

# EXPANDING MFW: DELAWARE LAW SHOULD OFFER A BUSINESS JUDGMENT RULE SAFE HARBOR FOR ALL CONFLICTED CONTROLLER TRANSACTIONS

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## ABSTRACT

While courts usually defer to a board's business decisions under the business judgment rule, courts will apply a much less deferential standard of review due to loyalty concerns if a conflicted controller is involved in a business decision such as a merger. However, in *Kahn v. M & F Worldwide* ("MFW") when a squeeze out merger was challenged by a minority stockholder, the Delaware Supreme Court reviewed the transaction under the deferential business judgment rule standard because the Court found that the structure of the transaction neutralized the controller loyalty concerns. Building on this reasoning, the Court developed a checklist of procedural protections (the "MFW factors") that, if followed, can allow a controller to earn business judgment rule deference in a squeeze out merger transaction.

The Delaware Chancery Court has since applied the MFW factors and granted business judgment rule deference in other types of conflicted controller transactions such as controller compensation packages. However, the legitimacy of this expansion of *MFW* remains uncertain. This Note discusses the background leading up to the development of the MFW factors, analyzes the effectiveness of the MFW factors in squeeze out mergers specifically, and considers the expansion of the MFW factors beyond squeeze out mergers. Ultimately, this Note proposes that, even though the MFW factors were developed in the context of squeeze out mergers specifically, the MFW factors should

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be expanded to apply to all conflicted controller transactions because the factors target the loyalty concerns present in all conflicted controller transactions.

INTRODUCTION.....	341
I. BACKGROUND .....	344
A. Delaware Corporate Law .....	344
1. Fiduciary Duties.....	344
2. Standards of Review .....	345
3. Squeeze Out Mergers.....	347
B. Addressing Controller Self-Dealing in Squeeze Out Mergers .....	349
1. <i>Weinberger v. UOP, Inc.</i> .....	350
2. <i>Khan v. Lynch Communication Systems, Inc.</i> .....	351
3. <i>Khan v. M &amp; F Worldwide Corp.</i> .....	353
C. Addressing Controller Self-Dealing in Other Transactions .....	355
II. SHOULD MFW APPLY TO ALL CONFLICTED CONTROLLER TRANSACTIONS?.....	358
A. Whether the MFW Factors Effectively Protect Minority Stockholders.....	359
1. The MFW Factors Create a Protective Transactional Structure.....	359
2. The MFW Factors Are Just an Artificial Mechanism .....	363
B. Whether Application of the MFW Factors Should Be Expanded.....	366
1. Equal Treatment Under MFW .....	367
a. All Conflicted Controller Transactions .....	367
b. Some Additional Conflicted Controller Transactions.....	369
c. No Additional Conflicted Controller Transactions.....	370
2. Efficiency of the MFW Factors as a Planning Tool	372
a. The MFW Factors Are an Efficient Tool .....	372
b. The MFW Factors Are Not an Efficient Tool ...	374
III. MFW SHOULD BE READ BROADLY TO APPLY TO ALL CONFLICTED CONTROLLER TRANSACTIONS.....	375
A. The Delaware Supreme Court Should Clarify MFW's Reach.....	376
B. MFW Should Be Applied as a Uniform Standard .....	377

C. Application of the MFW Factors to Other Conflicted Controller Transactions.....	379
CONCLUSION.....	381

## INTRODUCTION

In 2018, Elon Musk, Tesla’s chief executive officer and controlling stockholder, received an incentives-based compensation package with stock options potentially worth over \$55.8 billion.<sup>1</sup> The plan had been approved by both Tesla’s Board of Directors and a simple majority of stockholders.<sup>2</sup> A few months after the compensation package was approved, one Tesla stockholder challenged the compensation package as excessive and claimed that the compensation package resulted from Musk’s breach of fiduciary duties as a controlling stockholder.<sup>3</sup> The stockholder alleged that Musk breached his fiduciary duty of loyalty to the minority stockholders by using his power as controlling shareholder to unfairly extract value from Tesla through this excessive compensation package.<sup>4</sup>

Usually, when reviewing business decisions such as compensation packages, courts will grant great deference to a board’s business decisions under the business judgment rule—especially board decisions approved by the stockholders.<sup>5</sup> Under the business judgment rule, courts presume in the absence of a showing of bad faith that a board always acts in the best interests of the corporation and its stockholders.<sup>6</sup> However, courts will apply the entire fairness framework—a much less deferential standard of review—to business decisions where a stockholder successfully alleges a breach of fiduciary duty.<sup>7</sup> This higher standard of review is necessary to address concerns that a controlling stockholder may have unduly influenced a board’s decision.<sup>8</sup> In *Musk*, the stockholder successfully alleged a breach of the fiduciary duty of loyalty in approving Musk’s compensation package, so the court declined to grant deference

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1. *Tornetta v. Musk*, 250 A.3d 793, 796–97 (Del. Ch. 2019).
  2. *Id.* at 796.
  3. *Id.*
  4. *Id.* at 796–97.
  5. See Randy J. Holland, *Delaware Directors’ Fiduciary Duties: The Focus on Loyalty*, 11 U. Pa. J. BUS. L. 675, 681 (2009).
  6. *In re Multiplan Corp. S’holders Litig.*, 268 A.3d 784, 809 (Del. Ch. 2022).
  7. *Id.*
  8. See *Musk*, 250 A.3d at 797–98.

under the business judgment rule and applied the entire fairness standard instead.<sup>9</sup>

While reviewing Musk's compensation package, the court noted that the board could have structured the approval process in a different way to earn business judgment rule deference despite the alleged duty of loyalty breach.<sup>10</sup> In *MFW*, the court developed six procedural protections, later titled the MFW factors, that can be implemented in squeeze out mergers to counter controller loyalty concerns and earn business judgment rule deference.<sup>11</sup> The court in *Musk* reasoned that if the board had followed those six MFW factors—conditioning the compensation package from the beginning on both disinterested and empowered special committee approval and an informed and uncoerced majority of the minority stockholder vote—"the Court's suspicions regarding the controller's influence would have been assuaged and deference to the Board and stockholder decisions would have been justified" under the business judgment rule.<sup>12</sup> Even though the MFW factors were developed in the context of a squeeze out merger, the court found that the factor's dual procedural protections could be "potent neutralizers in other applications," but did not explicitly expand the reach of *MFW* beyond squeeze out mergers.<sup>13</sup>

The *Musk* case follows a line of cases that show the Delaware Chancery Court's willingness to expand the application of *MFW* beyond squeeze out mergers in a phenomenon that Delaware courts have labeled

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9. *See id.* at 805.

10. *See id.* at 798.

11. *Kahn v. M & F Worldwide (MFW)*, 88 A.3d 635, 645 (Del. 2014), *overruled by* *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018). The Delaware Supreme Court's decision in *MFW* held that in challenged squeeze out mergers, the deferential

business judgment standard of review will be applied *if and only if*: (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.

*MFW*, 88 A.3d at 645.

12. *Musk*, 250 A.3d at 800.

13. *Id.*

“MFW creep.”<sup>14</sup> Although the Chancery Court has shown a willingness to expand *MFW*,<sup>15</sup> the Delaware Supreme Court has not yet confirmed the legitimacy of MFW creep, so a question remains as to the scope of *MFW*. This Note will examine that scope and ultimately argue that *MFW* should be expanded to apply to all conflicted controller transactions.

First, Part I introduces fiduciary duties under Delaware law and explains their impact on conflicted controller transactions. Part I.A introduces fiduciary duties, standards of review, and squeeze out mergers. Part I.B analyzes how Delaware courts address controller self-dealing in squeeze out mergers, and Part I.C discusses how Delaware courts address controller self-dealing in other types of transactions.

Second, Part II considers whether *MFW* should be expanded to apply beyond squeeze out mergers. Initially, Part II.A considers the effectiveness of the MFW factors in squeeze out mergers, and Part II.B explores the arguments for and against application of the MFW factors outside of the squeeze out merger context.

Third, Part III proposes that *MFW* should be expanded to apply to all conflicted controller transactions. To start, Part III.A explains the need for the Delaware Supreme Court to clarify the reach of *MFW*. Part III.B proposes that *MFW* should be read broadly to offer the MFW factors as a safe harbor in all conflicted controller transactions, and finally, Part III.C applies the MFW factors to a few categories of conflicted controller transactions.

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14. Lawrence Hamermesh et al., *Optimizing the World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead*, 72 BUS. L. 321, 337 (2022); see, e.g., *In re Match Grp. Derivative Litig.*, No. 2020-0505-MTZ, 2022 WL 3970159, at \*15 (Del. Ch. Sept. 1, 2022); *In re EZCORP Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at \*13 (Del. Ch. Jan. 25, 2016) (pointing out that *MFW* might apply to a broad range of transactions in which a controlling stockholder extracts a non-ratable benefit); *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at \*2 (Del. Ch. Aug. 18, 2017) (applying *MFW* to a transaction in which a controller allegedly extracted disparate consideration from the transaction not shared with the common stockholders); *IRA Tr. FBO Bobbie Ahmed v. Crane*, Consol. C.A. No. 12742-CB, 2017 WL 7053964, at \*9 (Del. Ch. Dec. 11, 2017) (applying MFW to a stock reclassification); *Musk*, 250 A.3d at 810–12 (finding that MFW would apply to a controller's compensation package decision and permit business judgment rule deference if all six MFW requirements were met).

15. See *supra* note 14.

## I. BACKGROUND

### A. DELAWARE CORPORATE LAW

#### 1. *Fiduciary Duties*

Corporate internal affairs are governed by state law, and the specific state law that is applied to each corporation depends on the corporation's state of incorporation.<sup>16</sup> Many corporations are intentionally incorporated in the state of Delaware to gain the benefits of Delaware state law because Delaware has courts that specialize in corporate law and because Delaware's corporate statute (the "DGCL") keeps state statutory mandates to a minimum.<sup>17</sup> As experts in corporate law, Delaware courts understand complex business disputes and recognize "the social utility of an active engaged central management" in creating stockholder wealth.<sup>18</sup> Delaware courts work in tandem with the Delaware legislature to embrace this social utility by interpreting the DGCL in a way that invests central management "with wide discretion to make business decisions and a wide choice of means to effect those decisions."<sup>19</sup>

However, Delaware corporate law also recognizes the potential for management to abuse such wide discretion, so Delaware courts police corporate actors through fiduciary duties.<sup>20</sup> Under Delaware corporate law, directors, officers, and controlling stockholders of a corporation owe fiduciary duties to the corporation to both the corporation and the minority stockholders of the corporation.<sup>21</sup> While directors and officers are identifiable by their position within the corporation, Delaware courts recognize a controlling stockholder only where the stockholder "owns a majority interest in or *exercises control* over the business affairs of the

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16. See Hon. Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 673 (2005).

