SIMPSON THACHER

SECURITIES LAW ALERT

JUNE 2013

This month's Alert addresses a First Circuit decision reinstating a securities fraud action against CVS Caremark Corporation and holding that a corrective disclosure does not have to mirror the original misrepresentation for loss causation purposes. We also discuss a Ninth Circuit decision finding that the presumption of prudence does not apply in an ERISA action against Amgen, and reversing the district court's dismissal of the complaint.

In addition, we address a Southern District of New York opinion relying on the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010) to deny Fabrice Tourre's motion for summary judgment on the SEC's Section 17(a) claims against him.

Finally, we discuss a Delaware Chancery Court decision holding that the business judgment rule standard of review applies to a controlling stockholder transaction conditioned on approval by both a special committee and a majority-of-the-minority vote.

Reminder Regarding Our Annual CLE Program

On Monday, June 24th at 4:00 p.m., we will host our annual CLE panel discussion on recent decisions, emerging trends and breaking developments in securities and corporate litigation. Cocktails to follow. Please RSVP for this event by contacting Emma Rotenberg at erotenberg@stblaw.com or 212-455-3529.

First Circuit Vacates Dismissal of Securities Fraud Action against CVS Caremark, Holding That a Corrective Disclosure Does Not Have to Mirror the Original Misrepresentation for Loss Causation Purposes

On May 24, 2013, the First Circuit vacated dismissal of a securities fraud action against CVS Caremark Corporation and certain of its current and former executives in connection with the merger of CVS Corp. and Caremark Rx. *Mass. Ret. Sys. v. CVS Caremark Corp.*, 2013 WL 2278599 (1st Cir. May 24, 2013) (Howard, J.). The First Circuit held that in order to allege loss causation, plaintiffs need not identify a corrective disclosure that is the "mirror-image" of the alleged misrepresentation. The First Circuit further ruled that if the alleged corrective disclosure does not directly acknowledge a prior misrepresentation,

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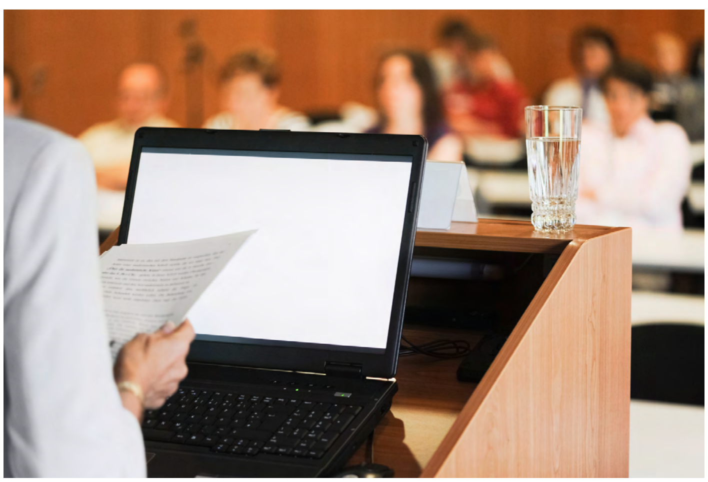
then courts may consider the market's response when determining whether the statement at issue amounted to a corrective disclosure.

Background

In November 2006, CVS and Caremark announced their planned merger. CVS was, at the time, the biggest retail pharmacy chain in the country. Caremark was the second-largest prescription benefits manager ("PBM") in the country. From the outset, CVS President and CEO Thomas M. Ryan "recognized that the combined company's success would depend on its ability to deliver quality service," which in turn would depend on the integration of the CVS and Caremark computer systems. In March 2007, the merger was completed. Ryan became the President and CEO of the combined entity.



In November 2007, Ryan stated that he was "pleased" that the company had "completed the integration of both the organization and back end systems quickly and successfully." In October 2008, Ryan acknowledged that CVS Caremark had lost a number of significant accounts, but anticipated that the company would "continue to gain [market] share because" the company provided "excellent service."

In January 2009, Ryan announced that CVS Caremark had "repriced a significant amount of business." Responding to analyst concerns, Ryan stated that there was no "hidden agenda here about giving a lower price because of lack of service." He also said that the company's systems were "able to talk to each other."

