DELAWARE CORPORATE LAW BULLETIN

APPLICATION OF *MFW* FRAMEWORK DEFEATS CHALLENGE TO CORPORATE CHARTER AMENDMENT FAVORING CONTROL STOCKHOLDER

Chancery Court determines that special committee process and proxy disclosures were adequate to justify pleading-stage dismissal of public stockholder challenge

Robert S. Reder

Professor of the Practice of Law at Vanderbilt University Law School. Professor Reder has been serving as a consulting attorney at Milbank LLP in New York City since his retirement as a partner in April 2011.

Kathryn A. Fish

Vanderbilt University Law School, J.D. Candidate, May 2024.

INTRODUCTION

In *City Pension Fund for Firefighters and Police Officers in Miami v. The Trade Desk, Inc.*, C.A. No. 2021-0560-PAF (Del. Ch. July 29, 2022) ("*The Trade Desk*"), the Delaware Court of Chancery ("*Chancery Court*") examined the approval process for an amendment to a corporation's certificate of incorporation. The amendment was championed by, and ultimately benefitted, the corporation's control stockholder. As usually is the case in control stockholder-related litigation in Delaware, a key gating issue for Vice Chancellor Paul A. Fioravanti, Jr. was selection of the appropriate standard of judicial review.

I. LEGAL BACKGROUND

Traditionally, the Chancery Court reviewed breach of fiduciary duty claims arising in connection with control stockholder-related transactions under the entire fairness standard—the most "exacting" standard of review. In this context, the control stockholder bears the burden of establishing the transaction's entire fairness. *See* Robert S. Reder, *MFW Framework Requires Majority-of-Minority Stockholder Approval Even When Controller Structures Transaction to Avoid Statutory Stockholder Vote*, 75 VAND. L. REV. EN BANC 157 (2022).

This tradition was uprooted in *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("*MFW*"), when the Delaware Supreme Court "endorsed a framework that would alter the standard of review in a conflicted controlling stockholder transaction from entire fairness to the more lenient business judgment standard." Under this framework ("*MFW Framework*"), six conditions must be satisfied before a Delaware court will permit the favorable burden shift:

> (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.

Pleading-stage dismissal usually follows when the *MFW* Framework is satisfied. *See* Robert S. Reder & Lauren Messonnier Meyers, *Delaware Supreme Court Affirms Pleading-Stage Dismissal of Control Stockholder Buyout Litigation*, 69 Vand. L. Rev. En Banc 17 (2016).

MFW and the Delaware cases that followed in its immediate wake involved "freeze-out" mergers effected by control stockholders to cash out public stockholders without their consent. However, since that time, the Chancery Court has expanded application of the *MFW* Framework to other control stockholder-related corporate transactions. As the Chancery Court explained in *IRA Trust FBO Bobbie Ahmed v. Crane*, No. 12742-CB, 2017 WL 7053964 (Del. Ch. Dec. 11, 2017), the *MFW* framework "should be encouraged to protect the interests of the minority stockholders in transactions involving controllers, whether it be a squeeze-out merger (*MFW*), a merger with a third party (*Martha Stewart*), or one in which the minority stockholders retain their interests in the corporation (*EZCORP*)." For a summary of decisions extending application of the *MFW* Framework beyond freeze-out mergers, *see* Robert S. Reder & Alexandra Bakalar, *Chancery Court Indicates Willingness to Extend M&F to Compensation Award to Controlling Stockholder*," 73 VAND. L. REV. EN BANC 61 (2020).

* * *

In *The Trade Desk*, Vice Chancellor Fioravanti applied the *MFW* Framework when public stockholders challenged a charter amendment that benefited the corporation's control stockholder. Upon determining that the *MFW* Framework's conditions had been satisfied, the Vice Chancellor, applying the deferential business judgment standard of review, granted defendants' pleading-stage motion to dismiss.

II. FACTUAL BACKGROUND

The Trade Desk, Inc. ("*TTD*" or "*Company*") "is a technology company that markets 'a software platform to provide data-driven digital advertising campaigns.' "

A. TTD Adopts Dual-Class Stock Structure

In conjunction with its 2016 initial public offering ("*IPO*"), the Company amended and restated its certificate of incorporation ("*Certificate*") to adopt a dual-class stock structure:

1) Class A common stock ("*Class A Stock*"), which carries one vote per share, is publicly traded on the NASDAQ Global Market; and
2) Class B common stock ("*Class B Stock*"), which carries ten votes per share, is owned primarily by Jeff Green ("*Green*"), the Company's co-founder and CEO, thereby vesting voting control in Green.

