accepted Dell's offer with a valuation of \$109 per share, which was announced in the beginning of July 2018.⁸⁰ Large minority stockholders immediately objected to this offer.⁸¹ Thereafter, the controllers continuously met and negotiated with larger minority stockholders without involving the special committee.⁸² These meetings and negotiations were disclosed to the special committee.⁸³ In the beginning of November 2018, the special committee's advisor informed the committee that all contacted shareholders reject the current proposal of the controller.⁸⁴ The contacted shareholders conditioned their approval on a better price.⁸⁵ The special committee decided to counteroffer a higher consideration at \$125 per share.⁸⁶

When the special committee informed the controller of this counteroffer, the controller ignored it.⁸⁷ By that point, the controller and larger minority shareholders had already agreed on an offer with a valuation of \$120 per share.⁸⁸ On November 14, 2018, the special committee and the board approved this new offer during a late-night meeting.⁸⁹ The next month 61% of the minority stockholders voted in favor of this offer, and the transaction was closed before year end.⁹⁰

2. No Direct Negotiations After *MFW*-Devices Are in Place

The Court of Chancery made it clear the protections of the special committee and the minority plebiscite, as per *MFW*, are complements rather than substitutes.⁹¹ Both need to be satisfied to restore the business

⁷⁹*In re Dell*, 2020 WL 3096748, at *1.

⁸⁰*Id.* at *10.

⁸¹*Id.* at *11.

⁸²*Id.*

⁸³*In re Dell*, 2020 WL 3096748, at *11.

⁸⁴*Id.* at *12.

⁸⁵*Id.*

⁸⁶*Id.*

⁸⁷*In re Dell*, 2020 WL 3096748, at *12.

⁸⁸*Id.* at *13.

⁸⁹*Id.*

⁹⁰*Id.*

⁹¹*In re Dell*, 2020 WL 3096748, at *15.

judgment rule.⁹² In *In re Dell*, the plaintiffs succeeded to allege a pleading stage inference that the controller bypassed the special committee.⁹³

The court's holding is based on the fact the special committee stopped acting as the minority shareholders' bargaining agent after the first objection of large minority shareholders in July 2018. The committee, however, had a duty to negotiate.⁹⁴ Since the special committee remained passive, plaintiffs duly inferred that the committee saw itself as powerless.⁹⁵ When the special committee became active again and made the \$125 per share counteroffer, the controller had already agreed with larger minority shareholders on a lower price (\$120).⁹⁶ Therefore, the special committee was bypassed, which made the *MFW* protections unavailable.⁹⁷

The Court of Chancery had already decided a stockholder cannot replace the special committee acting as stockholders' agent in order to achieve the best price or to say no for other reasons.⁹⁸ In *In re Dell*, the court repeated its reasons for this holding; stockholders have a collective action problem, and, unlike directors, have neither binding or fiduciary duties or access to internal information.⁹⁹ Stockholders' role in the *MFW* standard is at the minority plebiscite stage, not during the special committee's negotiation and decision.¹⁰⁰

B. *In re HomeFed*

1. Facts

Since 2014, Jefferies Financial Group Inc. ("Jefferies") controlled HomeFed Corporation ("HomeFed").¹⁰¹ On September 26, 2017, HomeFed's independent director, Considine, proposed a merger between Jefferies and HomeFed.¹⁰² Shortly thereafter, Jefferies reached out to the

⁹²*Id.*

⁹³*Id.*

⁹⁴*Id.* at *16.

⁹⁵*In re Dell*, 2020 WL 3096748, at *16

⁹⁶*Id.*

⁹⁷*Id.* at *15.

⁹⁸*Id.* at 18. See *In re AmTrust Fin. Servs., Inc. S'holder Litig.*, C.A. 2018-0396-AGB, 2020 WL 914563, at *9 (Del. Ch. Feb. 26, 2020).

⁹⁹*In re Dell*, 2020 WL 3096748, at *17-18.

¹⁰⁰*Id.* at *18

¹⁰¹*In re HomeFed*, 2020 WL 3960335, at *2.

