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Delaware Court of Chancery Applies *MFW* to Dismiss Challenge to Reclassification

Recently in *IRA Trust FBO Bobbie Ahmed* v. *Crane*, the Delaware Court of Chancery clarified that the framework to invoke business judgment review in controlling stockholder squeeze-out mergers (set forth in *Kahn* v. *M&F Worldwide, Corp*. ("*MFW*")) applies generally to any conflicted controller transaction. In this particular case, the court concluded that application of the *MFW* framework restored business judgment review to an arguably *pro rata* share reclassification by NRG Yield, Inc. ("Yield"), which the court found was nevertheless conflicted because the transaction created a class of stock for the company to use for capital raises, while preserving the control position of NRG Energy, Inc. ("NRG").

Background

Yield owns and acquires income-producing energy generation and infrastructure assets, and then distributes dividends therefrom to public stockholders. At the time of its IPO in 2013, the company had two classes of stock (each with one vote per share): (i) Class B held by NRG, constituting approximately 65% of Yield's voting power, and (ii) Class A held by public stockholders, constituting the remainder of the voting power. NRG controls the day-to-day affairs of Yield under a management services agreement. To address potential conflicts between Yield and NRG, Yield had a standing Corporate Governance, Conflicts and Nominating Committee (the "Conflicts Committee") of directors independent from NRG to review and approve transactions between Yield and NRG.

Post-IPO, Yield issued additional equity and convertible notes to raise capital to make asset acquisitions, which it did at a pace that exceeded NRG's expectations and resulted in NRG's voting power in Yield falling from approximately 65% to 55%. In an effort to preserve its level of control while allowing Yield to raise capital for new acquisitions, NRG presented several alternatives to the Yield board. Over several months, the Conflicts Committee and NRG negotiated a solution, eventually agreeing to a reclassification of the company, whereby two new classes of common stock, Class C and Class D, would be established and then distributed to the holders of the outstanding Class A (*i.e.*, the public shareholders) and Class B shares (*i.e.*, NRG), respectively (the "Reclassification"). Each of the Class C and Class D shares would receive 1/100 of a vote per share, but the Class C shares would trade publicly and be used as currency to acquire assets in the future. From the outset of negotiations, the proposed Reclassification was conditioned on obtaining the approval of a majority of the minority Class A stock unaffiliated with NRG and subject to approval by the Conflicts Committee.

In May 2015, over 80% of the outstanding common stock (Class A and B) approved the Reclassification, including a majority of the outstanding shares of Class A common stock unaffiliated with NRG. The plaintiff brought claims alleging that the Yield directors and NRG breached their fiduciary duties in connection with approving the Reclassification.

Analysis

In an opinion by Chancellor Bouchard addressing defendants' motion to dismiss those claims, the court held as follows:

- *The Reclassification was a conflicted controller transaction*. The court found that although the Class C and Class D shares were distributed *pro rata*, NRG received a uniquely valuable benefit in connection with the Reclassification not shared with the other stockholders, namely the ability to perpetuate its control over Yield. Therefore, the Reclassification was a conflicted controller transaction that was presumptively subject to entire fairness review.

- *The* MFW *framework applied to the Reclassification, which the court found to be satisfied, thereby restoring business judgment review and leading to the dismissal of plaintiff's claims*.

  - The court first concluded that the *MFW* framework should extend beyond the squeeze-out merger context in which the framework originated. Citing both *EZCORP Inc. Consulting Agreement Derivative Litigation* and *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, cases in which the court first applied *MFW* outside of the squeeze-out merger context (*i.e.*, to an advisory agreement with a controller and a third party merger in which the controller received a non-*pro rata* benefit, respectively), the court wrote that it could "see 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." In fact, the court stated that the use of the protections set forth by *MFW* should be encouraged to protect the interests of minority stockholders in all types of controller transactions, not only squeeze-out mergers.

  - The court next concluded that the Reclassification satisfied the *MFW* framework, and therefore business judgment review applied. Here, the plaintiff's only serious challenge to the satisfaction of the *MFW* framework was that stockholders were not adequately informed in their vote due to various disclosure deficiencies in the proxy. The court concluded in each instance, however, that no disclosure violation existed. Therefore, the Reclassification satisfied the *MFW* framework such that business judgment applied. With business judgment review restored, the court dismissed plaintiff's claims.

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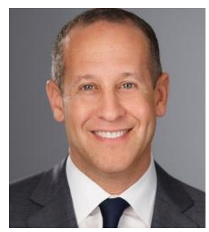
Scott A. Barshay
Partner
New York Office
+1-212-373-3040
Email

Ariel J. Deckelbaum
Partner
New York Office
+1-212-373-3546
Email

Ross A. Fieldston
Partner
New York Office
+1-212-373-3075
Email

Justin G. Hamill
Partner
New York Office
+1-212-373-3189
Email

Stephen P. Lamb
Partner
Wilmington Office
+1-302-655-4411
Email



Jeffrey D. Marell
Partner
New York Office
+1-212-373-3105
Email

Counsel Frances F. Mi and legal consultant Cara Grisin Fay contributed to this memorandum.

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