Delaware Court of Chancery Applies *MFW* Factors to 'Reverse Spinoff'

> See page 3 for key takeaways

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The Court of Chancery's decision in *In re Match Group, Inc. Derivative Litigation*[1] is the latest example of how the Delaware Supreme Court's watershed 2014 decision in *Kahn v. M & F Worldwide Corp.* (*MFW*)[2] has been applied to new and different transaction structures involving a controlling stockholder.

MFW

In *MFW*, the Delaware Supreme Court addressed which standard of review should apply to a controlling stockholder "squeeze-out" merger conditioned upfront on approval by both a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote. The Court concluded that in this limited category of controller mergers "where the controller voluntarily relinquishes its control — such that the negotiation and approval process replicate those that characterize a third-party merger," the deferential business judgment standard of review could apply.[3]

Specifically, a claim is subject to the business judgment standard of review if six prerequisites designed to protect the rights of the minority are present. Those prerequisites, now commonly known as the *MFW* factors, are:

1. the controller conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders *ab initio*;
2. the special committee is independent;
3. the special committee is empowered to freely select its own advisers and to say no definitively;
4. the special committee meets its duty of care in negotiating a fair price;
5. the vote of the minority is informed; and
6. there is no coercion of the minority.

In the years since, the Delaware Court of Chancery and the Delaware Supreme Court have articulated the contours of the *MFW* requirements.

For example, in 2018, the Delaware Supreme Court explained in *Flood v. Synutra International, Inc.* that in order to satisfy *MFW*'s *ab initio* prong, a controller must condition a transaction on the approval of both an *MFW*-compliant special committee of independent directors and a majority-of-the-minority stockholder vote before economic negotiations begin.[4]

Then, in *Salladay v. Lev*, the Court of Chancery offered further clarification, explaining that the *ab initio* prong of *MFW* "requires the committee's empowerment prior to 'substantive economic negotiations,' which include valuation and price discussions if such discussions 'set the field of play for the economic negotiations to come.'"[5]

[1] 2022 WL 3970159 (Del. Ch. Sept. 1, 2022).

[2] 88 A.3d 635, 645 (Del. 2014).

[3] *Id.* at 639.

[4] *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018).

[5] *Salladay v. Lev*, 2020 WL 954032, at *12 (Del. Ch. Feb. 27, 2020) (citation omitted).

In addition, Delaware courts have expanded the application of *MFW* to a number of other transactional contexts:

- In *In re EZCorp Inc. Consulting Agreement Derivative Litigation*, Vice Chancellor J. Travis Laster pointed out that *MFW* might apply to a broad range of transactions in which a controlling stockholder extracts a non-ratable benefit.[6]
- In 2017, in *In re Martha Stewart Living Omnimedia Inc. Stockholder Litigation*, Vice Chancellor Joseph R. Slights III applied *MFW* to a transaction in which a controller allegedly extracted disparate consideration from the transaction not shared with the common stockholders.[7]
- Later in 2017, in *IRA Trust FBO Bobbie Ahmed v. Crane*, Chancellor Andre G. Bouchard applied *MFW* to a stock reclassification, remarking that there was "no principled basis on which to conclude that the dual protections in the *MFW* framework should apply to squeeze-out mergers but not to other forms of controller transactions."[8]
- In *Tornetta v. Musk*, Vice Chancellor Slights applied *MFW* beyond "transformational" transactions, to other corporate decisions involving controlling stockholders, explaining that non-extraordinary transactions such as compensation decisions could be subject to business judgment review by following the procedures set forth in *MFW*.[9]

Match Group

Recently, Vice Chancellor Morgan T. Zurn applied *MFW* to a "multi-step reverse spinoff" in *Match Group*, dismissing breach of fiduciary duty claims after finding the controlling stockholder "reverse spinoff" complied with *MFW*'s dual protections and thus earned business judgment review.

IAC/InterActiveCorp (Old IAC or Controller) controlled Match Group, Inc. (Old Match). In 2019, in a series of transactions (the Separation) Old IAC separated its dating businesses (*i.e.*, Match.com and other websites) and some debt obligations (the Exchangeables) from the rest of its business. The Separation was accomplished by a transaction agreement dated December 19, 2019. In the Separation, Old IAC formed a subsidiary and spun its other businesses off to that subsidiary, IAC/Interactive Corp (New IAC). So divested, Old IAC held the Exchangeables and a stake in Old Match. Old IAC reclassified its two classes of high-vote and publicly traded stock into one class of common stock, and became known as MatchGroup Inc. (NewMatch). The reclassification decreased IAC's voting control in New Match. Then, Old Match merged with and into a New Match merger subsidiary; in that merger, minority Old Match stockholders received New Match stock. The merger subsidiary survived as a New Match subsidiary, and Old Match ceased to exist.

In the subsequent litigation, the court pointed out that "it [was] undisputed that the reverse spinoff was an interested transaction in which a controller obtained a nonratable benefit at the expense of the minority, presumptively subject to review under the exacting entire fairness standard." Thus, the central dispute before the court was whether the "reverse spinoff" satisfied *MFW*'s prerequisites. Because the plaintiff did not dispute the existence of the special committee or the uncoerced majority-of-the-minority vote, the court focused on *MFW* factors (2) through (5).

First, regarding the special committee's independence, the court found that just one of the three committee members lacked independence because he relied on the Controller or its affiliates as his primary employment for two decades and he made at least $58 million from those relationships. However, the court declined to find that this board member infected or dominated the other two committee members.

[6] *In re EZCorp Inc. Consulting Agreement Derivative Litig.*, 2016 WL 301245 (Del. Ch. Jan. 25, 2016).

[7] *In re Martha Stewart Living Omnimedia Inc. S'holder Litig.*, 2017 WL 3568089 (Del. Ch. Aug. 18, 2017).

[8] *IRA Tr. FBO Bobbie Ahmed v. Crane*, 2017 WL 7053964, at *11 (Del. Ch. Dec. 11, 2017).

[9] *Tornetta v. Musk*, 2019 WL 4566943 (Del. Ch. Sept. 20, 2019).

Second, the court concluded that the special committee was sufficiently empowered to choose its own advisers and say no.

Third, the court rejected the plaintiff's three duty of care arguments that the committee (1) had a "controlled mindset" and negotiated poorly; (2) hired a conflicted financial advisor; and (3) structured the Separation to extinguish derivative claims.

Finally, applying the materiality standard, the court determined that the minority vote on the Separation was fully informed. Because the Separation satisfied all *MFW* prerequisites, and the plaintiff did not even attempt to allege a claim for waste, the court dismissed the plaintiff's fiduciary claim.

With each new application of *MFW*, the Delaware courts offer "incentive for controllers to embrace the procedural approach most favorable to minority investors, with the incentive of obtaining the protection of the business judgment rule standard of review."[10]

[10] *Flood*, 195 A.3d at 756.

Takeaways

- Delaware courts continue to embrace the expansion of *MFW* beyond the squeeze-out merger context to include a variety of circumstances in which a controller receives a non-ratable benefit.
- Controllers and directors of controlled companies should consider the use of *MFW* in varying contexts.
- Controllers and directors should be mindful to ensure compliance with each *MFW* factor, including the *ab initio* requirement, as failure to satisfy even one factor would preclude dismissal at the pleading stage.

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