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CLIENT ALERT

Delaware Stockholder Litigation Update: Recent Cases Applying the *MFW* Cleansing Framework to Motions to Dismiss

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When a stockholder alleges breach of fiduciary duty, the applicable "standard of review" can be dispositive at the motion to dismiss stage. If the deferential "business judgment" rule applies, the court will not second-guess the judgment of the board of directors and the motion to dismiss will often be granted. But if more enhanced levels of scrutiny apply, such as "entire fairness," where the court reviews whether the transaction involved a "fair price" and "fair process," the motion to dismiss will likely be denied given these involve fact-intensive issues. Entire fairness can apply when a controller stands on both sides of the transaction or extracts unique benefits from the transaction (among other circumstances).

But even when a corporate action is facially subject to entire fairness review, if the defendant can show the transaction complied with the six-factor test in *Kahn v. M&F Worldwide Corp.*,[1] then the business judgment rule will apply and, at the motion to dismiss stage, dismissal can follow. The six well-known *MFW* "procedural protections" are that:

- the controller conditions, *ab initio* (at the outset and prior to any substantive economic discussions), the transaction on the approval of both a special committee and a majority of the minority stockholders;
- the special committee is independent;
- the special committee is empowered to freely select its own advisors and say no definitively;
- the special committee meets its duty of care and makes an informed decision regarding the terms;
- the vote of the minority is fully informed; and
- there is no coercion of the minority.[2]

Put succinctly, "the entire point of the *MFW* standard is to recognize the utility to stockholders of replicating the two key protections that exist in a third-party merger: an independent negotiating agent whose work is subject to stockholder approval."[3]

The Delaware Court of Chancery has recently applied this *MFW* framework in three decisions, leading to dismissal at the motion to dismiss stage. After briefly describing the transactions in those cases, we highlight the Court's

analysis for each of the relevant *MFW* factors.

Transactions at Issue in *Match Group*, *BridgeBio*, and *Trade Desk*

In *Match Group*, *BridgeBio*, and *Trade Desk*, the parties recognized that, in a vacuum, the transactions at issue would be subject to entire fairness scrutiny if challenged in court. Each case essentially involved conflicted controller transactions:

- In *Match Group*,[4] minority stockholders challenged a spinoff in which the controller separated its dating business from the rest of its businesses. As explained by the Court, the "minority stockholders are dissatisfied with how the transaction diverted cash to the controller at the post-spin company's expense, and how the transaction allocated assets and liabilities between the controller and the post-spin company."[5]
- In *BridgeBio*,[6] minority stockholders of Eidos Therapeutics, Inc. ("Eidos") challenged the company's acquisition by its controlling stockholder, BridgeBio Pharma, Inc. ("BridgeBio"). At the time, Eidos had received acquisition offers from a third party that would have led to a higher price per share, but the controlling stockholder refused to sell its shares and did not support the proposal.
- In *Trade Desk*,[7] The Trade Desk, Inc. ("Trade Desk") had a dual-class stock structure that entitled Class B stockholders to 10 votes per share, while Class A stockholders got one vote per share. The certificate of incorporation provided that Class B shares would be cancelled and converted into Class A shares if Class B shares represented less than 10% of the aggregate number of outstanding Class A shares (*e.*, a dilution trigger). According to plaintiff minority stockholders, to perpetuate the control of its founding member, Trade Desk empowered a special committee to consider (and eventually approve) an amendment to its certificate of incorporation that, among other things, delayed the dilution trigger until either five years after the amendment, or after its founder no longer served as CEO, President, or Chairman of the Board for Trade Desk.

In each case, plaintiff argued that *MFW* (and thus the business judgment rule) was inapplicable because certain of the requisite factors were not satisfied; no plaintiff claimed factor (1) was not met. For the remaining factors that plaintiffs did challenge, the Court in each of these cases rejected the plaintiffs' arguments.