Voting control was not intended to last into perpetuity. Rather, the Certificate included a provision "for the elimination of the Class B Stock once 'the number of outstanding shares of Class B Common Stock represent less than ten percent (10%) of the aggregate number of shares of the then outstanding' " Class A Stock and Class B Stock ("*Dilution Trigger*"). Once the Dilution Trigger was tripped, each share of Class B stock was "automatically converted into Class A common stock on a 1-for-1 basis. . .." The Certificate also provided that any share of Class B Stock transferred to anyone *other than* an original owner (*i.e.*, Green) or a limited group of permitted transferees "is automatically converted into Class A common stock on a 1-for-1 basis."

B. Dilution Trigger Looms "Large"

As of March 31, 2020, following sales by Green of Class B Stock in the public market to satisfy his desire for liquidity, "the Class B common stock constituted 11.2% of the Company's total outstanding Class A and Class B common stock." As a result, "the Dilution Trigger was looming large." Seeking a delay before his stock sales tripped the Dilution Trigger, Green initiated discussions with TTD's board of directors ("*Board*"). At the time, the Board consisted of Green, as Chair, "and seven outside directors."

C. Special Committee Negotiations

In response to Green's initiative, on June 3, the Board formed a three-person Special Committee ("*Special Committee*") "empowered. . .to evaluate a potential Certificate amendment to extend the Company's dual-class capitalization structure." The Special Committee retained Centerview Partners ("*Centerview*") as its financial advisor, as well as independent outside legal counsel. Then, on August 3, Green submitted "an *MFW*-compliant" proposal ("*Green Proposal*") to the Special Committee. The Green Proposal called for an amendment of the Certificate to, among other things, replace the Dilution Trigger with a provision automatically converting outstanding Class B Stock into Class A Stock upon the earlier of (i) the seven-year anniversary of the amendment, (ii) removal of Green from his positions as an officer or director by the Board "for cause," or (iii) "a date specified by the holders of at least 66-2/3% of the outstanding Class B common stock." Consistent with the *MFW* Framework, the Green Proposal contemplated two levels of corporate approval: *first*, by the Special Committee and,

thereafter, by a majority-of-the-minority vote of Company stockholders unaffiliated with Green ("*Majority-of-the-Minority Vote*").

At a subsequent meeting in early August, Centerview advised the Special Committee that the Dilution Trigger likely would be tripped in the second quarter of 2021. In light of this advice, and after further deliberation, the Special Committee concluded it would be in the "best interests" of Company stockholders for Green to retain control *via* the dual-class stock structure "for at least seven to ten years post initial public offering. . .." Then, on August 14, the Special Committee approved a counterproposal to the Green Proposal "with seven substantive modifications to Green's terms," including an alternative threshold for the Dilution Trigger and giving Class A Stockholders a right to elect a "to be" negotiated number of directors.

Although Green ultimately accepted most of these modifications, after further negotiations, the suggestion of a modified Dilution Trigger was scrapped, and the Special Committee and Green agreed that holders of Class A Stock thereafter would have "the right to elect [one] director if the board is eight or fewer directors, and [two] directors if the board is nine or more directors." The "agreement-in-principle" resulting from these negotiations was "memorialized" on August 27 in a term sheet ("*Term Sheet*").

D. Board and Stockholder Approvals

Based on the Special Committee's recommendation, on October 16, the Board approved an amendment to the Certificate reflecting the provisions of the Term Sheet ("*Dilution Trigger Amendment*"). The three Board members who owned Class B stock, including Green, abstained from voting on the Dilution Trigger Amendment. In effect, the Dilution Trigger Amendment, when subsequently adopted by a Majority-of-the-Minority Vote, "eliminated the Dilution Trigger, extended the duration of the dual-class structure, and enabled Green to maintain voting control," even as he sold additional shares of Class B Stock in the public market.