In August 2009, Ryan expressed his expectation that the company would enjoy earnings per share growth of at least 13% to 15% in 2010. However, on November 5, 2009, Ryan acknowledged that the company had suffered "some big client losses" worth a total of $4.5 billion in business. He downwardly revised the company's earlier earnings forecast, noting that the company had "lost more PBM business than … expected." Ryan insisted that none of the business was lost due to client dissatisfaction with the combined pharmacy-PBM model. However, he did acknowledge that one of the "varying reasons" for the loss of business was "service." Specifically, he stated that "[t]here were some service issues" that led to the loss of CVS Caremark's Medicare Part D business with Coventry, a major client. On the day of Ryan's announcement, the price of CVS Caremark shares closed 20% lower than the previous day.

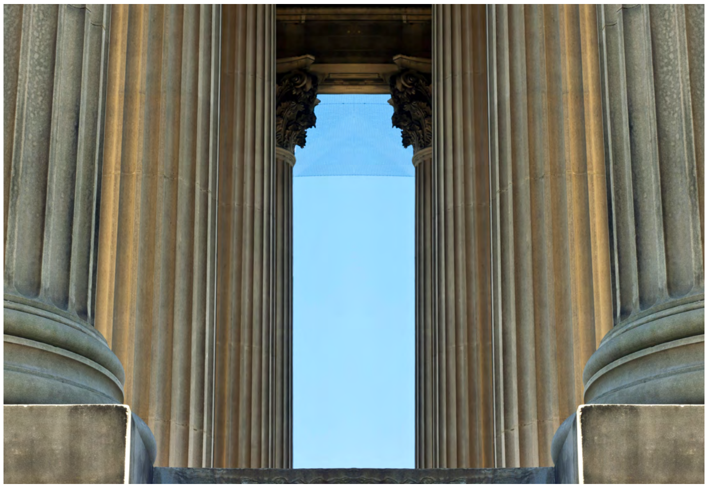
Plaintiffs subsequently brought suit against CVS Caremark, Ryan, the company's then-chief financial officer, and the former president of the company's pharmacy services division, alleging claims under Section 10(b), Section 20(a), and Rule 10b-5. Plaintiffs claimed that defendants had made material misrepresentations regarding the successful post-merger integration of CVS and Caremark. Defendants moved to dismiss.

District of Rhode Island Dismisses Complaint for Failure to Allege Loss Causation

On June 14, 2012, the District of Rhode Island granted defendants' motion to dismiss on the grounds that plaintiffs had "not plausibly alleged loss causation except as to the earnings projection" made by Ryan in August 2009. *City of Brockton Ret. Sys. v. CVS Caremark Corp.*, slip op. (D.R.I. Jun. 14, 2012) (Laplante, J.). The court further found that plaintiffs could not "premise their claim on the [earnings] projection because it [was] shielded by the statutory safe harbor" established by the Private Securities Litigation Reform Act.

Plaintiffs claimed that Ryan's statements on November 5, 2009 disclosed "the truth about [CVS Caremark's] failure to integrate the merged-entity, which resulted in the loss of billions of dollars in PBM contracts, and that the CVS Caremark retail-PBM model had failed to gain acceptance in the marketplace." However, the court found that "Ryan's remarks during the call did not, either on their face or [based on] any plausible construction, constitute a disclosure of his company's 'failure to integrate the merged entity' or its 'fail[ure] to gain acceptance in the marketplace.'"

In defense of their loss causation theory, plaintiffs pointed to analyst reports published following Ryan's November 2009 call stating that the "'Caremark merger is clearly not working,' that CVS Caremark had 'provided undeniable evidence … that it had mismanaged the Caremark acquisition,' … and the like." The court found that "these analysts' remarks, harsh as they were," could not "serve to alter the nature of what Ryan [had] actually said during the November 5 earnings call" and therefore did not "lend the requisite plausibility to [plaintiffs'] loss causation theory."



Finally, the court found that Ryan's discussion of the loss of key CVS Caremark accounts did not constitute a corrective disclosure "because the loss of each of these contracts had been disclosed several months prior." Plaintiffs appealed.

First Circuit Finds Ryan's Statements, When Viewed as a Whole, Constituted Corrective Disclosures

On appeal, the First Circuit held that "a corrective disclosure need not be a 'mirror-image' disclosure—a direct admission that a previous statement [was] untrue." While a "corrective disclosure must relate to the same subject matter as the alleged misrepresentation," "a defendant's failure to admit to making a misrepresentation, or his denial that a misrepresentation was made, does not necessarily preclude loss causation."