Factor (2): Special Committee Independence

To establish that a special committee lacks independence, a plaintiff must show that (i) a majority of the special committee lacked independence, or (ii) a minority of the special committee lacked independence and "infected" or "dominated" the special committee process writ large.[8]

In some cases, compensation paid to a special committee member may support a finding of lack of independence. In *Match Group*, one of the committee members had served as an executive for the company for nearly 10 years, during which he earned $55 million, and then served on the boards of several of the company's affiliates for another 10 years, earning another $3 million.[9] This level of compensation, coupled with a long tenure and other factors, supported an "inference of pecuniary materiality at the pleading stage."[10] In *Trade Desk*, the Court did not decide the compensation issue because, even assuming compensation was material to the director, the plaintiff did not allege facts "that create a reason to doubt that a majority of the committee lacked independence or that Buyer so dominated the committee process that it undermined its integrity as a whole."[11]

Importantly, showing a minority of the special committee lacks independence does not end the inquiry: that lack of independence must "infect" or "dominate" the committee process. As the Court in *Trade Desk* explained, "infecting" or "dominating" the process can include allegations that the conflicted special committee member "dominated negotiations" of the transaction, "bore significant financial ties to the controller," and/or "undermined the special committee process by selecting and hiring advisors before obtaining the approval of the committee."[12] In *Match Group*, even though the allegations plausibly suggested one member was not disinterested, the plaintiff did not adequately allege that the other two members—a retired lawyer and an individual who worked for the company's chair at another company—were not disinterested in the transaction. Thus, the majority of the committee was independent.[13]

Factor (3): Special Committee Is Empowered to Select Advisors and "Say No"

The Court in *Match Group* noted that "[t]he effectiveness of a Special Committee often lies in the quality of the advice its members receive from their legal and financial advisors," as well as the special committee's "power to say no."[14] Thus, it "must be apparent from the inception of negotiations that the controlling stockholder cannot bypass the special committee's ability to say no."[15] A committee is not empowered if it "does not have accurate information," "fac[es] an ultimatum from the controller, or is otherwise threatened."[16]

Sometimes, the allegations in the complaint make this inquiry fairly straightforward. In *Match Group*, the complaint itself alleged that the special committee had the "authority to say no," which the Court found dispositive on that issue, especially given the lack of allegations that the controller influenced the committee and its advisors.[17] But in other instances, the analysis is more nuanced. n *BridgeBio*, the plaintiff alleged that the special committee effectively lacked the power to say no because the controlling stockholder would not sell its shares in connection with any other transaction, thus preventing the special committee from accepting an alternate proposal. While recognizing that the controller's decision limited the committee's options, the Court still found this factor satisfied. Simply put, "BridgeBio's refusal to sell its controlling stake . . . does not mean that the Special Committee lacked power to reject a transaction with the controller."[18] The Court said that the plaintiff was, in effect, making a duty of care argument given that it questioned the fact that the committee "did not exercise its leverage to maximize stockholder value" by supporting an alternate offer that would have allegedly led to a higher price per share.[19]

Factor (4): Special Committee's Duty of Care In Negotiating Terms

Under *MFW*, the special committee must also exercise its fiduciary duty of care in negotiating the deal terms. To prevent application of the business judgment standard, a plaintiff "must plead that the committee acted with gross negligence," which in turn involves "reckless indifference" or actions beyond "the bounds of reason."[20] The focus of this inquiry is "on process," specifically the special committee's diligent negotiation with help from its advisors; questioning the special committee's strategy or sufficiency of the price "is not a duty of care violation."[21] Indeed, in *Match Group*, the plaintiff essentially alleged that the special committee approved a "bad deal," which was insufficient.[22] The special committee's process—over 20 committee meetings, multiple discussions and presentations with advisors, and long negotiations—all evinced due care in arriving at the proposal.[23] Likewise, the Court in *BridgeBio* found the number of meetings relevant to the duty of care analysis.[24] But unlike *Match Group*, the *BridgeBio* plaintiff pointed to a specific alternative offer the committee could have allegedly pursued. Even so, the Court found this factor satisfied because the committee took that offer to the controller in an effort to "test [its] unwillingness to sell" its shares, which "undercuts any possible inference of gross negligence."[25]

Factor (5): The Vote of the Minority Is Informed

Each of the three decisions involved the issue of whether the vote of the minority stockholders was "informed." For this inquiry, "[t]he essential question is whether there is a substantial likelihood that disclosure of the omitted fact 'would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'"[26] In addressing that issue, the Court's analysis in each case was necessarily fact-intensive, and tailored to the factual nuances of the case, which is beyond the scope of this article. In any event, there are a few prevailing rules that the Court of Chancery follows in analyzing this factor.

