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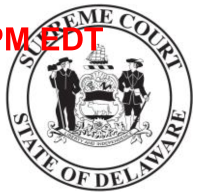

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE SYNUTRA INTERNATIONAL, INC. STOCKHOLDER LITIGATION	)	No. 101, 2018
ARTHUR FLOOD,	)	
Plaintiff-Below, Appellant	)	APPEAL FROM THE MEMORANDUM OPINION DATED FEBRUARY 2, 2018 OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN CONSOL. C.A. NO. 2017-0032-JTL
v.	)	
SYNUTRA INTERNATIONAL, INC., LIANG ZHANG, JINRONG CHEN, LEI LIN, YALIN WU, XIUNG MENG, BEAMS POWER MERGER SUB LIMITED, AND HOULIHAN LOKEY CAPITAL, INC.,	)	
Defendants-Below, Appellees	)	

APPELLANT'S OPENING BRIEF

Dated: April 12, 2018

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NATURE OF THE PROCEEDING

Plaintiff-below/Appellant Arthur Flood brings this appeal from the Delaware Court of Chancery's February 2, 2018 Order (the "Order") granting the Defendants-Below/Appellees' motions to dismiss the Verified Amended Class Action Complaint (the "Amended Complaint").

On November 17, 2016, Synutra International, Inc. ("Synutra" or the "Company") entered into an agreement and plan of merger (the "Merger Agreement") with its controlling stockholder, Beams Power Investment Limited, a limited liability company incorporated under the laws of the British Virgin Islands ("Beams Power"). Beams Power owned 63.5% of Synutra's outstanding common stock at that time. Mr. Liang Zhang ("Zhang"), the Company's Chairman and Chief Executive Officer ("CEO"), had dispositive and voting power over investments by Beams Power. Zhang's spouse, Ms. Xiuqing Meng ("Ms. Meng"), was the sole stockholder and director of Beams Power. Zhang, Ms. Meng, and Beams Power, are collectively referred to as the "Buyer Group." Pursuant to the Merger Agreement, the Buyer Group would take control of those shares it did not already own in a going-private transaction for a price of $6.05 per share of common stock (the "Buyout").

Following the announcement of the Buyout, on December 15, 2016, plaintiff Rudy Murillo filed a lawsuit in the Court of Chancery, alleging that the Defendants

had breached their fiduciary duties, or aided and abetted such a breach of duties, owed to Synutra stockholders.[1] On January 17, 2017, Plaintiff Arthur Flood filed a lawsuit in the Court of Chancery, alleging that the Buyout was subject to entire fairness review, that Synutra's Board of Directors (the "Board"), the special committee of the Board ("Special Committee"), and the Buyer Group breached their fiduciary duties owed to the unaffiliated stockholders of Synutra, and that Houlihan Lokey Capital, Inc. ("Houlihan Lokey") had aided and abetted the breach of fiduciary duties. Plaintiff Flood filed his Verified Amended Class Action Complaint (the "Complaint") on February 10, 2017.

On August 7, 2017, the Court of Chancery consolidated the two actions into the above-captioned Action, appointing Plaintiff Arthur Flood as interim lead plaintiff ("Plaintiff").

On October 12, 2017, the Defendants filed motions and briefs to dismiss the Complaint pursuant to Court of Chancery Rule 12(b)(6).

On February 2, 2018, after full briefing and a hearing, the Court of Chancery issued the Order, finding that the Buyout qualified for business judgement review under *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) and dismissed the Complaint with prejudice.[2]

On February 26, 2018, Plaintiff timely filed his Notice of Appeal.

[1] Plaintiff Murillo did not allege that the Transaction was subject to entire fairness review.
[2] A copy of the Order Granting Defendants' Motion to Dismiss is attached hereto as Exhibit A.

SUMMARY OF ARGUMENT

1. The trial court improperly held that the Buyout was conditioned *ab initio* on the dual protections outlined in *Kahn v. M&F Worldwide*, 88 A.3d 635, 644 (Del. 2014) (*"M&F Worldwide"*): "both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders." The initial offer letter from the Buyer Group did not contain the dual protections, thus, the *ab initio* requirements were not satisfied. In holding that the *ab initio* requirements were met because the Buyer Group later included these conditions before "any negotiations" took place, the trial court made a clear factual error and failed to follow the clear precedent set forth by this Court requiring that the dual protections be present at the outset.

By interpreting *ab initio* to mean any time before "any negotiations" begin, the trial court's decision contravenes precedent. It also exposes this bright-line rule to counterproductive subjectivity seemingly unintended by this Court. The *ab initio* requirement in *M&F Worldwide* created a clear blueprint for controlling stockholders to follow in a buyout scenario in order to obtain the business judgment standard of review. *Ab initio* means from the beginning, from the outset, not at some indeterminate later point. Thus, the trial court's order should be reversed.