The First Circuit determined that "the appropriate inquiry [was] whether the November 5 call, as a whole, plausibly revealed to the market that CVS Caremark had problems with service and the integration of its systems." The court found that several "aspects of the call len[t] plausibility to this theory of loss causation." Among these was the fact that "Ryan disclosed for the first time that 'service issues' had led to the loss of the Coventry contract." Plaintiffs interpreted this statement as "an admission that the failed integration of CVS Caremark was responsible for the loss of a major client." The First Circuit agreed that "the market could plausibly have drawn this conclusion" given that "analysts had questioned CVS's ability to integrate with Caremark" from the outset.

Moreover, the First Circuit found "the alarm of the market following disclosure of the magnitude of CVS Caremark's lost business likely reflected an understanding that something systemic had gone wrong." The court explained that "[t]he only systemic failure likely to produce these numbers and reactions was a failure to integrate the PBM systems." While the market may not have "perceive[d] every detail of CVS Caremark's struggles," "it knew enough to drive down the price of CVS Caremark shares by 20%."

Finally, although CVS Caremark's loss of several key clients "was public knowledge well before the November 5 call," the First Circuit found that plaintiffs' allegations went "beyond the mere loss of these contracts." Plaintiffs claimed that "during the November 5 call, the market learned for the first time the real reason for the loss: the failed integration of CVS and Caremark." The First Circuit determined that "[d]espite the earlier disclosure of CVS Caremark's lost contracts, this new information could plausibly have caused the Retirement Systems' losses."

First Circuit Holds Courts May Consider the Market's Response to Alleged Corrective Disclosures That Do Not Admit Earlier Misrepresentations

The First Circuit further ruled that "the analyst reports should have been considered in deciding the motion to dismiss." The court explained that "[w]hen a plaintiff alleges corrective disclosures that are not straightforward admissions of a defendant's previous misrepresentations, it is appropriate to look for indications of the market's contemporaneous response to those statements." If a plaintiff is not permitted to "rely[ ] on analyst reports that expose the limitations of a defendant's statements," then a defendant could "'defeat liability by refusing to admit the falsity of its prior misstatements.'"

While acknowledging that "Ryan did not admit on the November 5 call that he had misrepresented the success of the merger," the First Circuit found that "various aspects of the call, taken together, plausibly could have alerted the market that the merger had been unsuccessful." The First Circuit determined that "the contemporaneous analyst reports could have represented the market's understanding that the PBM business's poor performance was not a mere stumble but a signal that the merger had failed to produce any value for CVS Caremark."

The First Circuit vacated the district court's dismissal of the complaint and remanded the case.

Ninth Circuit Reinstates ERISA Action against Amgen, Finding Presumption of Prudence Does Not Apply

On June 4, 2013, the Ninth Circuit reversed dismissal of an ERISA action brought by participants in the Amgen Retirement and Savings Plan and the Retirement and Savings Plan for Amgen Manufacturing, Limited (together, the "Plans"). *Harris v. Amgen, Inc.*, 2013 WL 2397404 (9th Cir. Jun. 4, 2013) (Fletcher, J.). The Ninth Circuit found that the Plans did not require or encourage the fiduciaries to invest primarily in Amgen stock. The court therefore held that the presumption of prudence set forth by the Third Circuit in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), and later adopted by the Ninth Circuit in *Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010), did not apply.

Background

Amgen is a leading biotechnology company; Amgen Manufacturing, Limited ("AML") is one of its subsidiaries.

Amgen "commercialized the manufacture of a class of drugs known as erythropoiesis-stimulating agents ('ESAs') to treat anemia." Amgen marketed two different ESAs, Aranesp and Epogen, both of which were commercial successes. In 2006, sales of Aranesp and Epogen accounted for "roughly half of Amgen's $14.3 billion in revenue."

Beginning in the late 1990s, "several clinical trials raised safety concerns regarding the use of ESAs for particular anemic populations." In May 2004, during a meeting of the Oncology Drug Advisory Committee ("ODAC"), the Food & Drug Administration ("FDA") "urged Amgen to conduct further clinical trials to test the safety of ESAs for uses that had already been approved by the FDA." Amgen represented that it had "five ongoing or planned clinical trials testing Aranesp."

One of Amgen's clinical trials (the "DAHANCA trial") was temporarily halted in October 2006, and permanently terminated in December 2006, based on findings that patients who took Aranesp experienced worsened tumor growth. "Another clinical trial, CHOIR, raised additional safety concerns about ESAs."