17. See *id.* at 674, 682–83.

18. Strine, *supra* note 16, at 675.

19. See *id.* "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." DEL. CODE ANN. tit. 8, § 141(a) (2023).

20. Strine, *supra* note 16, at 675–76.

21. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

corporation.”<sup>22</sup> Once a stockholder has met either requirement, that stockholder is deemed a controlling stockholder with fiduciary duties to the corporation and the minority stockholders.<sup>23</sup>

The duty of loyalty—one of the most important fiduciary duties—prohibits fiduciaries from using “their position of trust and confidence to further their private interests.”<sup>24</sup> Delaware courts presume that fiduciaries are *uninterested* in a transaction and in compliance with this duty unless a stockholder shows otherwise.<sup>25</sup> A stockholder can show that a fiduciary is *interested* in a transaction and in violation of this duty by alleging either “self-dealing” or receipt of a “non-pro-rata benefit.”<sup>26</sup> Self-dealing occurs where a fiduciary stands on both sides of a transaction; a non-pro-rata benefit exists where the fiduciary receives a personal benefit distinct from the benefits received by the corporation or all stockholders generally.<sup>27</sup>

## 2. Standards of Review

The choice of the applicable standard of review can often be outcome determinative in Delaware fiduciary duty cases.<sup>28</sup> When a stockholder challenges a fiduciary’s business decision,<sup>29</sup> Delaware courts must determine which standard of review applies to the transaction: the “business judgment rule” or the “entire fairness framework”.<sup>30</sup> Each

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22. Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1113 (Del. 1994) (emphasis in original).

23. *Id.* at 1113–14.

24. Holland, *supra* note 5, at 683.

25. Christopher J. Merken, *Not Just Going Private: In re MFW Shareholder Litigation’s Evolution and Expansion Should Result in a Uniform Standard of Review in All Conflicted Controller Transactions*, 46 W. ST. L. REV. 1, 8–9 (2019).

26. *In re Martha Stewart Living Omnimedia, Inc. S’holder Litig.*, Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at \*11 (Del. Ch. Aug. 18, 2017).

27. Holland, *supra* note 5, at 683. “Among the cases that fit within this latter scenario are cases where the controller actually receives more in merger consideration than the other stockholders and cases where the controller diverts merger consideration from other stockholders by masking the payment as consideration for ‘side deals.’” *Stewart*, 2017 WL 3568089, at \*11.

28. Itai Fiegenbaum, *The Geography of MFW-Land*, 41 DEL. J. CORP. L. 763, 774 (2005) (quoting *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993)).

29. “Stockholders can enforce directors’ fiduciary duties through either a direct suit on behalf of that stockholder, where there is damage personal to that stockholder, or through a derivative suit to enforce the directors’ duties on behalf of the corporation.” Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 400 (2007).

30. Fiegenbaum, *supra* note 28, at 772–73.

standard differs “in the vigor of judicial scrutiny applied to the challenged” business transaction.<sup>31</sup> These two standards of review work together to (1) procedurally guide litigants through a burden shifting framework and (2) substantively guide the courts through rules of law.<sup>32</sup> In choosing between these standards, Delaware courts aim “to strike a delicate balance between board authority and board accountability.”<sup>33</sup>

Procedurally, these two standards guide litigants through a burden shifting framework.<sup>34</sup> First, the business judgment rule “places the initial burden of proof on the plaintiff” to show that a fiduciary, in reaching the challenged business decision, violated one of their fiduciary duties.<sup>35</sup> If a plaintiff fails to show breach of a fiduciary duty, the deferential business judgment rule applies.<sup>36</sup> However, if a plaintiff successfully shows breach of a fiduciary duty<sup>37</sup>, the evidentiary burden shifts to the fiduciary and the burdensome entire fairness framework applies; however, if the defendant presents evidence of a safe harbor, the burden shifts back to the business judgment rule.<sup>38</sup>

Substantively, these two standards guide the courts through rules of law.<sup>39</sup> When a plaintiff has failed to shift the burden and the business judgment rule applies, Delaware courts presume “that in making a business decision the [fiduciaries] of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.”<sup>40</sup> Further, a Delaware court applying the business judgment rule “will not substitute its judgment for that of the board if the latter’s decision ‘can be attributed to any rational business

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31. *Id.* at 772.

32. *See* Holland, *supra* note 5, at 682.

33. Fiegenbaum, *supra* note 28, at 772.

34. *See* Holland, *supra* note 5, at 682.

35. *Id.*

36. *Id.*

37. For example, a plaintiff could present evidence of self-dealing to show that the duty of loyalty has been breached. *See id.*

38. *See id.*

39. *See id.*

40. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds* by *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). “[T]he business judgment rule operates to provide substantive protection” for fiduciaries where their “business decisions [did] not result in financial success, even though the [fiduciary] properly discharged all of their fiduciary duties.” Holland, *supra* note 5, at 679, 682.



purpose.”<sup>41</sup> Therefore, defendants often succeed on a motion to dismiss whenever the challenged business decision is reviewed under the business judgment rule.<sup>42</sup>

However, if a plaintiff has successfully shifted the evidentiary burden, the defendant fiduciary must meet the demanding entire fairness framework.<sup>43</sup> Under this framework, the fiduciary can either show that the business transaction was entirely fair or present evidence of a safe harbor.<sup>44</sup> To show that a transactions is entirely fair, the fiduciary must face the burdensome task of showing that the business transaction was the result of fair process and fair price.<sup>45</sup> Alternatively, to show evidence of a safe harbor, the fiduciary must point to a specified procedural protection based on the type of challenged transaction.<sup>46</sup> Once evidence of a safe harbor is presented, the standard shifts back to the business judgment rule because courts trust that the processes required for each safe harbor neutralize the fiduciary duty concerns.<sup>47</sup> However, not all transactions have a safe harbor available.<sup>48</sup> Therefore, defendants will likely fail on any motions to dismiss if the challenged business decision triggers the entire fairness framework unless there is a safe harbor available because the fair process and fair price inquiry is so demanding.<sup>49</sup>

### 3. *Squeeze Out Mergers*

One type of transaction that triggers the entire fairness framework is a squeeze out merger.<sup>50</sup> A squeeze out merger occurs where a controlling stockholder of a corporation buys out—or squeezes out—the minority

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41. Holland, *supra* note 5, at 681 (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

42. *See id.*

43. *Id.* at 682.

44. *Id.*

45. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

46. Strine, *supra* note 16, at 678.

47. *Id.*

48. *Id.*

49. Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L. J. 1, 9 (2005). Squeeze out mergers “are also known with some occasional loss of precision, as ‘going private mergers,’ . . . ‘parent-subsidiary mergers,’ ‘minority buyouts,’ ‘take outs,’” or freezeouts. *Id.* at 5 n.1.

50. *MFW*, 88 A.3d at 644.

shareholders.<sup>51</sup> Squeeze out mergers always trigger the entire fairness framework based on a breach of the controller's duty of loyalty because the controller effectuating the squeeze out always stands on both sides of the transaction.<sup>52</sup>

Although controllers can achieve a squeeze out merger through a few different procedural pathways, the most common method is through a statutory merger under section 251 of the DGCL.<sup>53</sup> To execute a statutory merger under section 251, a controlling stockholder of the target corporation will establish a separate and wholly-owned corporation.<sup>54</sup> Then, the controller will send a merger proposal to the target corporation's board offering the minority stockholders either cash or stock in the controller's acquiring corporation in exchange for the minority stockholder's shares in the target corporation.<sup>55</sup> Under section 144 of Delaware's statute, that proposal must then be approved by both the target board and a majority of the stockholders of the target corporation before the merger can be consummated.<sup>56</sup> Therefore, because the controller stands on both sides of the squeeze out, self-dealing is inherent in the structure of the transaction.<sup>57</sup>

In other mergers where self-dealing is present, a potential safe harbor is available for directors and officers under section 144 of the DGCL.<sup>58</sup> The statute specifies that a director or officer can present evidence of any of these three options to shift the burden back to the business judgment rule: (1) approval by an informed majority of disinterested directors, (2) approval by an informed majority of stockholders, and (3) proof of entire fairness of the transaction.<sup>59</sup> Delaware courts have reasoned that, under this safe harbor, "respect for the business judgment of the board can be maintained with integrity, because the law has taken into account the conflict and required that the business judgment be either proposed by the

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51. Subramanian, *supra* note 49, at 9. Most often a controller will achieve a squeeze out merger to take a public corporation private or to acquire full control of the corporation. *See id.* at 9–10.

52. *Id.* at 9; DEL. CODE ANN. tit. 8, § 251 (2023).

53. Subramanian, *supra* note 49, at 9.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. DEL. CODE ANN. tit. 8, § 144 (2023).

59. *Id.*

disinterested directors or ratified by the stockholders it affects.”<sup>60</sup> In director and officer conflicted mergers, the statutory merger requirements under section 251 are usually sufficient to show evidence of this safe harbor as long as the target board and stockholders were fully informed when they approved the merger.<sup>61</sup>

However, this safe harbor is not available to controlling stockholders.<sup>62</sup> Delaware courts are “more suspicious when the fiduciary who is interested is a controlling stockholder” because the controller has the power to undermine both board and stockholder approval.<sup>63</sup> The controller can undermine the target board approval because “there is an obvious fear that even putatively independent directors may owe or feel a more-than-wholesome allegiance to the interests of the controller, rather than to the corporation and its public stockholders.”<sup>64</sup> Approval by a majority of the stockholders of the target corporation is meaningless because the controller likely owns a majority of the total shares.<sup>65</sup>

Even if the controller does not own a majority of shares, the minority stockholders may still vote yes where they would otherwise vote no due to a fear of that controller’s retribution.<sup>66</sup> Therefore, controllers have the ability to undermine both procedural protections and approve a merger proposal that is unfair to the minority stockholders.<sup>67</sup> Consequently, the Delaware legislature excludes controllers from the safe harbor for self-dealing under section 144 of the DGCL.<sup>68</sup>

## B. ADDRESSING CONTROLLER SELF-DEALING IN SQUEEZE OUT MERGERS

Because the Delaware statute does not provide a safe harbor for controller self-dealing, Delaware courts have used case law to address controller self-dealing instead.<sup>69</sup> When addressing controller self-dealing, Delaware courts have attempted to balance two competing goals: (1) to

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60. *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 614 (Del. Ch. 2005).

61. *See* DEL. CODE ANN. tit. 8, § 144 (2023).

62. *In re Martha Stewart Living Omnimedia, Inc. S’holder Litig.*, Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at \*11 (Del. Ch. Aug. 18, 2017).

63. Strine, *supra* note 16, at 678.

64. *Id.*

65. *Id.*

66. *MFW*, 88 A.3d at 644.

67. *Id.*

68. Strine, *supra* note 16, at 678.

69. *See, e.g.*, *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110 (Del. 1994); *MFW*, 88 A.3d.

“provide effective protection and redress for minority stockholders that find themselves faced with a potentially dire situation” and (2) to “minimize unnecessary transaction costs that ultimately harm minority stockholders.”<sup>70</sup> The three most influential cases discussing controller self-dealing in squeeze out mergers will be discussed below.

*1. Weinberger v. UOP, Inc.*

In *Weinberger*, the Delaware Supreme Court clarified two important points about the standard of review for a challenged squeeze out merger.<sup>71</sup> First, the Court clarified that a challenged squeeze out merger triggers the entire fairness framework.<sup>72</sup> The court confirmed that when a minority shareholder challenges the fairness of a controller’s squeeze out merger, the “ultimate burden of proof is on the majority shareholder to show by a preponderance of evidence that the transaction is fair” because the controller stands on both sides of the transaction.<sup>73</sup> The court established that the entire fairness is a fact-intensive inquiry with “two basic aspects: fair dealing and fair price.”<sup>74</sup>

Second, the court confirmed that the demanding burden of showing entire fairness shifts to the plaintiff if the challenged squeeze out merger is approved by an informed majority of the minority stockholder vote (“MOM vote”).<sup>75</sup> The court held that “where corporate action has been approved by an informed [MOM vote], . . . the burden entirely shifts to the plaintiff to show that the transaction was unfair to the minority.”<sup>76</sup>

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70. Fiegenbaum, *supra* note 28, at 772.