2. The trial court erred in holding that business judgment was the proper standard of review where the Complaint alleged that the Special Committee accepted an inadequate and unfair price as a result of deferring to conflicted management and accepting skewed valuation analyses. This Court has held that "allegations about the sufficiency of the price call into question the adequacy of the Special Committee's negotiations" such that a complaint can survive a motion to dismiss under the new standard articulated in *M&F Worldwide*. 88 A.3d at 645 n.14.

The trial court's decision, while purportedly considering Plaintiff's duty of care claims individually and in the aggregate, focuses improperly on the number of meetings held by the Special Committee and the advice given by its independent advisors. The trial court failed to give proper weight to Plaintiff's pleading of unfair price, which, when viewed in the aggregate with the allegations regarding the Special Committee's negotiations, states a claim for breach of duty of care. The trial court's order should be reversed, and the proper standard of review for the Buyout should remain that of entire fairness.

STATEMENT OF FACTS

A. The Buyer Group's Control Of The Company

Before the Buyout, Beams Power owned 63.5% of Synutra. Zhang's wife, Defendant Ms. Meng controlled Beams Power. (Or. ¶ 1.) Zhang, the Company's CEO and Chairman of the Board beneficially owned 63.5% of the Company's common stock. (A016-17.)

B. The Buyer Group's Initial Offer Letter

On January 14, 2016, the Buyer Group submitted a preliminary non-binding proposal letter to the Board to acquire all outstanding shares of Synutra common stock not already owned by the Buyer Group for $5.91 per share in cash ("Initial Offer Letter"). *(*Or. ¶ 7b; A019-22.) The Initial Offer Letter did not even reference approval by an empowered and independent special committee, or by a majority of Synutra's unaffiliated stockholders. (Or. ¶ 7b; A019-22.)

C. Events Before Buyer Group Required The Dual Protections

On January 21, 2016, one week after Zhang delivered the Initial Offer Letter, the Board held a telephonic meeting that was also attended by Zhang, Ms. Ning Cai ("Cai"), the Company's Chief Financial Officer, and representatives of Davis Polk & Wardwell LLP ("Davis Polk"). (Or. ¶ 7c; A022-23.) By the time of this meeting, the Buyer Group had already retained Davis Polk as legal counsel in connection with the Buyout, and Cai had already "negotiated and agreed" to a

waiver of Davis Polk's conflict of interest on behalf of the Company, without Board input. (A063, A152.)

At the meeting, the Board appointed Yalin Wu ("Wu") as a new director of Synutra to fill a vacancy resulting from the resignation of Ms. Min Zhang in November 2015. (A065.) Wu "was referred by a personal friend to Mr. Zhang as a potential candidate as an independent director of the Company," and Zhang recommended that the Board consider Wu as a candidate. (Or. ¶ 9d quoting Proxy at 20.)

During that same meeting, representatives of Davis Polk, purportedly in their capacity as outside legal counsel to the Company, advised the directors as to their fiduciary duties in considering and evaluating the Initial Offer Letter, and advised that the Board should consider appointing a special committee. (A064.) The Board members, ***other than*** Zhang, then resolved to form the Special Committee consisting of Ms. Jinrong Chen ("Chen"), Mr. Lei Lin ("Lin"), and Wu, with Chen acting as the chairperson to consider the Buyout. (A064.)

Despite Zhang's attendance at this meeting, neither Zhang nor anyone else speaking for the Buyer Group conditioned the Buyout upon special committee appointment or approval, let alone the approval of a majority of the minority of shares of common stock.

D. The January 30, 2016 Buyer Group Letter And Subsequent Negotiations

On January 30, 2016, ***more than two weeks after*** sending the Initial Offer Letter, the Buyer Group submitted a second letter to the Special Committee indicating that they would not proceed with the Buyout unless it was approved by a special committee, and that the Buyout would be subject to a condition requiring the approval by holders of a majority of the shares of stock not owned by the Buyer Group. (Or. ¶ 7d; A065.)

On February 4, 2016, the Special Committee decided to engage Houlihan Lokey as its financial advisor. (A066.) On March 22, 2016, following several conversations with management regarding the need for Company financial projections, representatives of Houlihan Lokey met with Cai and discussed that the Special Committee and Houlihan Lokey would need to review the Company's financial projections to perform financial analyses in connection with the Buyout. (A066.) On April 7, 2016, however, before management even provided the requested financial projections to the Special Committee, Davis Polk sent Cleary Gottlieb Steen & Hamilton LLP ("Cleary") a draft of the Merger Agreement. (A067.)