On November 20, 2006, Amgen issued a public statement defending the safety of Epogen and Aranesp. Two weeks later, Amgen issued a press release to address what it claimed were "misleading and inaccurate news reports regarding" Epogen and Aranesp. Over the next several months, Amgen continued to make reassuring statements regarding the safety and effectiveness of the two drugs.

At the same time, the company "engaged in extensive marketing, encouraging both on- and off-label uses of its ESAs." These efforts yielded results: "Amgen's worldwide sales of Aranesp increased fourteen percent during the first quarter of 2007 compared to the same quarter in 2006."

In February 2007, *The Cancer Letter* reported that Amgen had failed to disclose that the DAHANCA trial had been suspended due to negative outcomes. Later that month, *The New York Times* published an article reporting that new studies were "raising questions about whether [ESAs] that have been used by millions of cancer patients might actually be harming them." The *Times* article noted that "the new results suggest[ed] that the drugs may make the cancer itself worse."

On March 9, 2007, the FDA "mandated a 'black box' warning for off-label use of Aranesp and Epogen." The warning stated that recent studies showed various adverse consequences associated with the use of these medications, such as "an increased risk of death, blood clots, strokes, and heart attacks in patients with kidney failure where ESAs were given at higher than recommended doses."

On March 21, 2007, two House of Representatives subcommittees commenced an investigation into "the safety profile of Aranesp and Epogen as well as into Amgen's off-label marketing practices." On May 8, 2007, the FDA stated on its website that the two drugs "'were clearly demonstrated to be unacceptable' in high doses." On May 10, 2007, ODAC "voted to restrict the use of ESAs, to expand existing warnings, and to require ESA manufacturers to conduct further studies."

"Between September 19, 2005," when Amgen common stock was at a high of $86.17, "and the ODAC vote, the price of Amgen stock dropped $28.83, or thirty-three percent." Investors in the Amgen Plan and the AML Plan brought suit alleging breach of fiduciary duty claims under ERISA against Amgen,

AML, nine of Amgen's directors, and the Plans' Fiduciary Committees and their members. "All of the plaintiffs' [eligible individual account plans ('EIAPs')] included holdings in the Amgen Common Stock Fund, … [which] held only Amgen common stock." In March 2010, the Central District of California dismissed the complaint in its entirety, finding that plaintiffs had (1) failed to allege that Amgen was a fiduciary and (2) failed to state a claim as to the remaining defendants. Defendants appealed.

The Central District of California declined to dismiss a separate class action alleging violations of the federal securities laws based on the same allegations at issue in the ERISA action. The court later granted plaintiffs' motion for class certification, and the Supreme Court ultimately affirmed the district court's class certification order in *Amgen, Inc. v. Connecticut Retirement Plans & Trust Funds*, 133 S. Ct. 1184 (2013).

Ninth Circuit Finds the *Moench* Presumption of Prudence Does Not Apply Because the Plans Did Not "Require or Encourage" the Fiduciaries to Invest Primarily in Amgen Stock

Under the *Moench* presumption, "an [employee stock ownership plan] fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." *Moench*, 62 F.3d 553. In *Quan*, the Ninth Circuit held that the presumption of prudence only applies "when plan terms require or encourage the fiduciary to invest primarily in employer stock." *Quan*, 623 F.3d 870.

The parties agreed that the key issue before the Ninth Circuit was "whether the [Amgen and AML] Plans 'required or encouraged' the fiduciaries to invest in Amgen stock." "To answer that question," the Ninth Circuit considered "the written terms of the Plans." The

court concluded that "[t]here is no language in the Plans requiring that a Company Stock Fund be established as an available investment for plan participants." The court further determined that there is no "language in the Plans requiring that a Company Stock Fund, once established, be continued as an available investment."

Defendants argued that "the Plans specifically refer to a Company Stock Fund as a permissible investment." However, the Ninth Circuit held that "an explicit statement that plan fiduciaries *may* offer a Company Stock Fund as an investment to participants does not tell us that they were encouraged to do so within the meaning of the presumption of prudence." The Ninth Circuit found that in *Taveras v. UBS AG*, 708 F.3d 436 (2d Cir. 2013), the Second Circuit "concluded that almost identical plan language [did] not give rise to the presumption of prudence." The Second Circuit explained that:

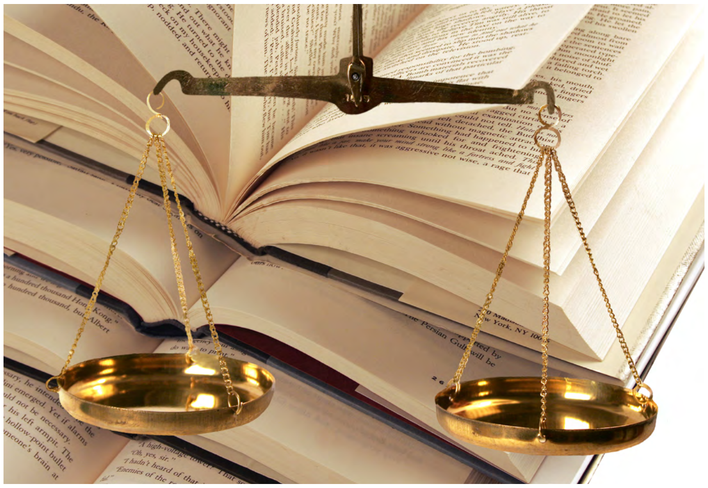
> If the presumption of prudence was triggered in every instance where the EIAP plan document, as here, simply (1) named and defined the employer's stock in the plan document's terms, and (2) allowed for the employer stock to be offered by the plan's fiduciaries on a discretionary basis to plan participants, then we are hard pressed to imagine that there exists *any* EIAP that merely offered the option to participants to invest in their employer's stock

whose fiduciaries would not be entitled to the presumption of prudence.

The Ninth Circuit "conclude[d] that defendants were neither required nor encouraged by the terms of the Plans to invest in Amgen stock," and therefore held that they were "not entitled to a presumption of prudence." The court ruled that "[t]he normal prudent man standard therefore applies to defendants' investment decisions as fiduciaries under the Plans."

Ninth Circuit Applies Prudent Man Standard of Care and Finds Plaintiffs Adequately Alleged Breaches of Fiduciary Duty

Under ERISA's prudent man standard of care, a fiduciary is required to "discharge his duties … with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." 28 U.S.C. § 1104(a)(1)(B). In *Quan*, the Ninth Circuit observed that "[a] court's task in evaluating a fiduciary's compliance with this standard is to inquire whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment."



Plaintiffs contended that defendants had violated their fiduciary duty of care insofar as they "knew or should have known about material omissions and misrepresentations, as well as illegal off-label sales, that artificially inflated the price of the stock while, at the same time, they continued to offer the Amgen Common Stock Fund as an investment alternative to plan participants." The Ninth Circuit determined that "none" of the defendants' various arguments "in favor of dismissal … [was] persuasive."

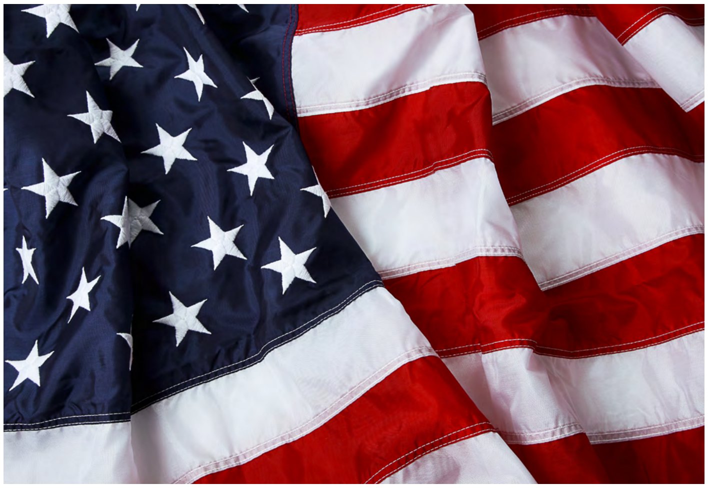
The Ninth Circuit found that "[i]f the alleged misrepresentations and omissions, scienter, and resulting decline in share price in *Connecticut Retirement Plans* were sufficient to state a claim that defendants [had] violated their duties under Section 10(b), the alleged misrepresentations and omissions, scienter, and resulting decline in share price in this case [were also] sufficient to state a claim that defendants [had] violated their more stringent duty of care under ERISA." The court explained that "[i]f defendants had revealed material information in a timely fashion to the general public (including plan participants), thereby allowing informed plan participants to decide whether to invest in the Amgen Common Stock Fund, they would have simultaneously satisfied their duties under both the securities laws and ERISA."