71. *Weinberger*, 457 A.2d at 703, 711.

72. *See id.* at 703.

73. *Id.*

74. *Id.* at 711:

The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company’s stock.

75. *Id.* at 703.

76. *Id.*

However, even with this evidentiary burden shift, the court confirmed that the demanding entire fairness framework, rather than the business judgment rule, will apply because “the requirement of fairness is unflinching in its demand” for controllers standing on both sides of a challenged transaction and the controller’s conduct must “pass the test of careful scrutiny by the courts.”<sup>77</sup>

Additionally in footnote 7, the court suggested that if the board members who negotiated the conflicted controller transaction were all disinterested directors, the use of a special committee of disinterested directors to negotiate with the controller would stand as strong evidence of the fairness of the transaction.<sup>78</sup> In cases of self-dealing, special committees allow an interested fiduciary to recuse themselves from decision-making in that transaction.<sup>79</sup> To be effective in conflicted controller transactions such as squeeze out mergers, the special committee’s members must be disinterested and independent from the controller.<sup>80</sup> The court stated that use of an independent negotiating committee to negotiate with the controller in *Weinberger* could have produced a different result, but the court did not clarify what that different result would be.<sup>81</sup>

After *Weinberger*, practitioners took the court’s suggestion, and special committees became standard in squeeze out deal structures,<sup>82</sup> but the benefits of using a special committee remained uncertain.<sup>83</sup> Some Delaware judges held that use of a special committee lowered the standard to the business judgment rule while other Delaware judges retained the demanding entire fairness framework but shifted the burden to plaintiffs to show unfairness.<sup>84</sup>

## 2. *Khan v. Lynch Communication Systems, Inc.*

The Delaware Supreme Court resolved this split in *Lynch*.<sup>85</sup> While the burden did not shift in *Lynch*, the court addressed the “differing views

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77. *Id.* at 710.

78. *Id.* at 709 n.7.

79. *See Merken, supra* note 25, at 8.

80. *Id.*

81. *Weinberger*, 457 A.2d at 709 n.7.

82. Subramanian, *supra* note 49, at 12.

83. Merken, *supra* note 25, n.27.

84. Subramanian, *supra* note 49, at 13–14.

85. Carl L. Stine, *MFW and the Legal Fiction of Market Equivalency*, 44 DEL. J. CORP. L. 57, 60 (2020).

regarding the effect” of special committee approval.<sup>86</sup> Ultimately, the court held that approval by a special committee or an informed MOM vote “shifts the burden of proof on the issue of fairness” from the controller to the plaintiff.<sup>87</sup> The court found that “an entire fairness analysis is the only proper standard of judicial review,” rather than the business judgment rule, because both the special committee and the MOM vote face a high risk of undue influence by the controller.<sup>88</sup> Controllers have “a superior bargaining position and ability to extract revenge should the corporate agents refuse to bow down to [the controller’s] demand[s].”<sup>89</sup> Squeeze out mergers “are proposed by a party that controls, and will continue to control . . . whether or not the minority stockholders vote to approve or reject the transaction.”<sup>90</sup> Therefore, the courts must strictly review these procedural protections to ensure that minority stockholders are effectively protected.<sup>91</sup>

Further, the court endorsed a two-part test that a special committee must meet before the fairness burden will be shifted because the presence of the special committee alone is not enough to protect the minority stockholders effectively.<sup>92</sup> Once a controller has established a special committee, the controller (1) “must not dictate the terms of the merger” and (2) “the special committee must have real bargaining power that it can exercise with the [controller] on an arm’s length basis.”<sup>93</sup>

While the *Lynch* holding clarified that a controller could use either a special committee or MOM vote provision to potentially shift the fairness burden to the plaintiff, the holding also created three major problems for transactional planners in squeeze out mergers.<sup>94</sup> First, *Lynch* made it impossible to structure a deal that permits controllers to obtain a dismissal on the pleadings because *Lynch* held that the highly fact-intensive fair process and fair price inquiry under the fairness framework is always the standard of review in a squeeze out merger whether or not the burden shifts.<sup>95</sup> Second, *Lynch* created high settlement value for frivolous

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86. Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994).

87. *Id.* at 1117.

88. *See id.* at 1116–17.

89. Fiegenbaum, *supra* note 28, at 784.

90. *Lynch*, 638 A.2d at 1116.

91. *Id.* at 1117.

92. *Id.*

93. *Id.*

94. Stine, *supra* note 85, at 64–66; *MFW*, 88 A.3d 635, 645 (Del. 2014).

95. Stine, *supra* note 85, at 64.

stockholder lawsuits in squeeze out mergers because *Lynch* made it difficult for controllers to succeed on a motion to dismiss on the pleadings.<sup>96</sup> Third, *Lynch* does not preclude controllers from bypassing entire fairness review through a tender offer.<sup>97</sup>

Even though *Lynch* recognized the protection afforded to minority stockholders by both a special committee and an informed MOM vote provision, *Lynch* offered no incentive for controllers to use both protections simultaneously.<sup>98</sup> The impact of simultaneous deployment of both a special committee and an informed MOM vote was not addressed until about two decades later when the court reviewed a squeeze out merger that deployed both procedural protections in *MFW*.<sup>99</sup>

### 3. *Khan v. M & F Worldwide Corp.*

In *MFW*, the court found use of both protections to be a vital distinction from *Lynch* which justified deference under the business judgment rule.<sup>100</sup> The court found that these dual protections address a controller's potentially undermining influence by creating "a countervailing, offsetting influence of equal—if not greater—force."<sup>101</sup> This potential for deference under the business judgment rule incentivizes controllers to give "minority stockholders much broader access to the transactional structure that is most likely to effectively protect their interests" by replicating the arm's length merger steps of the DGCL by requiring two independent approvals.<sup>102</sup> Overall, the court found the collective wisdom of both qualified decisionmakers to be a suitable substitute for court oversight under the entire fairness framework.<sup>103</sup>

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96. Robert Lackey, *MFW Rocked the Rules for Controller Takeovers in Delaware, Will the Delaware Court of Chancery Apply that Same Revolutionary Framework to More Contexts?*, AM. U. BUS. L. REV. (Apr. 19, 2023, 5:39 PM), <https://aublr.org/2019/11/mfw-rocked-the-rules-for-controller-takeovers-in-delaware-will-the-delaware-court-of-chancery-apply-that-same-revolutionary-framework-to-more-contexts/> [<https://perma.cc/K73M-6MU5>].

97. Hamermesh et al., *supra* note 14, at 343.

98. Stine, *supra* note 85, at 64, 67.

99. *Id.* at 67–68.

100. *MFW*, 88 A.3d 635, 642 (Del. 2014).

101. *Id.* at 644.

102. *Id.* at 643. Entire fairness usually applies "in the controller merger context as a substitute for the dual statutory protections of disinterested board and stockholder approval, because both protections are potentially undermined by the influence of the controller." *Id.* at 644.

103. Fiengenbaum, *supra* note 28, at 781.

Although Delaware courts have long recognized the value of the dual procedural protections independently, “MFW was the first case [to] endorse[] . . . combining both protections [to get a] deferential standard of review.”<sup>104</sup>

The Delaware Supreme Court’s decision in *MFW* held that in challenged squeeze out mergers, the deferential

business judgment standard of review will be applied *if and only if*:

- (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.<sup>105</sup>

After *MFW*, courts have referred to these six requirements as the MFW factors and clarified what is necessary to satisfy each factor.<sup>106</sup> First, the “ab initio” or timing requirement, requires the controller to establish the dual procedural protections before any economic negotiations take place.<sup>107</sup> Second, under the committee independence requirement, the directors on the special committee must not be “ beholden to the controlling party or so under the controller’s influence that the director’s discretion would be sterilized.”<sup>108</sup> Third, to meet the committee empowerment requirement, the special committee, in addition to being

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104. Merken, *supra* note 25, at 12–13.

105. *MFW*, 88 A.3d at 645.

106. Flood v. Synutra Int’l, Inc., 195 A.3d 754, 769 (Del. 2018).

107. *Id.* at 763.

108. Merken, *supra* note 25, at 15 n.79 (citation omitted). Courts presume director independence, and a plaintiff must satisfy a materiality standard to rebut that presumption. *Id.* at 12.



able to freely select its own advisors and say no definitely,<sup>109</sup> cannot face a controller's threat of retribution or a tender offer during negotiations.<sup>110</sup> Fourth, the committee duty of care requirement "is measured by a gross negligence standard."<sup>111</sup>

Fifth, the informed MOM vote requirement requires directors to disclose all material facts and "provide stockholders with an accurate, full, and fair characterization of the events leading to a board's decision."<sup>112</sup> Sixth, the no coercion requirement prevents the controller from taking action, such as threat of retribution or worse terms under a tender offer, to induce stockholders to act on some basis other than the merits of the proposed transaction.<sup>113</sup> If a controller meets all six MFW factors in carrying out a squeeze out merger, any challenges to that merger will be reviewed under the highly deferential business judgment rule unless a plaintiff pleads "a reasonably conceivable set of facts showing that any or all of" the MFW factors did not exist.<sup>114</sup>

### C. ADDRESSING CONTROLLER SELF-DEALING IN OTHER TRANSACTIONS

While the court in *MFW* developed the MFW factors to address controller self-dealing in squeeze out mergers specifically, squeeze out mergers are not the only type of controller transaction which triggers the entire fairness framework.<sup>115</sup> Other transactions also trigger the

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109. *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1119 (Del. 1994) (citations omitted):

The power to say no is a significant power. It is the duty of directors serving on [an independent] committee to approve only a transaction that is in the best interests of the public shareholders, to say no to any transaction that is not fair to those shareholders and is not the best transaction available. It is not sufficient for such directors to achieve the best price that a fiduciary will pay if that price is not a fair price.

110. *Id.* at 1117.

111. *Synutra*, 195 A.3d at 768. A plaintiff cannot just plead insufficient price or simply "disagree with the [special] committee's strategy" of negotiation to show a violation of this duty of care. *Id.* (citations omitted).

112. *Merken*, *supra* note 25, at 22 (quotation omitted).

113. *In re Dell Techs. Inc. Class V S'holders Litig.*, No. 2018-0816-JTL, 2020 WL 3096748, at \*20 (Del. Ch. June 11, 2020).

114. *MFW*, 88 A.3d 635, 645 (Del. 2014).

115. *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at \*11 (Del. Ch. Aug. 18, 2017).

framework and become conflicted controller transactions where (1) a controlling stockholder is present and (2) that controller engages in self-dealing or receives a non-pro-rata benefit.<sup>116</sup> These conflicted controller transactions can range from significant transactions like squeeze out mergers and asset purchase agreements to less significant transactions like “compensation arrangements, consulting agreements, services agreements, and similar transactions between a controller or its affiliate and the controlled entity.”<sup>117</sup> Usually, all conflicted controller transactions trigger the entire fairness framework “even if the transaction was negotiated by independent directors or approved by the minority stockholders.”<sup>118</sup>

After *MFW*, the Delaware Chancery Court has applied the MFW factors to three other types of conflicted controller transactions that vary in their similarities to squeeze out mergers. These other types of transactions include (1) other types of mergers, (2) transactions that require a stockholder vote under the DGCL, and (3) transactions that do not require a stockholder vote under the DGCL.<sup>119</sup> This expansion of *MFW* to conflicted controller transactions other than squeeze out mergers has been described by courts and scholars as “MFW Creep.”<sup>120</sup> The

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116. Fiengenbaum, *supra* note 28, at 778–79.