E. The Company Management-Prepared Financial Projections

On or about April 22, 2016, more than a month after the financial projections had first been requested, Company management provided the Special

Committee and Houlihan Lokey with an initial draft of certain financial projections relating to the Company, which were subsequently updated on May 27, 2016 (the "May Projections"). (A067.) These projections were prepared specifically for the purpose of this process, and were not prepared or maintained in the ordinary course of business. (A191). On June 3, 2016, Houlihan Lokey delivered to the Special Committee preliminary financial discussion materials relating to the Company and the proposed transaction (the "June Discussion Materials"). (A068-70.) The June Discussion Materials included an "Illustrative Discounted Cash Flow Sensitivities" slide based on the May Projections. (A070.) In conducting this analysis, Houlihan Lokey used discount rates ranging from 10.0% to 20.0%, and perpetuity growth rates ranging from 1.00% to 5.00%, but provided no basis for the selection of these ranges. (A070.) The resulting table of implied per-share valuations of the Company ranged from $1.70 to $20.03. (A070.) The table actually illustrated what inputs would be necessary (and could be selected) in a discounted cash flow analysis for an implied value per share that would support an offer by Zhang. After reviewing the materials, the Special Committee decided that the offer price of $5.91 per share merited further consideration and negotiation with the Buyer Group. (A070.)

Despite the Buyer Group's position that it had no interest in selling its stake of the Company, between July 25 and August 24, 2016, Houlihan Lokey contacted

twenty-five potential bidders. (A071.) Of the twenty-five potential bidders contacted, eight parties were not responsive and seventeen declined. (A071.) Those parties that provided a response noted the controlling stock ownership of the Buyer Group as a reason for their declination. (A071.) At this time, the Initial Offer Letter and subsequent January 30, 2016 letter had been publicly disclosed in SEC filings.

On August 17, 2016, management provided to the Special Committee and Houlihan Lokey updated financial projections (the "August Projections") purportedly because, among other reasons: (i) the Company had materially failed to meet its revenue and net income forecasts for four consecutive quarters before the quarter ended June 30, 2016 and the financial results of the Company in the First Quarter Financials did not meet the May Projections; (ii) the sales of the Company's liquid milk products were materially below expectations of the Company for the quarter ended June 30, 2016 and the first several months for the fiscal year 2017; and (iii) the Company's French facility project, which had been expected to be fully operational in the summer of 2016, had been delayed. (A070-71.) Despite the temporary nature of these setbacks, management revised downward the projections for the years following 2017 as well. (A071.) Neither the Special Committee nor Houlihan Lokey had any discussions with management

regarding the August Projections; it appears that the Special Committee accepted the August Projections without question or further due diligence.

On September 8, 2016, the Special Committee met and representatives of Houlihan Lokey reviewed updated financial analyses (the "September Discussion Materials"), which utilized the August Projections. (A073-074.) In its discounted cash flow analysis, Houlihan Lokey selected a discount rate range of 12.0% to 15% and a perpetuity growth rate range of 2.0% to 4.0%, but the analysis again failed to disclose how the discount rate range was selected. (A074.) The Buyout price of $5.91 was well below the midpoint of the resulting discounted cash flow implied per share price range of $4.03 to $9.62 per share. *Id.* Ever mindful of appearances, the Special Committee instructed Houlihan Lokey to negotiate with the Buyer Group and seek a "meaningful increase" in the price. *Id.* On the same day, as instructed by the Special Committee, Cleary delivered to Davis Polk a new draft of the Merger Agreement, despite the fact that there had not yet been an agreement on price. *Id.*

On September 9, 2016, almost nine months following the Initial Offer Letter, Houlihan Lokey requested for the first time that the Buyer Group increase the consideration. *Id.* Immediately, Zhang, on behalf of the Buyer Group, offered to increase the price to $6.05 per share but indicated that it was a "best-and-final" offer. *Id.* On September 19, 2016, Davis Polk provided a revised draft of the

Merger Agreement to Cleary, which reflected the Buyer Group's positions with respect to the terms of the Merger Agreement, including, among other things, that, regardless of whether the Board changed its recommendation to the stockholders, the proposed transaction would have to be submitted to Synutra's minority stockholders for a vote unless the Merger Agreement had been terminated (the "Force the Vote Provision"). (A074-75.)

On September 22, 2016, the Special Committee determined to accept the Buyer Group's offer price of $6.05 per share. (A075.) On October 20, 2016, Cleary provided revised drafts of the Merger Agreement and the limited guarantee to Davis Polk, which reflected the Special Committee's package proposal on the key issues in the Merger Agreement, including, among other things, that the Special Committee agreed to include the Force the Vote Provision with regard to Intervening Events (i.e., the Special Committee agreed not to request a termination right of the Company upon the occurrence of an Intervening Event). *Id.*

F. Company Management Further Revises Projections Downward And Special Committee Approves The Buyout

On November 4, 2016, Houlihan Lokey informed the Special Committee that Company management had updated Synutra's financial projections, which were subsequently further revised downward by management on November 10, 2016 and November 11, 2016, respectively (the "Company Projections"). (A076.)

On November 11, 2016, the Special Committee held a telephonic meeting during which representatives of Houlihan Lokey reviewed the Company Projections. (A078.) The Special Committee did not assess whether the Company's lowered projections were appropriate. (A078.) Rather, the Special Committee accepted the Company Projections without contest and permitted Houlihan Lokey to revise its analyses to incorporate the lowered projections. (A078.) The lowering of the projections had the obvious effect of helping the Buyout price seem fair in the publicly disclosed financial analysis underlying Houlihan Lokey's fairness opinion. (A078-79.) Houlihan Lokey revised its discounted cash flow analysis to reflect the Company Projections, and the resulting range of implied values for the Company was \$3.81 to \$9.29, thus causing the \$6.05 offer price to fall just below the midpoint of the range. (A078-79.)

