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## **Delaware Supreme Court Clarifies *MFW*'s “*Ab Initio*” Requirement and Partially Reverses Chancery Court Dismissal**

In *Olenik v. Lodzinski*, the Delaware Supreme Court held that plaintiffs had sufficiently pled facts that the dual protections of a special committee and majority-of-the-minority-vote under the *MFW* roadmap was not in place before the start of substantive economic negotiations in a controller-led merger transaction, and thus entire fairness, not business judgment review, should apply. In reversing the Chancery Court's dismissal of the case on this issue, the Supreme Court – in a decision written by Justice Seitz – cited its intervening *Flood v. Synutra* opinion for the proposition that dismissal is unavailable if *MFW*'s dual protections are not established “early in the process . . . before there has been any economic horse trading.”

*Flood* involved a situation where the controlling stockholder's first expression of interest in a controlled target failed to include the requisite *MFW* protections, but the stockholder's second proposal included the necessary conditions and, importantly, arrived before the target special committee had begun any substantive evaluation or negotiation of the transaction. Thus, *Flood* held that *MFW*'s requirement that the dual protections be in place “up front” was met. While *Olenik* was not a controller transaction per se, the court stated that the same concepts apply where the controller is directly or indirectly exerting its influence over the transaction.

In *Olenik*, the court noted significant differences in timing and process from *Flood*. For one, the time between the initial stages of discussion and when the *MFW* protections were in place was not two weeks as in *Flood*, but eight months. Then, unlike in *Flood* where the special committee had not conducted due diligence, retained advisors or negotiated on price before the *MFW* protections were set, plaintiffs allege that here Earthstone Energy, Inc. (the acquirer), Bold Energy III LLC (the target) and controlling shareholder EnCap Investments (the beneficial owner of 41% of Earthstone and 96% of Bold) had engaged in substantial economic negotiations before the protections were added. Among other things, EnCap entered into a confidentiality agreement with Earthstone so they could exchange information about Bold (including giving Earthstone data room access); provided its marketing materials for Bold to Earthstone; gave Earthstone access to its bankers for discussions about Bold's assets and other matters and held multiple meetings with Earthstone and Bold to discuss the potential deal in the interim period. Importantly, the court noted that while some of the early interactions between Earthstone and EnCap could be considered preliminary, they soon blossomed into a “joint exercise to value Earthstone and Bold,” with those valuations effectively setting “the field of play for the economic negotiations to come by fixing the range in which offers and counteroffers might be made.” This was supported by the actual outcome, in which the initial and final offers from Earthstone for Bold fell into that valuation range set before the *MFW*

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protections were established. Based on the foregoing, the Supreme Court remanded the case back to Chancery Court for further proceedings on these issues.

The Supreme Court further affirmed the Chancery Court's dismissal of plaintiffs' disclosure claims and declined to affirm the Chancery Court's decision on defendants' arguments that EnCap was not a controlling stockholder of Earthstone because, although its beneficial ownership of Earthstone fell to 41% during the course of negotiations, the court found that EnCap was a controller while key economic negotiations were occurring.

*Olenik* shows that the Delaware courts are prepared to engage in a factual investigation into whether the "up front" requirement of *MFW* has been met – as could be expected coming out of the *Flood* decision and which the *Flood* dissent had argued should be avoided with a bright-line test.

For our prior client alerts on *Flood v. Synutra*, see [here](#); on the Chancery Court's *Olenik* decision, see [here](#) and on *Kahn v. M&F Worldwide*, see [here](#).

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