117. *In re EZCORP Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at \*15 (Del. Ch. Jan. 25, 2016).

118. *Tornetta v. Musk*, 250 A.3d 793, 800 (Del. Ch. 2019) (quoting *Strine, supra* note 16, at 678); *see, e.g., Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 900 (Del. Ch. 1999) (stating “it appears that a corporation with a controlling or majority stockholder may, under current Delaware law, never escape the exacting entire fairness standard”); *see also Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994). This determination would not change even if the majority of the board was independent from the controlling shareholder. *See Emerald Partners v. Berlin*, 787 A.2d 85, 96–97 (Del. 2001).

119. *See, e.g., In re Match Grp. Derivative Litig.*, No. 2020-0505-MTZ, 2022 WL 3970159, at \*15 (Del. Ch. Sept. 1, 2022); *EZCORP*, 2016 WL 301245, at \*13 (pointing out that MFW might apply to a broad range of transactions in which a controlling stockholder extracts a non-ratable benefit); *Stewart*, 2017 WL 3568089, at \*2 (applying MFW to a transaction in which a controller allegedly extracted disparate consideration from the transaction not shared with the common stockholders); *IRA Tr. FBO Bobbie Ahmed v. Crane*, No. 12742-CB, 2017 WL 7053964, at \*9 (Del. Ch. Jan. 26, 2018); *Musk*, 250 A.3d at 810–12 (finding that MFW would apply to a controller’s compensation package decision and permit business judgment rule deference if all six MFW requirements were met).

120. Hamermesh et al., *supra* note 14, at 337.

application of *MFW* to a transaction from each of these categories will be discussed below.

In the first category for other types of mergers, the court has applied *MFW* to third party mergers where a controller has received a non-pro-rata benefit.<sup>121</sup> A third party merger operates under section 251 of the DGCL and is similar to squeeze out mergers except a third party, rather than a controller, purchases the shares in the target corporation.<sup>122</sup> Even though the controller does not stand on both sides of this transaction, the entire fairness framework is triggered if the controller receives a non-pro-rata benefit from the third party as compensation for the controller's cooperation in the merger transaction.<sup>123</sup>

In *Stewart*, the court held that the MFW factors apply to one sided conflicted controller transactions as well as squeeze out mergers.<sup>124</sup> The court found that, because there is a conflicted controller present in both squeeze out and third party mergers, the risks and incentives do not differ significantly between these two types of mergers.<sup>125</sup> Therefore, in both transactions, application of the MFW factors as a safe harbor must be available to incentivize fiduciaries to implement procedural protections for minority stockholders.<sup>126</sup>

For other types of transactions that require a stockholder vote under the DGCL, the court has applied *MFW* to a charter amendment which reclassified the corporation's shares in a way that ensured the controller "would be able to retain voting control of" the corporation.<sup>127</sup> Under Delaware law, every corporation is governed by a charter—"the equivalent of the corporate constitution"—which sets forth how the corporation must conduct its business including how to issue stock in the corporation.<sup>128</sup> Under the DGCL, each corporation's charter "can only be amended upon recommendation by the board of directors and with stockholder approval."<sup>129</sup> If a controller receives a non-ratable benefit in connection with a charter amendment that is not shared with the minority

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121. *Stewart*, 2017 WL 3568089, at \*16–17.

122. DEL. CODE ANN. tit. 8, § 251; *see supra* Section I.A.3; *see also Stewart*, 2017 WL 3568089, at \*11.

123. *Stewart*, 2017 WL 3568089, at \*11.

124. *Id.* at \*16–17.

125. *Id.* at \*17.

126. *Id.*

127. IRA Tr. FBO Bobbie Ahmed v. Crane, No. 12742-CB, 2017 WL 7053964, at \*9 (Del. Ch. Jan. 26, 2018).

128. Strine, *supra* note 16, at 674.

129. *Id.* at 674–75.

stockholders, the charter amendment triggers the entire fairness framework.<sup>130</sup>

In *IRA Trust FBO Bobbie Ahmed v. Crane*, the court found that *MFW* also applies to charter amendments where a conflicted controller is present.<sup>131</sup> The court found “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.”<sup>132</sup> In fact, the court encouraged the use of the dual protections in all conflicted controller transactions to protect minority stockholders.<sup>133</sup>

For transactions that do not require a statutory vote, the court has applied *MFW* to the approval of a controller’s compensation package.<sup>134</sup> Because compensation packages do not require a stockholder vote under the DGCL, they usually only require board approval.<sup>135</sup> When the recipient of the compensation package is a controller, the entire fairness framework is triggered.<sup>136</sup> In *Musk*, the court held that *MFW* also applies to compensation packages because deployment of the factors assuages the court’s loyalty concerns and justifies judicial deference.<sup>137</sup> Even though the Delaware Chancery Court has expanded the application of *MFW* to various conflicted controller transactions other than squeeze out mergers,<sup>138</sup> the Delaware Supreme Court has yet to speak on the legitimacy or bounds of *MFW* Creep.

## II. SHOULD *MFW* APPLY TO ALL CONFLICTED CONTROLLER TRANSACTIONS?

Although *MFW* creep has shown the Delaware courts’ willingness to expand *MFW* and apply the *MFW* factors to conflicted controller transactions other than squeeze out mergers,<sup>139</sup> the scope of *MFW* remains uncertain. Part II will discuss whether the scope of *MFW* should be

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130. *Crane*, 2017 WL 7053964, at \*7.

131. *Id.* at \*9.

132. *Id.* at \*11.

133. *Id.*

134. *Tornetta v. Musk*, 250 A.3d 793, 800 (Del. Ch. 2019).

135. *See id.* at 796–97.

136. *See id.* at 800.

137. *See id.*

138. *See supra* note 14.

139. *See Hamermesh et al., supra* note 14, at 337.

limited to squeeze out mergers or expanded to all conflicted controller transactions. First, Section A will explore the effectiveness of the MFW factors in protecting minority stockholders in squeeze out mergers specifically. With that effectiveness in mind, Section B will consider arguments for and against the application of the MFW factors to conflicted controller transactions other than squeeze out mergers.

#### A. WHETHER THE MFW FACTORS EFFECTIVELY PROTECT MINORITY STOCKHOLDERS

This Section will consider the overall adequacy of the MFW factors in protecting minority stockholders in squeeze out mergers specifically. The effectiveness of the MFW factors will be discussed below.

##### 1. *The MFW Factors Create a Protective Transactional Structure*

Many Delaware courts, legal scholars, and practitioners argue that the MFW factors adequately protect minority stockholders in squeeze out mergers.<sup>140</sup> In *MFW*, the Delaware Supreme Court argued that the combined use of all six MFW factors creates a transactional structure that provides “the best protection” to minority stockholders.<sup>141</sup> The six MFW factors can be organized into three categories: (1) the ab initio timing requirement where the controller must condition “the transaction on the approval of both a Special Committee and a majority of the minority stockholders” before moving forward with negotiations; (2) the special committee requirements where the special committee must be independent, “empowered to freely select its own advisors and to say no definitively,” and meet “its duty of care in negotiating a fair price”; and (3) the MOM vote requirements where the vote must be informed and not coerced.<sup>142</sup> The protection accorded to minority stockholders by each category of MFW factors will be discussed below.

The first category titled the ab initio timing requirement—where a controller must condition the transaction on dual approval—creates a “potent tool to extract good value for the minority.”<sup>143</sup> Establishing these conditions up front ensures that controllers cannot threaten use of the

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140. *MFW*, 88 A.3d at 644.

141. *Id.*

142. *Id.* at 645.

143. *Id.* at 644; *see also* Flood v. Synutra Int’l, Inc., 195 A.3d 754, 763 (Del. 2018).

conditions later as bargaining chips during economic negotiations.<sup>144</sup> Before entering economic negotiations, the controlling stockholder “knows that it cannot bypass the special committee’s ability to say no” nor “dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move.”<sup>145</sup> Therefore, the timing requirement protects minority stockholders by setting clear expectations at the start of economic negotiations.

The second category labeled the special committee requirements—where the committee must be independent, empowered, and meet its duty of care—ensure that the special committee will serve as an effective bargaining agent for the minority because these requirements implicate “a qualitative inquiry as to how the committee actually functioned” rather than just a finding “that the process checked certain boxes.”<sup>146</sup> These three special committee requirements work together to guarantee that the committee exercises real bargaining power at an arm’s length.<sup>147</sup>

The independence requirement filters undue influence by a controller to ensure that a controller will not dictate the terms of the transaction.<sup>148</sup> Independent directors have increasingly shown themselves capable of standing up to controllers in order to win the favor of powerful public investors.<sup>149</sup> Controllers are aware of “the prospect that replacing independent directors who said no to a conflict transaction with ones who would do their bidding would impair [the controller’s] ability to raise debt and other capital.”<sup>150</sup> Therefore, the independence requirement prevents controllers from dictating the terms of the transaction by influencing directors.

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144. *MFW*, 88 A.3d at 644; *see also Synutra*, 195 A.3d at 762–63.

145. *MFW*, 88 A.3d at 644; *see also Synutra*, 195 A.3d at 763.

146. *Synutra*, 195 A.3d at 769 (Valihura, J., dissenting).

147. William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporate Law*, 26 DEL. J. CORP. L. 859, 880 (2001).

148. *See MFW*, 88 A.3d at 644.

149. Hamermesh et al., *supra* note 14, at 341. Independent directors now increasingly owe their continued access to directorships “to their willingness to support policies that powerful investors liked” rather than to management ties. *Id.* Public investors expect independent directors to act aggressively to negotiate good deals. *Id.* at 342. “Independent directors who run afoul of investor . . . sentiment . . . at one company . . . can face withhold votes at other companies on whose boards they serve.” *Id.*

150. *Id.* at 341.

Next, the empowerment requirement equips the special committee to effectively bargain with the controller at arm's length in two distinct ways.<sup>151</sup> One, it ensures that the special committee can overcome any lack of managerial expertise by consulting with experienced financial and legal advisors “who know how to pull the levers in merger transactions [to] extract economic advantage.”<sup>152</sup> And two, it gives the special committee the power to definitively say no if the transaction is not fair to the minority.<sup>153</sup> The special committee must be able to reject a controller's best offer: “It is not sufficient for [directors] to achieve the best price that a fiduciary will pay if that price is not a fair price.”<sup>154</sup> Additionally, the duty of care requirement ensures that the committee's actions are not grossly negligent.<sup>155</sup>

The third category known as the MOM vote requirements—which state that the vote must be informed and uncoerced—gives the minority stockholders an opportunity to effectively evaluate the special committee's work.<sup>156</sup> The requirements ensure that all material facts bearing on the approval decision must be disclosed, and minority stockholders cannot face coercion in the voting process.<sup>157</sup> The informed vote requirement and market changes such as (1) institutional investor activism, (2) increased SEC disclosure regulations, and (3) enormous information flow made possible by new technology have armed minority stockholders with adequate information to meaningfully assess the special committee's proposed transaction terms.<sup>158</sup> These three market changes will be discussed in turn.