¹⁰²*Id.* at *2-3.

largest minority shareholder in HomeFed, BMO, to discuss the potential merger.¹⁰³

In December 2017, the HomeFed-board appointed independent directors, Considine and Lobatz, to its special committee for negotiating a merger between Jefferies and HomeFed.¹⁰⁴ On March 15, 2018, Jefferies informed the special committee of the controller's intention to no longer pursue the proposed merger.¹⁰⁵

Jefferies, however, continued to negotiate on the proposed merger with HomeFed's biggest minority stockholder, BMO.¹⁰⁶ Nearly a year later, in mid-February 2019, the special committee learned of the negotiations with BMO.¹⁰⁷ The special committee's advisor informed that BMO supports Jefferies' offer of a 2:1 share exchange; because another minority stockholder (RBC) joined BMO, 70% of the minority stockholders favored this 2:1 share exchange.¹⁰⁸ Later, the special committee unsuccessfully counter-offered Jefferies a fixed price of \$42 per share.¹⁰⁹

Further negotiations between Jefferies and the special committee, as well as between Jefferies and BMO/RBC, followed.¹¹⁰ Some of the direct negotiations between Jefferies and the stockholders were previously approved by the special committee while other negotiations were not, to which the special committee occasionally expressed its opposition.¹¹¹ Later during these negotiations, RBC also indicated "any cash option was not attractive."¹¹² On May 2, 2019, the HomeFed-board and special committee approved the merger agreement based on the 2:1 share exchange.¹¹³ The minority stockholder approved the transaction the next month.¹¹⁴

¹⁰³*Id.*

¹⁰⁴*Id.* at *2.

¹⁰⁵*In re HomeFed*, 2020 WL 3960335, at *2.

¹⁰⁶*Id.* at *4.

¹⁰⁷*Id.*

¹⁰⁸*Id.*

¹⁰⁹*In re HomeFed*, 2020 WL 3960335, at *6.

¹¹⁰*Id.* at *7.

¹¹¹*Id.* at *6-7.

¹¹²*Id.* at *7.

¹¹³*In re HomeFed*, 2020 WL 3960335, at *7.

¹¹⁴*Id.*

2. No Direct Negotiations Before *MFW*-Devices are in Place

In September 2017, Jefferies reached out to BMO to discuss the potential merger before Jefferies conditioned the transaction on the *MFW* standard.¹¹⁵ Therefore, Jefferies did not satisfy with the *ab initio* requirement of *MFW*.¹¹⁶

The defendants argued that the negotiations were only preliminary, and did not pass the point of no return for the *MFW* protections to be invoked.¹¹⁷ However, the facts convinced the court to say that the negotiations concerned mainly price (the share exchange) which was clearly an important term of this transaction.¹¹⁸ Defendants also alleged the direct negotiations made *MFW* protections available because the minority stockholders did not have authority to bind HomeFed.¹¹⁹ The court did not follow this argument due to the lack of supporting authority.¹²⁰

The *In re HomeFed*-court also relied on the holding in *In re Dell*, which emphasized only directors have access to HomeFed's internal documents and are subject to the fiduciary duties.¹²¹ More specifically, the court mentioned that Jefferies' direct negotiations with the stockholders undermined the special committee's forty-two-dollar-fixed-price counteroffer because Jefferies knew that BMO supported his share exchange proposal.¹²²

The motion to dismiss was denied.¹²³ The court emphasized the importance of the special committee in its negotiations, which must not be undermined by direct negotiations between the controller and minority stockholders.¹²⁴

C. Discussion

1. Undermining the Special Committee's Role

In re Dell and *In re HomeFed* both demonstrate how the special committee's role as agent of the minority stockholders is put to its best use when the special committee negotiates with the controller without direct

¹¹⁵*Id.* at *3, 9.

¹¹⁶*Id.* at *10.

¹¹⁷*In re HomeFed*, 2020 WL 3960335, at *11.

¹¹⁸*Id.* at *12

¹¹⁹*Id.*

¹²⁰*Id.*

¹²¹*In re HomeFed*, 2020 WL 3960335, at *9.

¹²²*Id.* at *10.

¹²³*Id.*

¹²⁴*Id.*

negotiations between the controller and certain stockholders. The *In re HomeFed* court was specific when mentioning that such direct negotiations undermine the special committee's position.¹²⁵ This argument is easy to follow and best illustrated by the *HomeFed*-facts itself.

When the controller negotiated the share exchange ratio (2:1) with stockholders representing 70% of the minority, the chances for the special committee supporting a different ratio were low.¹²⁶ The controller already knew the stockholders supported its share exchange offer.¹²⁷ Additionally, the interests of the negotiating stockholder may have been different from the other stockholders which were not involved. RBC wanted to stay invested in the surviving company but that did not necessarily mean a "cash option" was unattractive to all stockholders.¹²⁸ It is the special committee's role to act on behalf of all minority stockholders.¹²⁹ When RBC negotiated, it was very unlikely it represented the views of the stockholders who preferred a "cash option."¹³⁰

Hence, the holdings in *In re Dell* and *In re HomeFed* regarding direct negotiations make sense in light of the purpose of the *MFW* standard—employing procedural devices to replicate arm's length transactions.¹³¹ Direct negotiations between the controller and certain stockholders tend to undermine this purpose, which answers the initially posed question one.¹³²

2. Direct Negotiations are Problematic in Most Circumstances

When commenting on the same decisions, Gail Weinstein, Mark Lucas, and Randi Lally concluded discussions between the controller and minority stockholders should generally not be problematic, so long as discussions are not substantive economic negotiations or occur after the *MFW* protections were put in place.¹³³ They conditioned their advice to the special committee members being independent and the special committee

¹²⁵*In re HomeFed*, 2020 WL 3960335, at *10.