Following preparation and filing with the Securities and Exchange Commission of proxy materials for a special meeting of Company stockholders to vote on the Dilution Trigger Amendment ("2020 *Special Proxy*"), on December 22 the Company held a special stockholders' meeting ("*Special Meeting*"). At the Special Meeting, the Dilution Trigger Amendment was approved "with 52% of the unaffiliated shares voting in favor." Freed from the specter of a looming Dilution Trigger, Green recommenced public sales of Class B Stock.

E. Litigation Ensues

Six months after the Special Meeting, a holder of Class A Stock ("*Plaintiff*") challenged the Dilution Trigger Amendment in Chancery Court. Specifically, Plaintiff alleged that Green, as control stockholder, and the other Board members breached their fiduciary duties to the public stockholders by, *first*, "imposing the unfair Trigger Amendment" on the Company and the public stockholders and, *second*, "failing to disclose to stockholders Green's desire to sell Trade Desk shares and the date of the anticipated sunset of the dual class capitalization structure." In response, Green and the other defendants filed a motion to dismiss, arguing that the approval process for the Dilution Trigger Amendment satisfied the various elements of the *MFW* Framework. In *The Trading Desk*, Vice Chancellor Fioravanti granted pleading-stage dismissal to defendants.

III. VICE CHANCELLOR FIORAVANTI'S ANALYSIS

Vice Chancellor Fioravanti was not required to analyze whether either (i) adoption of the Dilution Trigger Amendment was "presumptively subject to review under the entire fairness standard" or (ii) the *MFW* Framework was available (if the Framework's conditions were satisfied) to shift the judicial standard of review to business judgment. All the litigants conceded as much. Accordingly, the Vice Chancellor's analysis focused on Plaintiff's contention that the approval process failed to satisfy two elements of the *MFW* Framework: *first*, "the Special Committee was not independent" [*element #2*] and, *second*, "the stockholder vote was uninformed" [*element #5*]. If Plaintiff was able to establish, *at the pleading stage*, that "it is reasonably conceivable. . .that either element is not satisfied, then Defendants will be unable to benefit from the deferential business judgment standard of review." In granting defendants' motion to dismiss, the Vice Chancellor determined that Plaintiff failed to satisfy this burden.

A. Special Committee Independence

Plaintiff challenged the Special Committee's independence in two ways: *first*, the Chair of the Special Committee was not independent due to compensation she received both as a Company consultant and as a Board member, thereby undermining the independence of the whole committee and, *second*, the Special Committee "labored under a 'controlled mindset,' bending to Green's wishes."

With respect to Plaintiff's *first* contention, the Vice Chancellor explained that "[t]he determination of whether a director's compensation from the Company is sufficient to raise a reason to doubt her independence is a fact intensive inquiry," focusing on the materiality of the compensation to the director. Because "[g]enerally, serving as a director on the board of a Delaware corporation is not a pro bono gig; Delaware law recognizes that directors will be paid a fair and reasonable amount." Regardless, "Plaintiff has not pleaded sufficient facts alleging that [the Chair's] conduct dominated or subverted the Special Committee process so as to render the entire committee defective, even if she was determined to be lacking in independence."

To promote its *second* contention, Plaintiff argued that the Special Committee members "labored under a controlled mindset" due to their understanding "that securing Green's control would ingratiate themselves with Green and ensure their continued directorships at the Green-controlled Company." The Vice Chancellor also dismissed this contention: in his view, Plaintiff's allegations did not "substantively challenge the Special Committee's independence." Rather, "Plaintiff's challenge. . .is grounded in Plaintiff's belief that maintaining the dual-class structure through the Dilution Trigger Amendment was a bad deal for TTD stockholders." Even if that were so, "the Delaware Supreme Court has clarified that this court's role in applying the *MFW* framework is limited to a process analysis, not second guessing the ultimate 'give' and 'get'. . .." On this basis, the Vice Chancellor concluded "it is not reasonably conceivable. . .the Special Committee lacked independence or failed to satisfy its duty of care."

B. Public Stockholder Vote

To support its claim that Company stockholders were not adequately informed about the Dilution Trigger Amendment, Plaintiff argued that the 2020 Special Proxy failed to properly disclose (among other matters):

1) Green's desire to sell Class B stock.
2) The expected date for tripping the Dilution Trigger.
3) Centerview's advice to the Special Committee.
4) The acknowledgement by Green's counsel that TTD would need a business rationale to justify the Dilution Trigger Amendment.