One, institutional investors have the specialized knowledge and resources to assess the complex transactions proposed by a special

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151. See Subramanian, *supra* note 49, at 55. Special committees reduce the information asymmetry between parties at the table and reduce a “controller's ability to engage in socially inefficient opportunistic behavior.” *Id.*

152. *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 618 (Del. Ch. 2005).

153. See *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1119 (Del. 1994).

154. *Id.* The power to reject a controller's offer is also essential because special committees cannot seek out competing bids; controllers cannot be compelled to sell their shares to a higher value bidder. Subramanian, *supra* note 49, at 54. The power to seek out other options away from the table is usually considered an important source of bargaining power in negotiations generally. *Id.*

155. See *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754, 756 (Del. 2018).

156. Allen et al., *supra* note 147, at 880.

157. *Cox*, 879 A.2d at 618–19.

158. Allen et al., *supra* note 147, at 880.

committee.<sup>159</sup> Relatedly, institutional investors are motivated to share their assessment with retail investors approving transactions because they have large investments to lose if the deal is not fair.<sup>160</sup> Two, increased SEC requirements have increased the amount and quality of public information available to stockholders.<sup>161</sup> Lastly, Delaware courts have also found that minority stockholders are more knowledgeable about the companies in which they invest due to internet expansion.<sup>162</sup> And “Delaware courts have proven vigilant in policing electoral manipulation and coercion of stockholders in the voting process.”<sup>163</sup> Thus, these vote requirements and market changes allow stockholders to “protect themselves at the ballot box.”<sup>164</sup>

As a whole, the MOM vote also motivates the special committee to negotiate as the stockholder’s bargaining agent effectively. The MOM vote empowers stockholders “to hold their bargaining agent’s feet to the fire by wielding the power at the ballot box to either ratify or reject their agent’s work product.”<sup>165</sup> If, for whatever reason, the stockholders believe that the special committee has negotiated poorly, the stockholders can protect themselves by simply voting no.<sup>166</sup> Further, the MOM vote also provides minority stockholders with an opportunity to have their individual voice heard.<sup>167</sup> This is especially relevant under Delaware law where the Delaware Supreme Court has emphasized the importance of the stockholder vote which “remains the ideological underpinning upon which the legitimacy of directorial power rests.”<sup>168</sup>

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159. Merken, *supra* note 25, at \*10–11. Investors also benefit from proxy advisors and analysts who analyze deals. Hamermesh et al., *supra* note 14, at 342.

160. Merken, *supra* note 25, at \*11. Institutional investors have a powerful voice and challenge controllers frequently. Hamermesh et al., *supra* note 14, at 342.

161. See Hamermesh et al., *supra* note 14, at 341–42.

162. Merken, *supra* note 25, at \*11–12.

163. Hamermesh et al., *supra* note 14, at 341. Delaware courts “would readily address any controller who reacted to a negative vote with retribution.” *Id.*

164. *Id.* at 342. “[T]hese market developments . . . would at least as forcefully deter a controller in settings involving conflict transactions other than going private mergers.” *Id.*

165. *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 618–19 (Del. Ch. 2005).

166. See *id.* at 619. The vote also reduces “the likelihood of a self-serving error by the original corporate actors.” Fiengenbaum, *supra* note 28, at 783.

167. Merken, *supra* note 25, at 10–12.

168. Fiengenbaum, *supra* note 28, at 783 (quoting *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988)).



Ultimately, the third category of MFW factors, the MOM vote, and market changes work together to give minority stockholders the power to effectively evaluate and accept or reject the special committee's work. To conclude, the MFW factors as a whole work together to create a structure that effectively protects minority stockholders in squeeze out mergers.<sup>169</sup>

## 2. *The MFW Factors Are Just an Artificial Mechanism*

Conversely, many legal scholars and practitioners argue that the MFW factors do not effectively protect minority stockholders in squeeze out mergers.<sup>170</sup> One practitioner claims the MFW factors are just “some artificial mechanism to help controllers obtain dismissal at the pleadings stage.”<sup>171</sup> The arguments against the effectiveness of each category of MFW factors will be discussed below.

Regarding the first category, the “ab initio” timing requirement lacks the effectiveness of a bright-line rule.<sup>172</sup> The Delaware Supreme Court’s “when the negotiations begin” test invites factual inquiries that defeat the purpose of what should be more of a bright[-]line” rule.<sup>173</sup> While the ab initio requirement is met if the dual procedural protections are conditioned before economic negotiations begin, economic negotiations are not the only event that impacts the integrity of a controller’s proposal.<sup>174</sup> For example, the ab initio requirement could still be met if the dual procedural protections were conditioned after (1) a controller has submitted its initial proposal, (2) a special committee has been formed, and (3) a team of committee advisors have been selected as long as the protections were conditioned before economic negotiations began.<sup>175</sup>

Delaware courts and treatises have long recognized that integrity in the formation of the special committee and selection of committee advisors is crucial to protect stockholders.<sup>176</sup> Under the Supreme Court’s loose application of the ab initio timing requirement, these crucial steps

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169. See *MFW*, 88 A.3d at 644 (Del. 2014). “[T]his transactional structure is the optimal one for minority stockholders.” *In re MFW S’holders Litig.*, 67 A.3d 496, 527 (Del. Ch. 2013), *aff’d sub nom.*, *MFW*, 88 A.3d.

170. See Stine, *supra* note 85, at 69–76.

171. *Id.* at 59.

172. *Flood v. Synutra Int’l, Inc.*, 195 A.3d 754, 768 (Del. 2018) (Valihura, J., dissenting).

173. *Id.*

174. See *id.* at 777.

175. See *id.* at 776.

176. *Id.*

can occur long before the controller is required to condition the transaction on the dual procedural protections, and the controller can still earn business judgment rule deference as long as they condition the dual procedural protections before economic negotiations begin.<sup>177</sup> Therefore, the ab initio requirement does not effectively protect minority stockholders because it is not a bright-line rule.<sup>178</sup>

The second category, titled the special committee requirements, does not guarantee the integrity of the special committee as an effective bargaining agent for minority stockholders.<sup>179</sup> Even experienced practitioners “recognize that the integrity of the special disinterested director committee process remains subject to debate” for the following two main reasons: (1) under the MFW factors, an arm’s length transaction is not effectively replicated, and (2) the special committee lacks the ability to develop options away from the table.<sup>180</sup>

One, the MFW factors do not effectively replicate an arm’s length transaction.<sup>181</sup> While in *MFW*, the Delaware Supreme Court stated that the dual procedural protections were designed to replicate the dual statutory protections in arm’s length mergers,<sup>182</sup> “common sense tells us that these negotiations cannot in any sense be mistaken for arms-length negotiations with strangers.”<sup>183</sup> To start, under the MFW factors, special committee board members are not negotiating with a stranger or competitor; board members have usually known and worked closely with a controller for years before negotiations begin.<sup>184</sup>

In fact, “it is commonplace for outside directors to have social, and in some cases business, relationships” with a controller.<sup>185</sup> Therefore,

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177. *See id.*

178. *See id.* at 768–70. To effectively prevent a controller from threatening the integrity of the MFW factors, the ab initio requirement should only be satisfied “when the [d]ual [p]rotections are contained in the controller’s initial formal written proposal.” *Id.* at 768. “This bright-line makes sense because the controller dictates when to commence the transactional process so that the outset is clear.” *Id.*

179. Allen et al., *supra* note 147, at 881. “[P]ossible ineptitude and timidity of directors’ may undermine the special committee protection.” *MFW*, 88 A.3d at 643.

180. Allen et al., *supra* note 147, at 881.

181. *See* Stine, *supra* note 85, at 69–76.

182. *MFW*, 88 A.3d at 644.

183. Stine, *supra* note 85, at 71.

184. *Id.* at 70–73.

185. *See* Allen et al., *supra* note 147, at 881. “That reality may explain the Delaware supreme court’s reluctance to give the special committee device full credit as a cleansing mechanism.” *Id.*

special committee board members may act under the undue influence of their relationship with the controller rather than in the best interests of the stockholders.<sup>186</sup> Additionally, controllers have access to inside information, not available to strangers or competitors, and can use that information to strategically plan the time and terms of their transaction proposal.<sup>187</sup> Hence, the MFW factors can never effectively replicate merger statutory protections.

Two, the special committee lacks the ability to develop options away from the table which is usually “considered to be an important source of bargaining power in negotiations generally.”<sup>188</sup> In squeeze out mergers, controllers often announce at the beginning of negotiations that they have no interest in selling their shares to a third party, and they have the power to enforce this refusal.<sup>189</sup> Therefore, special committee members are stripped of “the ability to canvass the market with the possibility of a third-party making a topping bid” because a majority of the shares can never be sold to that third party.<sup>190</sup> Consequently, special committees lack an important source of bargaining power in squeeze out mergers.<sup>191</sup> Therefore, the special committee requirements under *MFW* do not effectively guarantee the integrity of the special committee as a bargaining agent.

The third category known as the MOM vote requirements does not transform the MOM vote into a real “referendum on the fairness of the transaction.”<sup>192</sup> Most minority stockholders understand the inevitability of consummation of a proposed transaction<sup>193</sup> and have no allegiance to any particular company, so they usually will not “wait around just to voice their opposition in what almost always ends up being a hollow gesture.”<sup>194</sup> Even if some minority stockholders speak out against a proposed

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186. Stine, *supra* note 85, at 71–72. Special committee directors may fear retribution from a controller if they do not act in the best interests of that controller. *Id.* at 71.

187. *Id.* at 68.

188. Subramanian, *supra* note 49, at 54.

189. Stine, *supra* note 85, at 73. “Controller[s] [have] implemented the ultimate deal-protection device.” *Id.*

190. *See id.*

191. *See id.*

192. *Id.* at 74–75.

193. “In the real world, almost every deal that gets announced is consummated at the price announced.” *Id.* at 75 (citation omitted).

194. *Id.* “The huge spike in volume that always accompanies these deal announcements demonstrates that a significant portion of the public [stockholders] would rather accept a few cents below the deal price now . . . rather than wait a few months or more to get the full deal price.” *Id.*

transaction, those “stockholders are poorly positioned to extract the controllers’ best price” in a binary yes or no vote because they do not have the ability to bargain the price up.<sup>195</sup>

Additionally, market changes such as institutional investor activism, deal arbitrageurs, and enormous information flow made possible by new technology actually make it more difficult for minority stockholders to evaluate the fairness of a proposed transaction.<sup>196</sup> While institutional investors may have the knowledge and resources to effectively evaluate a proposed transaction, they may lack any practical incentive to oppose an unfair merger because their “compensation often ‘depends on generating short-term returns’” which can often be achieved in any transaction that offers a market premium even if that market premium price is unfair.<sup>197</sup>

Deal arbitrageurs similarly lack any “incentive to vote against the deal even if they do believe the price is unfair.”<sup>198</sup> Betting that the deal will go through, deal arbitrageurs buy shares at “slightly less than the deal price” and are only “looking to profit [for a] few cents per share” when the deal goes through.<sup>199</sup> Moreover, even though stockholders now have access to more information about publicly traded companies due to new technology, the consequence of such access is often information overload which can serve more as a detriment than a benefit.<sup>200</sup> For these reasons, many legal scholars and practitioners argue that the MOM vote requirements do not adequately protect minority stockholders.<sup>201</sup> Therefore, for all of the reasons mentioned above, the MFW factors as a whole do not effectively protect minority stockholders in squeeze out mergers.