The lowering of the Company's projections was not supported by the Company's stated prospects and results. Synutra had publicly stated that "the Company remain[ed] optimistic about its prospects for continued strong growth above the industry average for fiscal 2017 and beyond, once its French facility is fully operational." (A059.) The new milk powder factory in France (the "French Facility") was a key investment for the Company. The France Facility would create new milk powder, a key ingredient in Synutra's baby formula. (A080.) Synutra had previously purchased milk powder from third parties for import into

China. *Id*. The Company anticipated that importing premium milk products from the French Facility would help it capitalize on industry consolidation and help to establish Synutra as a leading formula producer in China. *Id*. Additionally, the French Facility's operation would allow the Company to increase production capacity and decrease costs going forward. *Id*.

After Zhang sent the Initial Offer Letter, the Company continued to announce setbacks, delays, and increased costs related to the France Facility. *Id*. This negatively impacted the Company's stock price. *Id*. However, the French Facility came online and was operational as of September 2016. (A080-81.) When the French Facility opened on September 30, 2016, the Company's stock price closed at its highest since May 2016. (A081.)

Moreover, China was undergoing regulatory changes at the time that were expected to benefit the Company. (A081-82.) Under new rules that were set to go into effect on October, 1, 2016, a point at which the Buyout was already a *fait accompli*, every infant-formula manufacturer – domestic and foreign – must register each of their products with the China Food and Drug Administration ("CFDA") and produce no more than nine formulas under up to three brands. (A081.) Synutra has nearly 200 formulas, according to the Company's website. *Id*. According to a person with knowledge of the matter, the Company had started to abandon some subsidiaries, most of which once made baby-milk powder for

better-known companies. (A081-82.) Getting rid of these subsidiaries would not have a major impact on Synutra because these subsidiaries only contributed to a minor fraction of the Company's revenue. *Id.*

The Chinese regulatory changes were predicted to squeeze out less competitive businesses and thus provide an opportunity for Synutra to grow and thrive. And the Company itself had publicly stated that its operations would dramatically improve after the opening of the French Facility (which, again, took place in September of 2016). Nevertheless, the Company's management continued to depress the Company's financial projections in the face of these positive developments. (A080.)

On November 17, 2016, the Special Committee held a telephonic meeting where Houlihan Lokey rendered its fairness opinion. (A079.) That same day, the Special Committee and the Board approved the Buyout. *Id.* Starting on November 24, 2016, Houlihan Lokey commenced a post-signing "go-shop" process in accordance with the terms of the Merger Agreement. *Id.* As of December 8, 2016, Houlihan Lokey initiated contact with 36 parties to gauge their interest in a potential transaction involving the Company and, not surprisingly, none expressed any interest. *Id.*

G. The Special Committee's Aid To The Buyer Group During The Process

Beginning in February 2016, the supposedly independent Special Committee, formed for the purpose of evaluating the Buyer Group's proposal, assisted Beams Power in the refinancing of a $55 million debt facility with Forebright Capital. (A066.) In fact, on February 16, 2016, Davis Polk delivered a request to the Special Committee's legal counsel, Cleary, that the Special Committee "facilitate a proposed transaction" because this refinancing would "remove the risk of [Beams Power], the Company's majority stockholder, being exposed to a default" and "would allow the buyer group to focus its attention on negotiating a possible transaction with the special committee and its advisors, increasing the possibility of a value-maximizing transaction for the unaffiliated stockholders." (A155.) This refinancing was discussed and approved by the Special Committee within ten days as a written consent letter was delivered by Cleary to Davis Polk on February 25, 2016.

The Special Committee's assistance to the Buyer Group did not end there. Beginning in July of 2016, the Special Committee and the Company started assisting the Buyer Group in negotiations with Shanghai Pudong Development Bank Co., Ltd. ("SPDB") to finance the Buyout. (A071.) Ultimately SPDB made a $150 million credit facility available to the Buyer Group, under which the Company is described as an "obligor. *Id.*

ARGUMENT

I. THE COURT ERRED IN HOLDING THAT THE PROCESS MET THE *AB INITIO* REQUIREMENTS WHEN THE INITIAL OFFER LETTER DID NOT CONTAIN THOSE CONDITIONS

A. Question Presented

Did the trial court err in holding that the dual protections outlined in *M&F Worldwide* were met *ab initio* when the Initial Offer Letter did not condition a potential transaction on both a favorable special committee recommendation and approval by a majority of the disinterested stockholders? (A363-70, A482-89.)

B. Scope of Review

This Court reviews a trial court's ruling on a motion to dismiss *de novo* to "determine whether the trial judge erred as a matter of law in formulating or applying legal precepts." *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009) (quoting *Feldman v. Cutaia*, 951 A.2d 727, 730-31 (Del. 2008).