¹²⁶*See supra* notes 114-15.

¹²⁷*See supra* notes 114-15.

¹²⁸*See supra* notes 114-15.

¹²⁹*In re HomeFed*, 2020 WL 3960335, at *11.

¹³⁰*See supra* notes 114-15.

¹³¹*MFW*, 88 A.3d at 643; *see also* Simpson & Brody, *supra* note 3, at 1126.

¹³²*See supra* Section 0.

¹³³Gail Weinstein et al., *When Investor Talks Render Biz Judgment Review Unavailable*, LAW360, (Aug. 7, 2020), <https://www.law360.com/articles/1297911/print?section=assetmanagement>.

functioning effectively.¹³⁴ This comment deals with questions two and three.¹³⁵

MFW makes the *ab initio* requirement clear; direct negotiations—before the controller conditions the transaction on the procedural devices of *MFW*—renders *MFW* unavailable to the controller.¹³⁶ *In re HomeFed* specifies the same requirement applies for discussions labeled "preliminary" should such discussions concern the price as a key economic term to the transaction.¹³⁷

For the period after the *MFW* devices are put in place, *In re Dell* and *In re HomeFed* must be considered; both cases involved direct negotiations after the controller conditioned the transaction on *MFW*.¹³⁸ The three arguments used by the courts against direct negotiations regarding fiduciary duties, accessing information, and undermining the special committee's role indicate the following: direct negotiations of substantive economic terms between the controller and stockholders after the *MFW*-protections were established make these protections unavailable.¹³⁹ As mentioned in the preceding Section, such direct negotiations tend to undermine the special committee's role. Hence, a controller may want to be more cautious than *Weinstein et al.* suggested above, as the Court of Chancery gave a shareholder a more protective view for direct negotiations after the *MFW* framework was put in place.

The other exception mentioned by *Weinstein et al.*—that discussions which do not deal with substantive economic matters are acceptable—is problematic. There is no bright-line test to know *ex-ante* which terms of a transaction will be non-substantive and where the negotiations between controller and stockholder will lead. Additionally, when the direct negotiations exclusively concern non-substantive matters, the benefit of such negotiations is likely to be smaller than the risk of thwarting the *MFW*-protections.

On the initially posed third question,¹⁴⁰ one may wonder if prior approval by the special committee makes the direct negotiations unproblematic.¹⁴¹ It seems the decisions in *In re Dell* and *In re HomeFed* do not clearly answer this question. Considering the reasons the courts provided against the direct negotiations, it seems unlikely that prior

¹³⁴*Id.*

¹³⁵*See supra* Section 0.

¹³⁶*MFW*, 88 A.3d at 645.

¹³⁷*In re HomeFed*, 2020 WL 3960335, at *10.

¹³⁸*See supra* Sections 0 and 0.

¹³⁹*See supra* Sections 0 and 0.

¹⁴⁰*See supra* Section 0.

¹⁴¹*See Weinstein, supra* note 137, at 5.

approval by the special committee renders direct negotiations unproblematic. However, an approval by the special committee does mitigate some of these reasons provided by the court.

A slightly better option may be to include members of the special committee in the negotiations between the controller or the stockholder.¹⁴² This would create an argument the negotiations were in fact not direct between the controller and stockholder, but rather included the special committee. *In re Dell* and *In re HomeFed* do not give guidance in this regard, which means that caution is necessary when pursuing such a path. It may be safer for a controller to not engage in direct negotiations with the stockholders, and to instead leave the discussions and negotiations completely up to the special committee.

V. CONCLUSION

When considering independence of a member of the special committee, a court also looks at the social and business relationship between the specific member and the controller. For the determination of independence of each member, precedents in demand-excuse cases provide the court guidance for dealing with specific questions of the *MFW* standard. However, different from the demand-excuse cases, the *MFW* standard likely requires each individual member of the special committee to be independent.

Direct negotiations between the controller and certain stockholders without the involvement of the special committee may make the protections of *MFW* unavailable. When a controller intends to subject itself to the *MFW* standard, it is safest to completely avoid direct discussions with stockholders and leave these discussions entirely to the special committee. This applies to the periods before and after the controller conditioned the transaction on the *MFW* protections.

¹⁴²See Weinstein, *supra* note 137, at 5.