#### B. WHETHER APPLICATION OF THE MFW FACTORS SHOULD BE EXPANDED

This Section will consider whether the MFW factors should be applied to other types of conflicted controller transactions. This Section

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195. *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 625 (Del. Ch. 2005). “The active agency of centralized management to test the market and bargain is not something that the stockholders can do for themselves.” *Id.* at 618.

196. Merken, *supra* note 25, at 11–12.

197. *Id.* at 11.

198. Stine, *supra* note 85, at 76.

199. *See id.*

200. Merken, *supra* note 25, at 12.

201. Stine, *supra* note 85, at 74–76; Merken, *supra* note 25, at 11–12.

will consider: (1) whether squeeze out mergers and other types of conflicted controller transactions should be treated equally under *MFW* and (2) whether the MFW factors are an efficient transactional planning tool for conflicted controller transactions other than squeeze out mergers.

### 1. *Equal Treatment Under MFW*

This Section will consider whether squeeze out mergers and other types of conflicted controller transactions should be treated equally under *MFW*. The equal application of *MFW* to each of the following will be discussed below: (i) all conflicted controller transactions, (ii) some additional conflicted controller transactions, and (iii) no additional conflicted controller transactions.

#### a. All Conflicted Controller Transactions

Many Delaware courts and leading scholars argue that all conflicted controller transactions should be treated equally under *MFW* because the loyalty concern addressed by the MFW factors arises in all conflicted controller transactions.<sup>202</sup> This loyalty concern stems from the risk that a controller will abuse their position of power to further their private interests at the expense of the minority stockholders.<sup>203</sup> While the loyalty concern in *MFW* arose due to the self-dealing inherent in the squeeze out merger structure,<sup>204</sup> the same loyalty concern emerges in all conflicted controller transactions whether the transaction is conflicted due to a

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202. See *In re EZCORP Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at \*13 (Del. Ch. Jan. 25, 2016).

203. *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at \*18 (Del. Ch. Aug. 18, 2017).

In colloquial terms, the Supreme Court saw the controlling stockholder as the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support).

*EZCORP*, 2016 WL 301245, at \*20 (citing *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002)).

204. See *MFW*, 88 A.3d at 644.

controller's self-dealing or a controller's receipt of a non-pro-rata benefit.<sup>205</sup>

Under current Delaware law, Delaware courts address this loyalty concern in conflicted controller transactions through application of the entire fairness framework.<sup>206</sup> Before *MFW*, there was no safe harbor available for any conflicted controller transactions, so defendants had to confront the burdensome fair process and fair price inquiry.<sup>207</sup> In *MFW*, the court found that the MFW factors could serve as a safe harbor under the entire fairness framework because the combination of the six MFW factors neutralizes the loyalty concern through “a countervailing, offsetting influence of equal—if not greater—force.”<sup>208</sup> When the MFW factors are met, Delaware courts can responsibly lower the standard of review and apply the business judgment rule because the MFW factors protect minority stockholders just as well as the fair process and fair price inquiry.<sup>209</sup>

The MFW factors should be available as a safe harbor in all conflicted controller transactions.<sup>210</sup> Many Delaware courts have explicitly found “no plausible rationale for a distinction between mergers and other corporate transactions” to justify disparate treatment under the

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205. See *EZCORP*, 2016 WL 301245, at \*13. Recent Delaware courts have “taken the view that inherent coercion exists in any situation where a controller has a conflict.” Hamermesh et al., *supra* note 14, at 337.

206. *EZCORP*, 2016 WL 301245, at \*12–13. Many courts have reviewed a variety of conflicted controller transactions under the entire fairness framework “implicitly rejecting the view that the framework only applies to squeeze-outs.” *Id.* at \*13; see, e.g., *Levco Alt. Fund Ltd. v. Reader’s Dig. Ass’n, Inc.*, 803 A.2d 428 (Del. 2002) (applying the entire fairness standard to a recapitalization in which a corporation repurchased shares from its controlling stockholder in return for a combination of cash and stock); *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993) (applying the entire fairness standard to transactions that the controlling stockholders of E.C. Barton & Co. used to generate liquidity for themselves and other company employees); *Summa Corp. v. Trans World Airlines, Inc.*, 540 A.2d 403 (Del. 1988) (applying the entire fairness framework to a series of transactions in which Trans World Airlines, Inc. purchased aircraft or leased planes from its controlling stockholder).

207. *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994).

208. *MFW*, 88 A.3d at 644.

209. *Id.*

210. See *EZCORP*, 2016 WL 301245, at \*23; see also AJ Harris, *SPAC The Deck: Why the Control Exerted by SPAC Sponsors Subjects De-SPAC Transactions to Entire Fairness Review*, 27 *FORDHAM J. CORP. & FIN. L.* 563, 602–04 (2022) (applying *MFW* to earn business judgment rule deference in De-SPAC transactions).

entire fairness framework.<sup>211</sup> Therefore, although the MFW factors were created in the context of squeeze out mergers specifically, the MFW factors should apply to all conflicted controller transactions because they address the loyalty concern present in such transactions.<sup>212</sup>

b. Some Additional Conflicted Controller Transactions

However, some legal scholars argue that the MFW factors should only apply to a specific category of conflicted controller transactions.<sup>213</sup> Lawrence Hamermesh,<sup>214</sup> the Honorable Jack B. Jacobs,<sup>215</sup> and the Honorable Leo E. Strine, Jr.<sup>216</sup> (“HJS”) argue that, at most, the MFW factors should only apply to conflicted controller transactions which require a vote under the DGCL.<sup>217</sup> Applying *MFW* only where a vote is statutorily required “would have some logic, because it would match the basic reasoning of the decision” in *MFW*.<sup>218</sup> The MFW factors are necessary in squeeze out mergers to create “the shareholder-protective characteristics of third-party, arm’s-length mergers” where, otherwise, a controller could undermine both “dual statutory protections of disinterested board and stockholder approval.”<sup>219</sup> This reasoning can only justify application to conflicted controller transactions that require a statutory vote because those transactions are the only ones where that vote could be undermined by the controller.<sup>220</sup> For transactions that do not require a statutory vote, that same concern is not present.<sup>221</sup>

In fact, HJS argue that, according to Delaware law, use of just one of the traditional cleansing techniques—either disinterested director approval or a MOM vote—in conflicted transactions where no statutory

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211. *EZCORP*, 2016 WL 301245, at \*12.

212. *See Merken, supra* note 25, at 31–32.

213. Hamermesh et al., *supra* note 14, at 343–44.

214. “Executive Director, Institute for Law & Economics, University of Pennsylvania Carey Law School; Professor Emeritus, Widener University Delaware Law School.” *Id.*

215. “Senior Counsel, Young, Conaway, Stargatt & Taylor; former Justice and Vice Chancellor, the State of Delaware.” *Id.*

216. “Michael L. Wachter Distinguished Fellow at the University of Pennsylvania Carey Law School; Senior Fellow, Harvard Program on Corporate Governance; Of Counsel, Wachtell, Lipton, Rosen & Katz; former Chief Justice and Chancellor, the State of Delaware.” *Id.*

217. *Id.*

218. *Id.*

219. *MFW*, 88 A.3d at 644.

220. *See Hamermesh et al., supra* note 14, at 343–44.

221. *See id.*

vote is required should grant business judgment rule deference.<sup>222</sup> The text of *MFW* states that “[o]utside the controlling stockholder merger context,” the court will grant business judgment rule deference for transactions—even conflicted ones—if they are approved by disinterested directors.<sup>223</sup> Therefore, *MFW* would have no application outside of the controlling stockholder merger context because a simple disinterested director approval will reach the same result as deployment of all six demanding MFW factors.<sup>224</sup> “Where no stockholder vote is required, *MFW*’s procedures have no fit, and their extension to such contexts involves judicial action better described as statute writing.”<sup>225</sup> Therefore, only squeeze out mergers and conflicted controller transactions that require a statutory vote should be treated equally under *MFW*.<sup>226</sup>

### c. No Additional Conflicted Controller Transactions

Many legal scholars and practitioners argue that the MFW factors should be limited to squeeze out mergers because the Delaware Supreme Court affirmed the MFW factors as only a bespoke solution for squeeze out mergers.<sup>227</sup> The court viewed the loyalty concerns in squeeze out mergers to be “particularly grave” and developed the MFW factors to protect minority stockholders in squeeze out mergers specifically.<sup>228</sup> The court intended to limit the MFW factors to squeeze out mergers for three reasons.<sup>229</sup> First, the court’s text in *MFW* addresses only squeeze out mergers.<sup>230</sup> Second, the court developed the MFW factors to address incentive problems that emerged after *Lynch*,<sup>231</sup> and third, the court modeled the MFW factors on the statutory requirements for arm’s length mergers.<sup>232</sup> These arguments will be discussed below.

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222. See *id.* at 340–42. “Applying *MFW* to transactions [such as the compensation package in Musk] where no statutory vote is required has had odd results.” *Id.* at 342 n.99.

223. *In re MFW S’holders Litig.*, 67 A.3d 496, 526–27 (Del. Ch. 2013), *aff’d sub nom.*, *MFW*, 88 A.3d ; see also Hamermesh et al., *supra* note 14, at 339.

224. See *MFW*, 88 A.3d at 645; see Hamermesh et al., *supra* note 14, at 340.

225. Hamermesh et al., *supra* note 14, at 343–44.

226. *Id.*

227. *Id.* at 339.

228. *Id.* at 336–37.

229. See *MFW*, 88 A.3d at 644–45.

230. Hamermesh et al., *supra* note 14, at 339; see *MFW*, 88 A.3d at 644.

231. Hamermesh et al., *supra* note 14, at 339.

232. *MFW*, 88 A.3d at 644.



First, *MFW*'s text addressed squeeze out mergers exclusively in both the question presented and the holding of the case.<sup>233</sup> The court narrowly “defined the question presented as ‘what should be the correct standard of review for *mergers between a controlling stockholder and its subsidiary.*’”<sup>234</sup> And, in summarizing its conclusion, the court clarified that “in *controller buyouts*, the business judgment standard of review will be applied if and only if” all the MFW factors are met.<sup>235</sup> This “precise and repetitive use of specific transactional terms-of-art clarifies the Supreme Court’s intent” that *MFW* was only intended to apply to squeeze out mergers.<sup>236</sup>

Second, the court specifically tailored the MFW factors to address the transactional planning incentive problems that emerged after *Lynch*.<sup>237</sup> In *Lynch*, the court held that, in a squeeze out merger, “an approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness” from the controller to the plaintiff.<sup>238</sup> By holding that the use of either procedural protections would shift the evidentiary burden, *Lynch* ensured that no added benefit will accrue from a controller’s voluntary inclusion of a MOM vote provision—effectively silencing minority stockholders by taking away their individual voice.<sup>239</sup> In addition, *Lynch* reduced special committees’ bargaining power because *Lynch* made it possible for a controller to “bypass the special committee by presenting a tender offer directly to the minority stockholders” if negotiations with the committee were not going in the controller’s favor.<sup>240</sup> In *MFW*, the court addressed these problems by conditioning business judgment rule deference on use of both procedural protections from the beginning.<sup>241</sup>

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233. Hamermesh et al., *supra* note 14, at 339–40; Fiengenbaum, *supra* note 28, at 789.