Ninth Circuit Finds Complaint Adequately Alleges Amgen's Status as a Fiduciary

The Ninth Circuit rejected Amgen's contention that it was "not a fiduciary under the Plan because it ha[d] delegated its discretionary authority … to trustees and investment managers." While the Amgen Plan "authorizes the Fiduciary Committee to act on behalf of Amgen," the court found that it "neither provides exclusive authority to the Committee, nor precludes Amgen from acting on its own behalf." Because "ERISA allows fiduciaries to have overlapping responsibilities under a plan, a clear grant of exclusive authority is necessary for proper delegation by a fiduciary." Here, the Ninth Circuit found "no clear delegation of exclusive authority" and therefore "reverse[d] the district court's dismissal of Amgen from the case as a non-fiduciary."

Southern District of New York Relies on *Morrison* to Deny Fabrice Tourre's Motion for Summary Judgment on the SEC's Section 17(a) Claims

On June 4, 2013, the Southern District of New York denied Fabrice Tourre's motion for summary judgment on the SEC's Section 17(a) claims against him. *SEC v. Tourre*, 2013 WL 2407172 (S.D.N.Y. June 4, 2013) (Forrest, J.). The court considered the question of "how to apply" the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010) to "claims under Section 17(a) of the Securities Act." The court held that "for claims of fraud 'in the offer' of securities, Section 17(a) … requires [only] that the relevant offer of securities be made in the United States."



Background

The SEC brought suit against Fabrice Tourre, a former vice president at Goldman Sachs & Co., alleging "various misstatements and omissions concerning the role of Paulson & Co., Inc. … in structuring" a collateralized debt obligation known as ABACUS 2007-AC1 ("AC1"). While "Paulson helped to select the assets that would determine AC1's value, it also shorted $1 billion of those assets through credit default swaps." The SEC alleged claims under Section 17(a) of the Securities Act, as well as claims under Section 10(b) of the Exchange Act and Rule 10b-5.

Under Section 17(a), the SEC may bring claims alleging fraud in connection with "the offer or sale of any securities." 15 U.S.C. § 77q(a). The SEC must "prove that a defendant: (1) committed a fraudulent act; (2) that was material; (3) in the offer or sale of a security or security-based swap agreement; (4) through the use of any means or instruments of interstate commerce; and, with certain exceptions, (5) with the requisite scienter." *Tourre*, 2013 WL 2407172.

With respect to "conduct that predates the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC must also prove that the fraud [was] domestic for purposes of *Morrison*."[1] In *Morrison*, the Supreme Court held that Section 10(b) only applies to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Morrison*, 130 S. Ct. 2869.

Tourre moved for summary judgment on the SEC's Section 17(a) claims insofar as the SEC "allege[d] fraud in 'offers' made to IKB Deutsche Industriebank AG ('IKB') [and] ABN AMRO Bank N.V. ('ABN')" because

1. The court observed that "the Dodd-Frank Act effectively reversed *Morrison* in the context of SEC enforcement actions."

the ultimate sale of interests in AC1 to IKB and ABN took place overseas. He claimed that "if [a] sale is not domestic, neither the sale nor the offer is actionable under *Morrison*." He further contended that "an offer is actionable if and only if it is both domestic and ultimately unconsummated."

The Southern District of New York Finds Section 17(a) Reaches Any Offer Made in the United States, Even if the Transaction Took Place Overseas or Was Never Consummated

"The primary question of law that the parties dispute[d]" here was "what it mean[t] for fraud made 'in the offer' of securities to be domestic for purposes of Section 17(a) and *Morrison*."

The court began its analysis with the text of Section 17(a), which "extends beyond consummated transactions" to encompass fraud in "connection with 'the offer or sale of any securities.'" Unlike Section 10(b), "Section 17(a) is not exclusively concerned with fraudulent conduct in connection with a transaction in securities, but rather is concerned with such conduct in either the offer or the sale of securities." The court determined that "the requirement of domestic conduct under Section 17(a) must be extended accordingly" to reach any "domestic offer … regardless of whether it results in a sale." In the court's view, "[t]his interpretation both provides the consistency and predictability sought by the *Morrison* [C]ourt and hews to the statutory text" of Section 17(a).

The court held that Section 17(a) also reaches domestic offers that ultimately result in foreign securities transactions. The court explained that it would "def[y] reason to adopt a construction of Section 17(a) that could permit the SEC to prove that each and every element of its claim occurred—and occurred in the United States—only to require dismissal because a

separate 'sale' took place abroad." "The presumption against extraterritoriality does not require such a result; *Morrison*'s holding does not require such a result; and the Court sees no reason to interpret *Morrison*'s dicta to require it either."