C. Merits of the Argument

The trial court's decision is premised on an incorrect application of the *ab initio* requirement set forth in *M&F Worldwide*. Under the rule applied by the trial court, the protections of both approval by an independent, adequately-empowered special committee, and the uncoerced, informed vote of a majority of the minority stockholders do not need to be present from the outset. Rather, the trial court held that the *ab initio* dual protections need only be present before "any negotiations"

begin. (Or. ¶ 7g). Based on an incorrect interpretation of this Court's precedent and clear factual errors, the trial court's decision must be reversed and vacated immediately.

1. *Ab Initio* Means "From The Beginning"

"*Ab initio*" translates to "from the beginning." This Court clearly held in *M&F Worldwide* that "business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, **where the merger is conditioned *ab initio* upon the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders**." 88 A.3d 635, 645 (Del. 2014) (emphasis added). There is no qualifying language in this Court's opinion. The holding is clear that these dual protections need to be in place from the beginning. This requirement was met in *M&F Worldwide* because the initial proposal by the controller stated explicitly that "[w]e will not move forward with the transaction unless it is approved by such a special committee. In addition, the transaction will be subject to a non-waivable condition requiring the approval of a majority of the shares of the Company not owned by M&F or its affiliate." *Id.* at 640. Given the controller's requirement at the outset, this Court found that the dual protections were in place *ab initio*. *Id*. at 646.

Where a proposed buyer is a controlling stockholder, ***negotiations commence with the initial proposal***, not from a subjective point later in the process following the initial offer letter. *In re Martha Stewart Living Omnimedia, Inc.*, 2017 WL 3568089, at *18 (Del. Ch. Aug. 18, 2017) (noting that where a controller is on both sides, "[b]ecause the controlling stockholder decides when to begin negotiations regarding a transaction and on what terms, the 'outset' of the transaction is clear") (emphasis added).

Indeed, negotiations are, by necessity, comprised of offers and counter-offers. Thus, the outset – the *initio* – of negotiations must tautologically be the first offer. Any other interpretation simply does not comport with the underlying concepts.

In a controlling stockholder buyout, there is one clear "blueprint for getting to the business judgment rule." *In re Sauer-Danfoss, Inc. S'holder Litig.*, 2013 WL 6735054, at *26 (Del. Ch. Oct. 23, 2013) (TRANSCRIPT) ("the controller has to step back in a matter analogous to a third-party transaction at both the board and stockholder levels, and *they have to do so at the outset*"); *see also In re Books-A-Million, Inc.*, 2016 WL 5874974, at *8 (Del. Ch. Oct. 10, 2016) (holding the *ab initio* requirement satisfied because the controller established the conditions in its initial offer letter). That blueprint requires the controller to self-disable at the outset of negotiations – that is, with the initial offer.

The clear implication of this Court's decision in *M&F Worldwide* was that, in a controlling stockholder squeeze-out merger, negotiations begin at the initial offer, and a controller must self-disable at that point if it is to receive the benefits of the business judgment rule. Setting a clear benchmark, as was intended in *M&F Worldwide*, ensures that all of the players know the rules and understand the expectations. By contrast, expanding the meaning of *ab initio* to anything beyond the initial offer will invite abuse and become a source of constant litigation. The trial court's ruling, if affirmed, would muddy the waters and inject subjectivity into what should be a clear, bright-line test. Given these considerations, the trial court's decision should be reversed.

2. The Court's Holding That A Process Meets *Ab Initio* Requirements When the Controller Announces the Conditions "Before Any Negotiations Took Place" Does Not Comport With *M&F Worldwide*

The trial court stated that "[a] process meets the *ab initio* requirement when the controller announces the conditions 'before any negations took place.'" (Or. ¶ 7c.) The qualifying language regarding the conditions being in place before negotiations occurred was not present in this Court's decision in *M&F Worldwide*. Rather, the trial court relied on its own opinion in *Swomley v. Schlecht*, 2014 WL 4470947 (Aug. 27, 2014) (TRANSCRIPT) for this holding. (Or. ¶ 7c.) Not only is *Swomley* not controlling precedent, but the trial court's decision here went well beyond the *Swomley* decision.

First, *Swomley* was decided at the trial court level. Thus, its holding does not supercede this Court's requirement that the dual protections be present *ab initio*. Second, *Swomley* is distinguishable from the facts here. Indeed, in *Swomley*, the Founder Group held only 46 percent of the company's common stock, and therefore, was not a true majority shareholder. *Swomley*, 2014 WL 4470947, at *2.

Moreover, in *Swomley*, the board resolved at its ***first meeting***, the very next day after the initial offer, to condition any deal on the approval of a special committee and majority-of-the-minority conditions. *Id*. at *4-5. Furthermore, the controlling stockholder was part of the Board making this resolution, and therefore, embraced it. *Id*. No meetings took place in the interim; no time really passed.