234. *In re MFW S’holders Litig.*, 67 A.3d 496, 524 (Del. Ch. 2013), *aff’d sub nom.*, *MFW*, 88 A.3d.

235. *MFW*, 88 A.3d at 645 (emphasis added).

236. Fiengenbaum, *supra* note 28, at 789.

237. *See* Hamermesh et al., *supra* note 14, at 336–39.

238. *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994). Both *MFW* and *Lynch* descend from a line of cases that address squeeze out mergers specifically. *See, e.g.*, *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Lynch*, 638 A.2d; *MFW*, 88 A.3d.

239. Fiengenbaum, *supra* note 28, at 794. Rational controllers would “shy away from the additional transactional risk” of a MOM vote provision. *Id.*

240. Hamermesh et al., *supra* note 14, at 339.

241. *MFW*, 88 A.3d at 644 (emphasis added).

Therefore, the MFW factors targeted problems specific to squeeze out mergers that arose after *Lynch*.<sup>242</sup>

Third, the court modeled the MFW factors on the statutory requirements for arm's length mergers.<sup>243</sup> In *MFW*, the court recognized that both statutory protections could potentially be undermined by the controller's undue influence and designed the MFW factors to "create a countervailing, offsetting influence of equal—if not greater—force."<sup>244</sup> However, many other types of conflicted controller transactions do not have a statutory equivalent or even a statutory vote requirement.<sup>245</sup> Therefore, the concern that the dual statutory protections—approval by both a disinterested board and stockholder vote—"are potentially undermined by the influence of the controller"—does not arise in those transactions, and application of the MFW factors would be irrelevant.<sup>246</sup> Accordingly, because squeeze out mergers are distinct from other types of conflicted controller transactions, the MFW factors—specifically tailored for squeeze out mergers—should not be expanded to apply beyond the squeeze out merger context.

## 2. *Efficiency of the MFW Factors as a Planning Tool*

This section will consider whether the MFW factors are an efficient planning tool for all conflicted controller transactions.

### a. The MFW Factors Are an Efficient Tool

Many Delaware courts, legal scholars, and practitioners argue that the MFW factors should apply to all conflicted controller transactions because the factors provide a clear roadmap for transactional planners.<sup>247</sup> The MFW factors lay out a guide for controllers to follow in order to (1) seek value creating transactions without risk of high litigation costs and (2) earn business judgment rule deference from the courts. These two arguments will be discussed in turn.

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242. *See id.*

243. *Id.* at 644–45.

244. *Id.* at 644.

245. Hamermesh et al., *supra* note 14, at 337–38 n.74.

246. *MFW*, 88 A.3d at 644; Hamermesh et al., *supra* note 14, at 337–38 n.74. The statutory safe harbor created by section 144 of the DGCL does not have a controlling stockholder equivalent. *See id.* at 340–41.

247. *See e.g.*, Merken, *supra* note 25, at 31.

First, the *MFW* framework encourages controllers to engage in value-creating transactions because the factors minimize the risk of high litigation costs. The factors provide “transactional planners with a basis to structure transactions from the beginning in a manner that, if properly implemented,” could obtain a dismissal on the complaint.<sup>248</sup> This increased chance of dismissal means that the *MFW* factors have the potential to alleviate substantial discovery and trial costs for controllers.<sup>249</sup> Therefore, the factors encourage controllers to engage in value-creating transactions—that might otherwise be deterred by substantial litigation risk—because the *MFW* factors decrease the risk of high litigation costs.<sup>250</sup>

Additionally, once a controller engages in a value creating transaction, more value will likely remain in the company—and in both the hands of the controlling and minority stockholders—because there is less risk that the company’s resources will be spent on substantial discovery and trial costs associated with duty of loyalty claims.<sup>251</sup>

Second, the *MFW* framework enables the courts to defer to the judgment of impartial directors and unconflicted stockholders consistent with principles of Delaware law.<sup>252</sup> In many cases, Chancery judges are hesitant to second guess business decisions and “may be institutionally inclined to avoid it wherever they can do so responsibly.”<sup>253</sup> Delaware courts must second guess business decisions to protect minority stockholders once the entire fairness framework is triggered by a loyalty concern.<sup>254</sup> However, when all six *MFW* factors are deployed in conflicted controller transactions, Delaware courts can responsibly grant business judgment rule deference because they trust that use of the factors adequately protects minority stockholders.<sup>255</sup> As long as these procedural protections are in place, the court will not “substitute its own law-trained business judgment for that of informed, disinterested persons.”<sup>256</sup> For

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248. *Id.*; *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 646 (Del. Ch. 2005).

249. Subramanian, *supra* note 49, at 45.

250. *See id.* at 23.

251. *See id.*

252. *See Cox*, 879 A.2d at 646.

253. Subramanian, *supra* note 49, at 23 (quoting WILLIAM T. ALLEN & REINER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 312 (2003)).

254. *See supra* Section I.A.2.

255. *See MFW*, 88 A.3d.

256. Hamermesh et al., *supra* note 14, at 342 n.99.

these reasons, the MFW factors are an efficient transactional tool for all conflicted controller transactions.

b. The MFW Factors Are Not an Efficient Tool

Conversely, some legal scholars and practitioners argue that the MFW factors are an inefficient tool for conflicted controller transactions other than squeeze out mergers.<sup>257</sup> HJS argue that expansion of the MFW factors to all conflicted controller transactions “will not generate systemic value for diversified stockholders” and instead, this expansion would “result in excessive transaction costs, increased [director] & [officer] insurance costs, and contrived settlements designed only to avoid the costs of discovery.”<sup>258</sup> As a result, controllers are likely to engage in fewer value-creating transactions for fear of massive transactional and litigation costs.<sup>259</sup>

Further, HJS argue that the MFW factors are not helpful outside of the squeeze out merger context because the MFW factors are not necessary to earn business judgment rule deference.<sup>260</sup> Many Delaware decisions have questioned “whether the full entire fairness framework applies outside of squeeze[]out mergers involving a controlling stockholder.”<sup>261</sup> In *In re MFW*, the court even reiterated that “[o]utside the

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257. *See id.* at 344.

258. *Id.*

259. *See id.*

260. *See id.* at 340.

261. *In re EZCORP Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at \*16 n.6 (Del. Ch. Jan. 25, 2016); *see In re MFW S’holders Litig.*, 67 A.3d 496, 526–27 (Del. Ch. 2013), *aff’d sub nom.*, *MFW*, 88 A.3d.

Outside the controlling stockholder merger context, it has long been the law that even when a transaction is an interested one but not requiring a stockholder vote, Delaware law has invoked the protections of the business judgment rule when the transaction was approved by disinterested directors acting with due care.

*Id.*; *see also e.g.*, *Teachers’ Ret. Sys. of La. v. Aidinoff*, 900 A.2d 654, 669 n.19 (Del. Ch. 2006) (commenting that the extent to which “a line of decisions that focus on conflicted mergers with controlling stockholders . . . applies outside that context is an ongoing subject of debate”); *Orman v. Cullman*, 794 A.2d 5, 21 (Del. Ch. 2002) (“Recognizing the practical implications of the automatic requirement of an entire fairness review has led our Supreme Court to limit such automatic requirement to the

controlling stockholder merger context, it has long been the law that even when a transaction is an interested one but not requiring a stockholder vote, Delaware law has invoked the protections of the business judgment rule when the transaction was approved by disinterested directors acting with due care.”<sup>262</sup> The kind of excessive fairness review necessitated by expansion of the MFW factors would “impose a toll on innovation, flexibility, and the cost of capital by facilitating rent-seeking in situations when sufficient, intra-corporate guarantees of fairness have been employed.”<sup>263</sup>

*MFW* should be seen as designing a bespoke solution for squeeze out mergers after the *Lynch* line of cases and “not as prescribing a rigid set of procedures applicable to any transaction between a controlling stockholder and a company.”<sup>264</sup> Neither the Delaware legislature nor the Delaware courts have declared a policy goal of subjecting all conflicted controller transactions “to first pass through dual procedural protections.”<sup>265</sup> Therefore, the MFW factors are not an efficient tool for conflicted controller transactions because they are burdensome to implement and wholly unnecessary for transactions that do not require a stockholder vote under the DGCL.<sup>266</sup>

### III. MFW SHOULD BE READ BROADLY TO APPLY TO ALL CONFLICTED CONTROLLER TRANSACTIONS

Part III will argue that the Delaware Supreme Court should read *MFW* broadly to offer a safe harbor for all types of conflicted controller transactions. Part A will explain why the Delaware Supreme Court should clarify the reach of *MFW*. Part B will propose that the MFW factors should be read broadly to apply as a safe harbor in all conflicted controller transactions, and Part C will apply the MFW factors to a few categories of conflicted controller transactions.

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narrow class of cases in which there is a controlling shareholder on both sides of a challenged merger.”).

262. *In re MFW S'holders Litig.*, 67 A.3d.

263. Hamermesh et al., *supra* note 14, at 344.

264. *Id.* at 343.

265. Lackey, *supra* note 96.

266. See Hamermesh et al., *supra* note 14, at 344.

## A. THE DELAWARE SUPREME COURT SHOULD CLARIFY MFW'S REACH

Although some Delaware courts have already granted business judgment rule deference based on application of the MFW factors in conflicted controller transactions other than squeeze out mergers, the Delaware Supreme Court has not yet confirmed the legitimacy of this MFW Creep.<sup>267</sup> The Delaware Supreme Court must speak on this issue to resolve this uncertainty and create reliable expectations for the courts, controllers, and minority stockholders.

The Delaware Supreme Court must define the reach of *MFW* to confirm whether the MFW factors are a safe harbor for all types of controller self-dealing. Currently, there is no safe harbor available for controller self-dealing other than the MFW factors,<sup>268</sup> but it is unclear whether this safe harbor applies to all conflicted controller transactions or just squeeze out mergers. HJS argue that according to Delaware law, use of just one of the traditional cleansing techniques—either disinterested director approval or a MOM vote—in conflicted transactions where no statutory vote is required should grant business judgment rule deference.<sup>269</sup> However, most Delaware courts have held that all transactions with conflicted controllers must be reviewed for entire fairness “even if the transaction was negotiated by independent directors or approved by the minority stockholders.”<sup>270</sup> Therefore, the MFW factors safe harbor is the only safe harbor potentially available for conflicted controller transactions subject to the entire fairness framework.

Currently, Delaware courts are unsure whether deployment of the six MFW factors in conflicted controller transactions other than squeeze out mergers (1) qualifies as a safe harbor where the court should grant judicial

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267. *Id.* at 340.

268. *MFW* is the only safe harbor that earns business judgment rule deference; controllers can shift the entire fairness burden to plaintiffs by getting approval from either a special committee or a MOM vote, but shifting the burden does not create a complete safe harbor. *See Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1111–12 (Del. 1994).

