

Delaware Supreme Court Expands MFW Applicability in Conflicted Controller Transactions



By **Jason Halper**
Partner | Global Litigation



By **Jared Stanisci**
Partner | Global Litigation



By **Rachel Skene**
Associate | Global Litigation

On April 4, 2024, the Delaware Supreme Court issued a much-anticipated decision, *In re Match Group Derivative Litigation* (“*In re Match Group*”), extending the MFW doctrine more broadly to all conflicted controller transactions. In *Kahn v. M & F Worldwide Corp.* (“MFW”), the Delaware Supreme Court first provided a framework for freeze-out mergers to receive business-judgment review if the transaction is subject to (1) approval by an independent special committee and (2) an uncoerced, fully informed vote by minority stockholders. Since the framework was established in 2014, however, debate has swirled as to whether MFW applied only to freeze-out mergers, where a controlling stockholder takes a company private, or all conflicted controller transactions.

The *Match* case continues the recent trend of Delaware courts expanding the MFW doctrine beyond its original applicability in squeeze-out mergers. The Court’s decision underscores the heightened focus companies and boards should afford special committees if they wish to avail themselves of business judgment review.

The case stemmed from the reverse spinoff of IAC/InteractiveCorp (“IAC”) from its controlled subsidiary, Match Group Inc. In 1999, IAC, through one of its subsidiaries, acquired the Match.com business, which ultimately went public in 2015 through a traditional IPO.

In 2019, IAC informed stockholders that it was considering separating from Match Group. At the time, IAC held 98.2% of Match’s voting power, and therefore could exert significant control over the Match Group Board. Further, because any potential separation would necessarily involve IAC on both sides of the transaction, the spinoff contemplated would thus be a conflicted controller transaction. In order to mitigate the legal implications of that control—and at the time presumably in line with the requirements of MFW—the respective IAC and Match Group Boards determined that any spinoff would require the recommendation of a Match Group Board Separation Committee and the approval of the holders of a majority of the shares held by Match Group’s unaffiliated stockholders.

The Match Group Board appointed three directors to the Separation Committee to assess the proposed transaction, including Thomas McInerney, the former CFO of IAC. On December 18, 2019, the parties reached a final separation agreement, pursuant to which IAC was re-classified into a corporation with one class of common stock (renamed Match Group, Inc.); Match Group itself was merged into an IAC subsidiary and ceased to exist. Match Group minority stockholders received shares of the new Match Group.

Former Match Group minority stockholders challenged the separation, alleging that the reverse spin-off was a conflicted transaction and that IAC obtained significant non-ratable benefits through the transaction, at the expense of Match and its minority stockholders.

The Court of Chancery granted the defendants' motion to dismiss, finding that the defendants satisfied the framework of *MFW*, leading to a review of the plaintiffs' claims under the highly deferential business judgment standard, principally because the transaction was contingent on the "approvals of a fully empowered, well-functioning special committee of independent directors and the uncoerced, fully informed vote of the minority stockholders." Although the plaintiffs successfully alleged facts impugning McInerney's independence from IAC, the Chancery Court held that a plaintiff must show that "either (i) 50% or more of the special committee was not disinterested and independent," or that "(ii) the minority of the special committee 'somehow infect[ed]' or 'dominate[ed]'" the Separation Committee's decision-making process.

On appeal to the Delaware Supreme Court, the plaintiffs argued that the policy underscoring *MFW* required every director on the Separation Committee to be fully independent. In reply, the defendants contended that the *MFW* framework only required a majority of Separation Committee directors to be independent and that, in any case, McInerney was fully independent. Separately, defendants claimed that the transaction only needed to employ one of *MFW*'s procedural safeguards, arguing that both an independent committee *and* a minority stockholder vote were only required in controller stockholder freeze out transactions, and not all other controlling stockholder transactions.

Agreeing with the plaintiffs first argument, the Supreme Court reversed the Court of Chancery, determining that a special committee seeking to fulfill *MFW*'s framework must be wholly independent, adding that "[a] controlling stockholder's influence is not 'disabled' when the special committee is staffed with members loyal to the controlling stockholder." The Supreme Court held that the Special Committee here was not independent so as to satisfy the special committee approval prong of *MFW* and therefore, remanded the case down to the Court of Chancery to consider the claims for breach of fiduciary duty under the more demanding entire fairness review.

As to the second argument, the Supreme Court again rejected the defendants' contentions. First, the Supreme Court reiterated that judicial scrutiny and the standard of review increase "where the danger of conflicts is inherent in the board's decision-making process." Looking to precedent, the Supreme Court found a "common thread running through [its] decisions" as "a heightened concern for self-dealing when a controlling stockholder stands on both sides of a transaction and receives a non-ratable benefit." As a result, the Supreme Court found that,

“unless defendants can satisfy *all* of MFW’s requirements,” entire fairness would apply.

Commentary

In recent decisions, including *In re Sears Hometown and Outlet Stores, Inc.* and *Tornetta v. Musk*, Delaware courts have scrutinized controller transactions, including transactions where the alleged controller holds significantly less than 50% of the voting power. The Supreme Court’s decision underscores the need for all transactions, even those that may not at first blush seem conflicted controller transactions, to “employ[] procedural tools to replicate arm’s length bargaining” as “best practice.”

The MFW framework provides a pathway for conflicted controller transactions to be reviewed under the more lenient business judgment rule standard which presumes that, in making business decisions, “the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” *In re Match Group Inc.* particularly emphasized the need for unquestionably independent directors. Interestingly, although the Court acknowledged the compensation paid to the director in question, its decision appeared to rest more on the appearance of a “debt of gratitude” between the director and the controller as sufficient to impugn the independence of the director, emphasizing the long-standing business affiliation as indicia of “personal ties of respect, loyalty, and affection.” This trend suggests an approach towards holistic and subjective suggestions of control, rather than objective bright line standards.