First, courts evaluate whether a statement is misleading or material from the perspective of a reasonable stockholder, obviating the need to disclose "redundant facts, insignificant details, or reasonable assumptions."[27] And second, efforts by the board to lobby support for a proposal do not negate the cleansing effects of the stockholder vote because "Delaware law does not require that directors remain neutral regarding the matters they propose for stockholder action."[28]

Factor (6): No Coercion of Minority in Voting

The coercion inquiry asks "whether the stockholders have been permitted to exercise their franchise free of undue external pressure created by the fiduciary that distracts them from the merits of the decision under consideration."[29]

"Coercion" exists when circumstances "prevent a stockholder vote from operating as a clear endorsement of a transaction."[30] Delaware courts recognize two forms of coercion: situational and structural. Situational coercion arises when the status quo is so unattractive that stockholders have no choice but to vote for a proposal—for example, if they must choose between accepting a proposal or holding worthless stock.[31] Structural coercion, on the other hand, exists where stockholder support for one proposal is used to approve a separate action to the benefit of the controller—for example, if approval of the former is conditioned on approval of the latter.[32] In either scenario, a court often cannot conclude that the stockholders freely voted for a challenged transaction since other factors effectively forced them to accept those terms.

In *BridgeBio*, the plaintiff argued that the stockholder vote was situationally coercive because the controller effectively blocked any potential sale to a third party.[33] The Court explained that was insufficient, largely because the company did not have to sell to anyone. Even if "the status quo [is] undesirable or unpleasant, . . . that fact does not render the transaction coercive."[34] The Court found there was no situational coercion because stockholders could have rejected the proposal without rendering their shares worthless.[35]

Conclusion

The Delaware Court of Chancery's recent dismissal of three cases under the *MFW* framework provides additional guidance in understanding the procedural protections that must exist to get the benefit of the business judgment rule in a transaction otherwise subject to entire fairness.

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[1] 88 A.3d 635 (Del. 2014).

[2] *Id.* at 645.

[3] *In re AmTrust Fin. Servs., Inc. S'holder Litig.*, 2020 WL 914563, at *9 (Del. Ch. Feb. 26, 2020).

[4] *In re Match Grp., Inc. Derivative Litig.*, No. 2020-0505, 2022 WL 3970159 (Del. Ch. Sept. 1, 2022).

[5] *Id.* at *1.

[6] *Smart Local Unions & Councils Pension Fund v. BridgeBio Pharma, Inc.*, No. 2021-1030, 2022 WL 17986515 (Del. Ch. Dec. 29, 2022).

[7] *City Pension Fund for Firefighters & Police Officers in the City of Miami v. The Trade Desk, Inc.*, No. 2021-0560, 2022 WL 3009959 (Del. Ch. Jul. 29, 2022).

[8] *Id.* at *13–14.

[9] *In re Match Grp.*, 2022 WL 3970159, at *18.

[10] *Id.* at *18–19.

[11] *Id.*

[12] *Trade Desk*, 2022 WL 3009959, at *14.

[13] *Match Grp.*, 2022 WL 3970159, at *19.

[14] *Id.* at *21, *22; *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1119 (Del. 1994).

[15] *Match Grp.*, 2022 WL 3970159, at *22.

[16] *Id.*

[17] *Id.* at *23.

[18] *BridgeBio*, 2022 WL 17986515 at *12.

[19] *Id.* at *13.

[20] *Match Grp.*, 2022 WL 3970159, at *23.

[21] *Id.*

[22] *Id.* at *24.

[23] *Id.* at *24–26.

[24] *BridgeBio*, 2022 WL 17986515 at *14.

[25] *Id.*

[26] *Id.* at *15.

[27] *Match Grp.*, 2022 WL 3970159, at *27.

[28] *Trade Desk*, 2022 WL 3009959, at *21.

[29] *BridgeBio*, 2022 WL 17986515 at *20.

[30] *Id.*

[31] *Id.* at *20–21.

[32] *Id.* at *21.

[33] *Id.*

[34] *Id.* at *20.

[35] *Id.* at *21.

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