The court next turned to the question of "when an offer is domestic" for purposes of Section 17(a). Tourre argued "that an offer should be considered domestic only if it is made to a person physically located in the United States." The SEC contended that "an offer is domestic if the person who makes the offer engages in the necessary 'offering conduct' in the United States."

Based on the statutory language, the court found that "[a]n offer is domestic if it is made in the United States." The court reasoned that "[t]he statute is not worded as 'to whom' an offer is made, or some other construct." The court found this "focus on the offering party … confirmed by the fact that Section 17(a) does not require proof of reliance or loss and does not provide a private right of action."

The court then applied these principles to the SEC's Section 17(a) claims against Tourre. "[T]o the extent the SEC [sought] to hold Tourre liable for fraudulent conduct in the offer of securities to IKB and ABN," the court determined that the SEC only had to "prove that Tourre [had] engaged in fraudulent conduct in connection with a domestic offer of those securities." "To make that showing," the SEC had to "prove only that the offeror was in the United States at the time he or she made the relevant offer." The court found that the SEC had "satisfied [this] burden" by "cit[ing] to record evidence that would allow a reasonable jury to find that Tourre [had] worked in New York at all relevant times" and had "e-mailed and called both IKB and ABN to discuss possible transactions involving AC1." The court further found that "[a] reasonable jury could conclude that [Tourre's] conduct amounted to an 'offer.'" The court held that "[t]hese materials suffice[d] to defeat summary judgment on the domestic element of the SEC's claims under Section 17(a) for fraud in connection with the offer of securities to IKB and ABN."

Delaware Chancery Court Applies Business Judgment Rule Standard of Review to Controlling Stockholder Merger Transaction

On May 29, 2013, the Delaware Chancery Court addressed "[t]he question of what standard of review should apply to a going private merger conditioned upfront by the controlling stockholder on approval by *both* a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote." *In re MFW S'holders Lit.*, 2013 WL 2436341 (Del. Ch. May 29, 2013) (Strine, C.). The court ruled that the business judgment rule standard of review, rather than the entire fairness standard, applies in such circumstances.

Background

MacAndrews & Forbes ("M&F"), a holding company owned by Ronald Perelman, was the controlling shareholder of M&F Worldwide ("MFW") and owned 43% of MFW's shares. On June 13, 2011, M&F "offered to purchase the rest of the corporation's equity in a going private merger for $24 per share." On June 10, 2011, the last business day before M&F's offer, MFW's shares closed at a price of $16.96.

From the outset, M&F made it clear that "it would not proceed with any going private transaction that was not approved: (i) by an independent special committee; and (ii) by a vote of a majority of the stockholders unaffiliated with the controlling stockholder (who, for simplicity's sake, are termed the 'minority')." MFW's board formed a special committee, which selected its own legal and financial advisors. The special committee met eight times in three months, and negotiated with M&F to obtain a higher price of $25 per share. A majority of the minority of MFW stockholders (65%) approved the transaction, and the merger closed on December 21, 2011.

Shareholders brought suit challenging the merger as unfair. Plaintiffs sought a post-closing damages remedy for breach of fiduciary duty. Defendants moved for summary judgment, arguing that "the merger was conditioned up front on two key procedural protections that, together, replicate[d] an arm's-length merger." Defendants contended that "the judicial standard of review should [therefore] be the business judgment rule," pursuant to which "the court is precluded from inquiring into the substantive

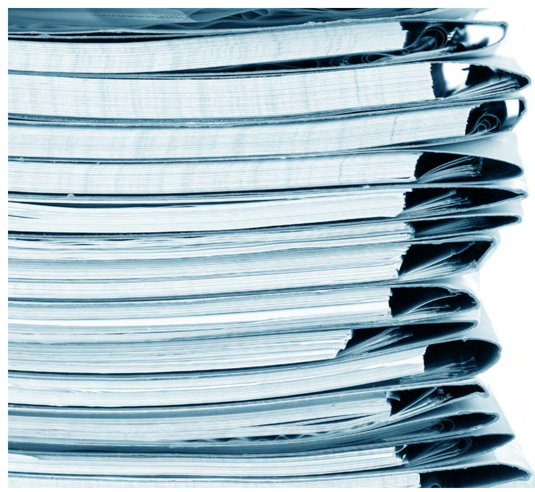
fairness of the merger, and must dismiss the challenge to the merger unless the merger's terms were so disparate that no rational person acting in good faith could have thought the merger was fair to the minority." Under this standard, defendants argued that "summary judgment [was] warranted" "[b]ecause the merger's terms [were] indisputably ones that a rational person could think fair to minority stockholders."