Additionally, the *Swomley* plaintiffs did not "legitimately call[] into question or raise[] a debate about the" *ab initio* protections. *Id*. at *22. In other words, the *Swomley* plaintiffs essentially waived this argument. Not so here.

Here, the trial court deemed the dual protections present *ab initio* despite the fact that they were not imposed until over two weeks after the Buyer Group submitted its Initial Offer Letter, because there were not "any negotiations" that took place during that time. (Or. ¶ 7c, 7g.) This finding is a clear error and improperly gave the defendants the benefit of the doubt on the factual inferences, because it is clear that the parties had, in fact, engaged in negotiations (concerning

the Davis Polk conflicts) and had met and discussed the terms of the offer. It is impermissible for the trial court to make such factual inferences in defendants' favor at the motion to dismiss stage. *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006) (requiring the acceptance of well-pled allegations as fact and the drawing of reasonable inferences in the non-movant's favor).

Aside from what was disclosed in the proxy, without discovery, there is no way of knowing what actually transpired during the time between the Initial Offer Letter dated January 14, 2016 and the January 30, 2016 letter first requiring the dual protections. Plaintiff clearly alleged that in the interim, Cai "negotiated and agreed" to a waiver of Davis Polk's conflict of interest before the January 21 board meeting, clearly admitting that some negotiation with the Buyer Group had already taken place before the Board formed the Special Committee. (A063-64).

The trial court recognized this as an "arguably substantive event" occurring before the dual protections were in place. (Or. ¶ 7f.) Yet the Court's order ignores Plaintiff's allegations regarding other events that occurred during this time: after Zhang sent the Initial Offer Letter, a telephonic board meeting, also attended by Zhang took place at which the Board discussed the terms of the proposal and appointed Wu, recommended by Zhang to serve as an independent director to fill a vacancy. (A063-64.) Wu would become a member of the Special Committee.

Additionally, at this same meeting Davis Polk advised the directors as to their fiduciary duties in considering and evaluating the Initial Offer Letter. (A063-64.)

Interpreting these facts and drawing all factual inferences in Plaintiff's favor, one could not properly conclude that the Buyer Group self-disabled before negotiations commenced, let alone *ab initio*.

II. THE TRIAL COURT ERRED IN HOLDING THAT PLAINTIFF FAILED TO PLEAD A BREACH OF THE DUTY OF CARE

A. Question Presented

Did the trial court err in holding that business judgment was the proper standard of review where the Complaint alleged that the Special Committee accepted an inadequate and unfair price as a result of deferring to conflicted management and accepting obviously skewed valuation analyses, thereby breaching its duty of care? (A374-77, A492-97.)

B. Scope of Review

This Court reviews a trial court's ruling on a motion to dismiss *de novo* to "determine whether the trial judge erred as a matter of law in formulating or applying legal precepts." *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009) (quoting *Feldman v. Cutaia*, 951 A.2d 727, 730-31 (Del. 2008)).

C. Merits of the Argument

The proper standard of review in a controller buyout is entire fairness, unless several requirements are met to shift that standard to business judgment. *M&F Worldwide*, 88 A.3d at 645. One such requirement is that the Special Committee meets its duty of care in negotiating a fair price. *Id.*

Here, the trial court found that, with respect to the Special Committee's negotiations, the Complaint's allegations, considered individually and in the aggregate, did not support an inference of gross negligence. (Or. ¶ 10h.) This

Court, however, has found that allegations regarding the sufficiency of price can call into question the adequacy of the Special Committee's negotiations, thereby surviving a motion to dismiss. *M&F Worldwide*, 88 A.3d at 645 n.14.

In finding that the Special Committee met its duty of care in negotiating a fair price here, the trial court considered that the "[t]he standard for determining whether the business judgement reached by a board of directors was an informed one is gross negligence." (Or. ¶ 10e.) The trial court then characterized gross negligence as "so grossly off-the-mark as to amount to reckless indifference or a gross abuse of discretion." (Or. ¶ 10f.) This standard, as it has been applied by this Court, is satisfied here; the trial court erred in finding otherwise.

In *M&F Worldwide*, this Court indicated in a footnote that the complaint at issue would have survived a motion to dismiss under this new standard because the "allegations about the sufficiency of the price call into question the adequacy of the Special Committee's negotiations, thereby necessitating discovery on all of the new prerequisites to the application of the business judgement rule." 88 A.3d at 645 n.14. This Court further pointed out the fact that in *Americas Mining*, it was not possible to make a pretrial determination that the independent committee had negotiated a fair price. *Id*. at 645 n.13.

In analyzing the allegations regarding the insufficiency of price in *M&F Worldwide*, this Court considered: (1) that the ratios used in valuing the company

were well below those of similar recent transactions; (2) that the merger price was below where the Company's stock had recently been trading; (3) particularized facts indicating that the share price had been depressed at the time of the offer; and (4) commentators' views that the price was low. *Id*. at 635 n.14.

