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Delaware Guidance for Deals Involving a Controlling Stockholder and a Third Party Acquirer

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August 25, 2017 — In *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, the Delaware Court of Chancery clarified how a controlling stockholder may obtain dismissal *at the pleadings stage* (as opposed to after lengthy and costly discovery) of minority stockholder challenges to deals where the controller allegedly received preferential consideration from a third party purchaser. The court determined that if the roadmap outlined in *Kahn v. M&F Worldwide* is followed, the controller would get the benefit of deferential “business judgment” review right away.

Practitioners have known for some time how to structure deals where the controller stands on both sides of the deal, e.g., in a “going private” merger where the controller buys out the minority stockholders. In *M&F Worldwide*, the Delaware Supreme Court decided that such a case will be dismissed at the pleadings stage if the deal is subject, from the outset, to approval by (1) an independent, disinterested and properly empowered special committee of directors, and (2) a non-waivable, fully informed and uncoerced vote of the majority of the minority stockholders.

In *Martha Stewart*, plaintiffs alleged that the controller had diverted transaction consideration away from the minority stockholders by entering into various “side deals” with the third party acquirer. The court determined that the *M&F Worldwide* framework also applied to this type of “one-sided controller” transaction, provided that the dual procedural safeguards outlined above are in place at the time the controller begins negotiating potentially preferential consideration with the third party acquirer. The court found that the *M&F Worldwide* framework had been complied with, and thus dismissed the lawsuit at the pleadings stage.

Prior to *Martha Stewart*, “one-sided controller” transactions were subject to some uncertainty, as meandering lines of case law had created different standards. *Martha Stewart* now clarifies that courts will grant deferential treatment in “one-sided controller” cases if the *M&F Worldwide* procedural safeguards are deployed when the controller begins negotiating the potentially preferential consideration terms with the third party acquirer.

Martha Stewart provides helpful guidance to have minority lawsuits in such “one-sided controller” cases dismissed at the pleadings stage and, therefore, significantly reduces deal delay and litigation expenses. Companies, controlling stockholders, third party acquirers and their counsel should follow the court’s roadmap with precision from the outset and throughout the entire deal process to take advantage of these benefits.

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