
**Abstract**

In a landmark decision now on appeal, *In re MFW Shareholders Litigation*, the Delaware Chancery Court ruled that a freeze-out merger negotiated by an independent special negotiating committee (SNC) and conditioned *in advance* on approval by a majority-of-the-minority (MOM) vote should be reviewed under the business judgment rule. Before *MFW*, the practice was to review all such mergers for entire fairness, albeit with the burden on the plaintiff if the merger is *either* negotiated by an independent SNC *or* ratified in a fully-informed MOM vote. In contrast, review under the business judgment rule requires plaintiffs to plead and prove their case—to show that the deal was not the product of good faith bargaining.

The stated rationale for the ruling in *MFW* is that subjecting a freeze-out merger to *both* conditions is equivalent to the protections afforded to stockholders in an arms-length merger with a third-party buyer. As the *MFW* court notes, routine fairness review seldom results in any significant increase in consideration and likely decreases stockholder wealth. Moreover, routine fairness review induces deals to be structured as a tender offer followed by a short-form merger, neither step of which is reviewed for fairness—even though such a structure may coerce minority stockholders to accept a lower price for fear of being left with an illiquid stub of shares following the tender offer.

Although these are powerful arguments, the *MFW* court understates the case for the approach it endorses. As shown here, the MOM vote does more than merely ratify the proposed deal. Rather, it assures that the price to be paid is at least sufficient to satisfy the median price that would be demanded by the minority stockholders in a hypothetical stagstep auction. Since MOM voting permits minority stockholders to register their opinions as to the adequacy of the offered price without the pressure to tender, the vote can be trusted to reflect stockholder opinion free from the distorting effects of the coercion inherent in a tender offer. To be sure, majority rule means that higher valuing stockholders may be undercompensated while lower valuing stockholders will be overcompensated. But the aggregate premium paid by the controlling stockholder will be equal to the aggregate of the premiums that would be demanded individually by the minority stockholders. Since most stockholders are diversified, they will be overcompensated at least as often as they are undercompensated—on the average and over time. Thus, stockholders should favor the *MFW* approach not only because it assures fair price, but also because it assures the maximum number of deals by minimizing the uncertainties inherent in fairness review—if not also assuring controlling stockholders against the danger of overpayment. Finally, negotiation by independent SNC assures that the minority will get any higher price that may result from a bilateral negotiation. In short, the *MFW* approach assures minority stockholders will get the better of the prices that would result from either approach alone. Thus, the price paid is by definition fair and should be protected by the business judgment rule subject only to review in an appraisal proceeding as is the general rule for mergers not involving a controlling stockholder.