269. Hamermesh et al., *supra* note 14, at 340.

270. *Tornetta v. Musk*, 250 A.3d 793, 800 (Del. Ch. 2019) (quoting Strine, Jr., *supra* note 16, at 678); *see Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 900 (Del. Ch. 1999) (stating “it appears that a corporation with a controlling or majority stockholder may, under current Delaware law, never escape the exacting entire fairness standard”); *see also Lynch*, 638 A.2d at 1116–17. This determination would not change even if the majority of the board was independent from the controlling shareholder. *See Emerald Partners v. Berlin*, 787 A.2d 85, 96–97 (Del. 2001).

deference under the business judgment rule or (2) does not qualify as a safe harbor where the court should instead inquire into fair process and fair price. The choice between these two options significantly impacts the amount of judicial deference granted and resources required to police business decisions.<sup>271</sup> This current confusion must be resolved to clarify the role of Delaware courts in reviewing conflicted controller transactions other than squeeze out mergers that have complied with the MFW factors.

The contours of the *MFW* safe harbor must also be clarified to create incentives for controlling stockholders contemplating conflicted transactions to protect minority stockholders through use of the MFW factors. Because deployment of all six factors is burdensome for controllers, controllers will only implement the factors—and create a transaction most protective for minority stockholders—if the controller is certain that they will receive business judgment rule deference for their efforts.<sup>272</sup> Additionally, the standard earned by use of the MFW factors must be defined to create expectations for minority stockholders considering a challenge to a conflicted controller transaction.<sup>273</sup> For these reasons, the Delaware Supreme Court should speak on the legitimacy of MFW Creep.

#### B. MFW SHOULD BE APPLIED AS A UNIFORM STANDARD

*MFW* should be applied as a uniform standard for all conflicted controller transactions because the MFW factors effectively neutralize the loyalty concerns present in conflicted controller transactions. All the conflicted controller transactions should be treated equally regardless of a stockholder vote requirement under the DGCL, and the Delaware Chancery court has already endorsed expansion of *MFW* through MFW Creep. These arguments will be addressed in turn.

The MFW factors are an effective substitute for entire fairness review in squeeze out mergers because the six MFW factors work together to provide the strongest protection for minority stockholders.<sup>274</sup> Each category of factors—the ab initio timing requirement, the special committee requirements, and the MOM vote requirements—offers a distinct aspect of protection to the minority stockholders. When these three categories of protections are combined in the structure of a

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271. See *Lynch*, 638 A.2d at 1116.

272. See *Merken*, *supra* note 25, at 31.

273. See *id.*

274. See *MFW*, 88 A.3d at 644.

conflicted controller transaction, courts can grant deference under the business judgment rule because the factors protect minority stockholders just as well as the fair process and fair price inquiry.<sup>275</sup>

The MFW factors should apply to all conflicted controller transactions regardless of statutory vote requirements. There should be no distinction under *MFW* between conflicted controller transactions that do and do not require a statutory vote. Under current law, the presence of a statutory vote requirement has no impact on a controller's duty of loyalty, nor on a court's analysis under the entire fairness framework of that duty of loyalty.<sup>276</sup> Although HJS argue that "where no stockholder vote is required, MFW's procedures have no fit," HJS do not cite to any caselaw to support this distinction.<sup>277</sup> A "controlling stockholder's potentially coercive influence is no less present, and no less consequential," in transactions that require a statutory vote and transactions that do not.<sup>278</sup> Accordingly, the presence of a statutory vote should have no impact on the application of *MFW*.

Additionally, controllers can achieve the same substance of a conflicted transaction through various procedural processes. If one type of conflicted controller transaction faces a lower standard of review, "then controllers will use that route to move value" away from the minority.<sup>279</sup> For example, if *MFW* only applied to transactions that require a statutory vote, a controller could choose to extract wealth from the controlled company through issuance of a new class of stock rather than a consulting agreement to earn a different standard of review.<sup>280</sup> Therefore, there should be no distinction between these transactions under the MFW factors, so controllers will be incentivized to comply with all the factors in each type of transaction rather than chase a more deferential standard of review.<sup>281</sup>

Further, MFW Creep has shown that the Delaware Chancery Court is willing to expand *MFW*.<sup>282</sup> Although the explicit language of the

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275. *Id.*

276. *Tornetta v. Musk*, 250 A.3d 793, 800 (Del. Ch. 2019) (quoting Strine, Jr., *supra* note 16, at 678).

277. *See Hamermesh et al.*, *supra* note 14, at 343–44.

278. *Musk*, 250 A.3d at 800.

279. *In re EZCORP Inc. Consulting Agreement Derivative Litig.*, No. CV 9962-VCL, 2016 WL 301245, at \*23 (Del. Ch. Jan. 25, 2016).

280. *See id.*

281. *See id.*

282. *See supra* note 14.



decision in *MFW* was limited in application to squeeze out mergers, “that does not mean MFW’s dual protections cannot be potent neutralizers in other applications.”<sup>283</sup> The Chancery Court is an expert in the adjudication of corporate law issues such as duty of loyalty concerns, so expansion of *MFW* by this Delaware court should hold great weight. Many Chancery Court decisions have endorsed the MFW factors as effective in contexts other than squeeze out mergers,<sup>284</sup> and the Delaware Supreme Court should follow in these footsteps to affirm the legitimacy of MFW Creep.

### C. APPLICATION OF THE MFW FACTORS TO OTHER CONFLICTED CONTROLLER TRANSACTIONS

The three categories of transactions previously discussed in Section III.C provide worthwhile cases to understand how the MFW factors would apply in various conflicted controller transactions if MFW was expanded to apply to all types of conflicted controller transactions.<sup>285</sup> The application of the MFW factors to these three categories of transactions will be discussed below.

The MFW factors could easily be integrated into the first two categories of transactions: (1) merger transactions, and (2) other transactions that require a stockholder vote under the DGCL. Due to DGCL statutory merger requirements, these transactions typically already require board and stockholder approval, so they have a large part of the necessary framework in place to meet the MFW factor requirements.<sup>286</sup> Therefore, to meet the *MFW* requirements and earn business judgment deference in these types of transactions when a conflicted controller is present, only two changes to the structure of each type of transaction must be made.

First, to comply with the ab initio requirement, these two types of transactions must be conditioned on the dual approvals before any economic negotiations have taken place. The economic negotiations look different in each of these transactions based on why the controller is conflicted. In one type of merger transaction, called a third-party merger, the controller’s loyalty concern stems from the controller’s receipt of non-pro-rata benefits in side deals related to the third-party merger.<sup>287</sup> In these

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283. *Musk*, 250 A.3d at 800.

284. *See supra* note 14.

285. *See supra* Section III.C.

286. DEL. CODE ANN. tit. 8, §§ 242, 251; *see supra* Section I.A.3.

287. *See infra* Section I.A.1.

third-party mergers, the relevant economic negotiations are the side deals between the third-party proposing the merger and the controller.<sup>288</sup> In other transactions that require a statutory vote such as a charter amendment to reclassify stock, the controller's loyalty concern stems from the reclassification's direct non-pro-rata benefit to the controller, so the relevant economic negotiations are the negotiations related to the reclassification itself.<sup>289</sup>

Although some argue that the Delaware Supreme Court has read this timing requirement too loosely,<sup>290</sup> this requirement does not need to be a bright-line rule in order to effectively disable the controller. The purpose of this timing requirement is to ensure that all actors, including the controller, are aware that both the special committee and the minority stockholders have final say on whether the transaction together with the non-pro-rata benefits will be approved before any economic terms are negotiated.<sup>291</sup> Delaware courts, as expert corporate law adjudicators, have determined that dual protections are effective as long as they have been put in place before the start of any economic negotiations.<sup>292</sup> Therefore, the *MFW* ab initio requirement in these first two types of transactions will be met if the dual procedural protections are solidified in the transactional structure prior to the start of any economic negotiations.

Second, the thresholds of both the board and stockholder approval must be raised to target the controller's influence at both the board and stockholder level. The board approval requirement must be raised to approval by an independent and empowered special committee comprised of board members meeting their duty of care, and the stockholder vote requirement must be raised to an informed and uncoerced MOM vote. Raising these approval thresholds will filter out the controller's influence at both the board and stockholder level.<sup>293</sup>

While some argue that the special committee and MOM vote requirements do not completely neutralize the controller's loyalty concerns, the transactional structure created by the *MFW* factors protects the minority stockholders just as well as the fair process and fair price

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288. *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at \*18 (Del. Ch. Aug. 18, 2017).

289. *See IRA Tr. FBO Bobbie Ahmed v. Crane*, No. 12742-CB, 2017 WL 7053964, at \*9 (Del. Ch. Jan. 26, 2018).

290. *See infra* Section II.A.2.

291. *See Stewart*, 2017 WL 3568089, at \*19.

292. *See Flood v. Synutra Int'l, Inc.*, 195 A.3d 754, 764 (Del. 2018).

293. *See supra* Section II.A.1.

inquiry.<sup>294</sup> Implementation of these two changes in the structure of mergers and other transactions that require a statutory vote will allow the court to responsibly step back and grant business judgment rule deference despite the presence of a conflicted controller.

The MFW factors could also easily be implemented in transactions, such as compensation agreements, that do not require a statutory vote under the DGCL even though stockholder approval is not statutorily required. To earn business judgment rule deference, a controller must simply follow the transactional roadmap set out in MFW. For example, with compensation agreements, the board must condition the consummation of the compensation agreement *ab initio* on the approval of both (1) an independent and empowered special committee of directors acting with due care and (2) an informed and uncoerced MOM vote.<sup>295</sup> If the MFW roadmap is followed, the court can responsibly grant business judgment rule deference.

Even though some argue that the MFW factors are excessive for conflicted controller transactions that do not require a statutory vote, the MFW factors are still an efficient planning tool.<sup>296</sup> Without the MFW factors, conflicted controllers would be burdened with showing the entire fairness of a transaction and courts would be required to substitute their judgment for the business judgment of the corporate actors. However, whenever the MFW transactional roadmap is followed, controllers can obtain dismissal on the complaint, and courts can defer to the judgment of impartial directors and unconflicted stockholders. Overall, the MFW factors protect all stockholders proactively while the entire fairness standard can only hold a controller responsible once a wronged stockholder deploys substantial resources to challenge the fairness of the controller's actions.

## CONCLUSION

In *MFW*, the Delaware Supreme Court developed the MFW factors as a safe harbor for conflicted controllers in squeeze out mergers.<sup>297</sup> The Court reasoned that the MFW factors' dual procedural protections address a controller's potentially undermining influence by creating "a countervailing, offsetting influence of equal—if not greater—force," and

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294. *See id.*

295. *Tornetta v. Musk*, 250 A.3d 793, 800 (Del. Ch. 2019).

296. *See supra* Section II.B.2.i.

297. *MFW*, 88 A.3d at 644.

therefore, use of all six factors could allow the Court to responsibly grant business judgment rule deference.<sup>298</sup> Following *MFW*, the Delaware Chancery Court has expanded the MFW factors to address a controller's potentially undermining influence in other types of conflicted controller transactions.<sup>299</sup>

Although the legitimacy of this MFW Creep remains uncertain, the scope of the MFW factors must be clarified to provide expectations for stockholders and the courts. Currently, controllers do not know the impact of implementing the factors, and courts do not know how to treat conflicted controller transactions other than squeeze out mergers that have implemented all six factors.<sup>300</sup> While the MFW factors were developed in the context of squeeze out mergers specifically, the factors effectively protect stockholders in all conflicted controller transactions because they target the loyalty concerns present in all conflicted controller transactions.<sup>301</sup> Therefore, the MFW factors should be expanded to protect minority stockholders in all transactions where a conflicted controller is present.

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298. *Id.*

299. *See supra* Section I.A.3.

300. *See supra* Section III.A.

301. *See supra* Section II.B.1.