Plaintiffs countered that defendants' use of these procedural protections only shifted the burden of proof under the rigorous entire fairness standard, pursuant to which a court must determine whether the transaction was the result of both fair dealing and fair price.

Chancery Court Finds Business Judgment Rule Standard of Review Applies When a Controlling Stockholder Transaction Is Conditioned on Approval by Both a Special Committee and a Majority-of-the-Minority Vote

The Chancery Court observed that "[t]he question of what standard of review should apply to a going private merger conditioned upfront by the controlling stockholder on approval by *both* a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote has been a subject of debate for decades." The court noted that this was "in part due to uncertainty arising from" the Delaware Supreme Court's decision in *Kahn v. Lynch Communication Systems, Inc.* 638 A.2d 1110 (Del. 1994).

As the Chancery Court explained, the *Lynch* court "held that the approval by *either* a special committee *or* the majority of the noncontrolling stockholders of a merger with a buying controlling stockholder would shift the burden of proof under the entire fairness standard from the defendant to the plaintiff." While "*Lynch* did not involve a merger conditioned by a controlling stockholder on both procedural protections," there were "statements in the decision [that] could be, and were, read as suggesting that a controlling stockholder who consented to both procedural protections for the minority would receive no extra legal credit for doing so." The prevailing interpretation of *Lynch* was that even if a controlling stockholder "employ[ed] both procedural protections, the merger would [still] be subject to review under the entire fairness standard."



The Chancery Court explained that "the incentive to use both procedural devices and thus replicate the key elements of the arm's-length merger process was therefore minimal to downright discouraging." As a result, "the underlying question … [of] the effect on the standard of review of using *both* of these procedural devices" had "never squarely been presented" to a Delaware court.

Before addressing that key question in this case, the Chancery Court first considered whether "the MFW special committee and the majority-of-the-minority vote qualif[ied] as cleansing devices" under Delaware law. With respect to the special committee, the court found "no triable issue of fact regarding (i) the independence of the special committee, (ii) its ability to employ financial and legal advisors and its exercise of that ability, and (iii) its empowerment to negotiate the merger and definitively to say no to the transaction." The Chancery Court determined that there were "no grounds for … plaintiffs to allege that the committee did not fulfill its duty of care." As to the majority-of-the-minority vote, the court noted that plaintiffs had effectively "admit[ted] that it was a fully informed vote" and there was no "evidence of coercion of the electorate."

The Chancery Court then considered whether the Delaware Supreme Court had already opined on this issue. The court found that "[i]n no prior case was [the Delaware] Supreme Court given the chance to determine whether a controlling stockholder merger conditioned on both independent committee approval and a majority-of-the-minority vote should receive the protection of the business judgment rule." Consequently, the Chancery Court concluded that "the question remains an open one for this court to address in the first instance."

Having resolved "these two predicate issues," the court determined that "the business judgment rule standard of review applies" in cases when:

> [A] controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors.

The Chancery Court explained that "[a] transactional structure with both these protections is fundamentally different from one with only one protection." While the establishment of a special committee "ensures … that there is a bargaining agent who can negotiate price and address the collective action problem facing stockholders," "it does not provide stockholders any chance to protect themselves." Conversely, "[a] majority-of-the-minority-vote provides stockholders a chance to vote on a merger proposed by a controller-dominated board, but with no chance to have an independent bargaining agent work on their behalf to negotiate the merger price, and determine whether it is a favorable one that the bargaining agent commends to the minority stockholders for acceptance at a vote." The Chancery Court found that the two protections "are complementary and effective in tandem."

By employing the business judgment rule standard of review for controlling stockholder transactions contingent on both approval by a special committee and a majority-of-the-minority vote, the court found that "an across-the-board incentive would be created to provide minority stockholders with the best procedural protections in all going private transactions." "[A] controlling stockholder would recognize that it would face entire fairness review unless it agreed not to proceed without the approval of an independent negotiator with the power to say no, and without the uncoerced, fully informed consent of a majority of the minority."

The court explained that its "conclusion [was] consistent with the central tradition of Delaware law, which defers to the informed decisions of impartial directors, especially when those decisions have been approved by the disinterested stockholders on full information and without coercion."

Applying the business judgment rule standard of review to M&F's acquisition by merger of MFW, the Chancery Court granted summary judgment in defendants' favor.

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