The Complaint alleged strikingly similar facts, demonstrating not only that the price was insufficient, but therefore, that the Special Committee was grossly negligent. These failures should have been held to state a claim for breach of fiduciary duty of care, and should have thereby precluded a shift of the standard of review from entire fairness to business judgment.

1. The Special Committee Repeatedly And Without Question Acceded To Management's Lowered Projections

On August 17, 2016, management provided to the Special Committee and Houlihan Lokey the August Projections, which revised downward the Company's projections. (A071.) Neither the Special Committee nor Houlihan Lokey had any discussions with management regarding the August Projections; it appears that the Special Committee accepted the August Projections without question. Houlihan Lokey's discounted cash flow analysis based on the August Projections resulted in an implied per share price range of \$4.03 to \$9.62 per share; the Buyout price of \$5.91 was well below the midpoint. (A073-74.)

On September 9, 2016, Zhang, on behalf of the Buyer Group, offered to increase the price to \$6.05 per share but indicated that it was a "best-and-final"

offer. (A073.) On September 22, 2016, the Special Committee determined to accept the Buyer Group's offer price of $6.05 per share, despite the fact that the price was a discount to the Company's recent public stock price and a fraction of the high end of the implied per share values derived from Houlihan Lokey's initial "Illustrative Discounted Cash Flow Sensitivities" performed only approximately three months earlier. (A074.)

After price had already been agreed upon, on November 4, 2016, Houlihan Lokey informed the Special Committee that Company management had again revised downward Synutra's financial projections on November 10, 2016 and November 11, 2016, respectively. (A076.) On November 11, 2016, the Special Committee held a telephonic meeting during which representatives of Houlihan Lokey reviewed the Company Projections. (A078.) The Special Committee did not assess whether the Company's lowered projections were appropriate. Rather, the Special Committee accepted the Company Projections without contest and permitted Houlihan Lokey to revise its analyses to incorporate the lowered projections. (A078.) Houlihan Lokey revised its discounted cash flow analysis to reflect the Company Projections, and the resulting range of implied values for the Company was $3.81 to $9.29, thus causing the $6.05 offer price to fall just below the midpoint of the range. (A078-79.)

The trial court recognized that at the pleading stage, this pattern of lowering projections "carries some weight." (Or. ¶10b.) The trial court further recognized that "the risk that management may shade information out of loyalty to the controller is another problem endemic to controlling stockholder squeeze outs." (Or. ¶10b.) Yet the trial court did not weigh these inferences in Plaintiff's favor. The lowered projections had the effect of making the price seem fair. Had the Special Committee been scrutinizing the price and negotiating with due care, it should have been questioning the repeatedly lowered projections. Prior to Houlihan Lokey rendering its fairness opinion, Company management lowered its projection three times in the span of one week. And yet the Special Committee asked no questions, according to the Proxy. Instead, Houlihan Lokey and the Special Committee took them at face value with no pushback.

Indeed, this acceptance of the depressed projections went well beyond mere credulity and extended into gross negligence because the Special Committee and its advisors knew that the issues impacting the Company's results had been fixed, and were not expected to affect the Company's future performance. In fact, Synutra had publicly stated that "the Company remain[ed] optimistic about its prospects for continued strong growth above the industry average for fiscal 2017 and beyond, once its French facility is fully operational." (A059.) That French Facility came online and was operational as of September 2016. (A081.)

Moreover, China was undergoing regulatory changes at the time that were expected to benefit the Company. (A081-82.) Nevertheless, the Company's management continued to depress the financial projections after that point. (A080.) This obvious contradiction demonstrates the Special Committee's gross negligence in failing to question or push back against the repeated downward revisions of the financial projections (which were specially prepared for this process by management beholden to the Buyout Group).

By accepting and using these depressed financial projections without further due diligence or pushback, the Special Committee members acted with gross negligence because they knew that these projections were being prepared by conflicted management and that the rationale for the continuing downward revisions conflicted with reality, and with management's prior statements. *See, e.g.*, *Gesoff v. IIC Industries, Inc.*, 902 A.2d 1130, 1148 (Del. Ch. 2006) ("At a minimum, the special committee should have control over its own sources of information and should have the loyalty of its advisors throughout the process."); *In re Emerging Commc'ns., Inc. S'holders Litig.*, 2004 WL 1305745, at *39-40 (Del. Ch. May 3, 2004) (finding a director liable for failing to act in good faith when that director had "strong reasons to believe" that the merger consideration was unfair notwithstanding Houlihan Lokey's fairness opinion).

2. Zhang's Offer Was Timed To Take Advantage Of The Company's Depressed Stock Price, Which Did Not Reflect The Company's Value

Zhang planned his proposal and negotiations to capture the Company's long-term growth prospects for a historically low price. As a result, the Buyout price was substantially lower than the value of the Company. After Zhang made the Initial Offer Letter, the Company continued to announce setbacks, delays, and increased costs related to the France Facility. This negatively impacted the Company's stock price.