At the outset, Vice Chancellor Fioravanti articulated the "well-recognized proposition that directors of Delaware corporations are under a

fiduciary duty to disclose fully and fairly *all material information* within the board's control when it seeks shareholder action." (emphasis added). And, for allegedly omitted information to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

According to the Vice Chancellor, the "alleged omissions, individually and collectively, did not result in an uninformed stockholder vote on the Dilution Trigger Amendment."

1. Green's Desire to Sell Class B Shares

Plaintiff alleged that Green's desire to obtain liquidity by selling shares of Class B Stock was material because "it reveals that the Special Committee should have had substantial negotiating leverage against Green." According to the Vice Chancellor, "Green's desire to sell TTD stock would not have significantly altered the total mix of information available to stockholders. . .." To the contrary, "the obvious effect of the amendment was that Green could dispose of Class B shares without risk of causing the automatic conversion of his remaining Class B shares." In short, the Vice Chancellor thought it obvious to "anyone reading" the 2020 Special Proxy "that Green desired to retain control through the Trigger Amendment" while "continu[ing] his (disclosed) historical practice of selling shares without losing that control."

2. Dilution Trigger Date

Plaintiff complained that the 2020 Special Proxy "misleadingly disclosed that 'the Dilution Trigger could occur as early as March 2021' and suggested that any crossing of the threshold was uncertain and could be delayed far longer (even by years)." The Vice Chancellor disagreed, reasoning that because (i) "[t]he Dilution Trigger Date was not knowable due to the factors identified in the 2020 Special Proxy" and (ii) disclosure materials generally "are not required to state 'opinions or possibilities. . .,' " the Company "was not obligated to provide additional possibilities, opinions, or characterizations as to a Dilution Trigger date that it did not have."

3. Centerview Slide

Plaintiff criticized the omission from the 2020 Special Proxy of a slide presented to the Special Committee by Centerview discussing economic considerations related to the Dilution Trigger Amendment. The Vice Chancellor rejected this contention, explaining that because the

Dilution Trigger Amendment proposal did not contain "economic terms, such as Green surrendering stock or the Company making a payment to unaffiliated stockholders. . .[s]tockholders were able to assess for themselves whether the deal struck by the Special Committee was in the best interests of the stockholders and the Company."

4. Business Rationale

Plaintiff argued that the 2020 Special Proxy's failure to disclose "that Green's counsel told the Special Committee 'on multiple occasions' that Green would be providing a 'business rationale' for the Dilution Trigger Amendment," in effect, "shows that there was none and that stockholders should have been so informed." The Vice Chancellor dismissed this inference, noting that counsel's recognition of the need for a business rationale simply confirmed that Green needed to show the Special Committee that repealing the Dilution Trigger was justified. Given that the 2020 Special Proxy contained Green's letter to the Special Committee explaining his rationale, as well as the Board's rationale in approving the Dilution Trigger Amendment, "[t]he TTD stockholders were fully capable of assessing the bona fides of Green's and the Special Committee's fully disclosed rationales and assessing whether the terms of the transaction were worthy of the stockholders' support."

CONCLUSION

By permitting potentially conflicted transactions to be structured to satisfy the *MFW* Framework, Delaware courts have paved the way for control stockholders and corporate boards to obtain pleading-stage dismissal of public stockholder challenges to those transactions. Although initially promulgated in the context of freeze-out mergers, courts have extended the application of the *MFW* doctrine to a variety of corporate transactions benefitting control stockholders to the detriment of the other stockholders. *The Trade Desk* expands the applicability of the *MFW* Framework even further: in this case, to a corporate charter amendment designed to retain voting control in the hands of a stockholder even while he sells shares to obtain liquidity. Moreover, Vice Chancellor Fioravanti's opinion demonstrates that conclusory challenges by public stockholders will not be sufficient to overcome application of *MFW*. Rather, for unhappy public stockholders to avoid pleading-stage dismissal of their claims, it must be "reasonably conceivable under the well-pleaded facts" that at least one of the *MFW* Framework's six elements has not been satisfied.