At the time the deal price had been set, the Company had just opened its France Facility, and expressed optimism about its long-term growth prospects as a result. Indeed, this optimism has been realized as news reports from France indicate that Synutra launched the largest dairy in Europe on sixteen hectares in September 2016, and an additional dairy in 2017 on thirteen hectares. Chloé Coupeau, *Les usines de lait pour la Chine se multiplient en France, eldorado ou mirage pour les éleveurs?*, Courrier Picard, July 28, 2017, http://www.courrier-picard.fr/46370/article/2017-07-28/les-usines-de-lait-pour-la-chine-se-multiplient-en-france-eldorado-ou-mirage (last visited November 30, 2017). Additionally, as discussed herein, the Company was set to benefit from changes in Chinese regulations regarding the infant formula market. (A081-82.)

In the months leading up to the Buyer Group's Initial Offer Letter, Zhang highlighted pricing pressure from online channels and setbacks related to niche products in the private label to explain decreasing sales. (A058-60.) He also cautioned stockholders that it might not meet its forecast for fiscal 2016 and that there would be delays in the completion of the France Facility. (A058-60.)

From the outset of these pessimistic press releases, the Company's stock price fell from a high of $7.90 in April of 2015 to $4.71 on December 31, 2015. (A060.) The Company's stock price continued to fall in January of 2016, and closed at a low for the year of $3.62 on January 13, 2016, the day before the Buyer Group's initial proposal. (A060.)

The trial court stated that there may have been competing explanations for these announcements, including "the obvious explanation that they simply were accurate statements about the Company, but at the pleading stage, they must be regarded with greater skepticism." (Or. ¶10b.) Nevertheless, the trial court gave no weight to Plaintiff's articulation of facts supporting the claim that the price was inadequate. Instead, the trial court drew inferences in defendants' favor and concluded that the Special Committee had negotiated a small increase in the offer price and advantageous merger terms, and thus were not grossly negligent. (Or. ¶ 10h.)

3. The Inputs To Houlihan's Discounted Cash Flow Analysis Appear Engineered To Support the Price

Any fair Capital Asset Pricing Model ("CAPM") analysis of a weighted average cost of capital ("WACC") leads to the conclusion that the selected discount rate range used by Houlihan Lokey here is unreasonably high. Using 2-year and 5-year betas for the Company, a cost of equity of 12.5% to 14.0% can be derived using a traditional U.S.-based CAPM approach. (A084.) Including, a conservative 1% country risk premium to the CAPM, the cost of equity increases to 13.5% and 15.5%. (A084.) The Company's pre-tax cost of debt is low (3.5%) and is comprised of floating rate and other bank debt. (A084.) No credit ratings are available for the Company's debt, and yield-to-maturity (YTM) information was also not available. (A084.) Although one source for approximating the Company's cost of debt is the financing being provided in the deal, the interest rate being charged on that debt was not disclosed. (A084.)

The Company's capital structure was financed approximately 70% with debt and 30% with equity. (A040). However, Houlihan Lokey appears to have assumed a capital structure far more weighted to equity than was the reality, and thereby minimized the offsetting effect of the low cost debt; Houlihan Lokey calculated a much higher WACC than would have resulted if it had applied the Company's actual debt to equity ratio. *Cede & Co. v. JRC Acquisition Corp.,* 2004 WL 286963, at *7 (Del. Ch. Feb. 10, 2004) ("the more weigh one gives to debt, the

lower the discount rate and the higher the valuation"). This unreasonable weighting bore no resemblance to the reality of the Company's situation, and appears to have been intended to inflate the discount rate for Houlihan Lokey's Discounted Cash Flow analysis (and thereby depress the resulting implied value of the Company). The Special Committee's acceptance of this unreasonable weighting is itself a strong indicator that the Special Committee breached its duty of care. *See e.g., Hintmann v. Fred Weber, Inc.*, 1998 WL 83052, at *5 (Del. Ch. Feb. 17, 1998) (relying on company's actual cost of debt because "[a]s with all other areas of business valuation, this Court prefers to use a company's actual information when possible, unless it is shown that the actual information would yield unreliable results"); *In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485, 493 (Del. Ch. 1991) (utilizing Radiology's actual debt to equity ratio in determining its WACC because "I must value Radiology, not some theoretical company"); *Cede & Co.,* 2004 WL 286963, at *7 ((opting to consider the company's actual capital structure as opposed to its optimal capital structure in determining an appropriate debt-to-equity ratio for DCF analysis.

The result of Plaintiff's independent analysis, as presented in the Complaint, is a WACC range of 6.5% to 7.0% -- a range significantly below that used by Houlihan Lokey. (A085.) Even using a 10% WACC and 2% perpetuity growth rate would have resulted in a $9.77 per share value, even when keeping all other

inputs in Houlihan Lokey's discounted cash flow model – including the dubiously depressed Company Projections -- constant. (A085.) Thus, there are considerable concerns raised by Houlihan Lokey's financial evaluation of the Buyout, which raises the clear specter of intentional manipulation of the valuation models.

Additionally, Houlihan Lokey's Selected Companies Trading Statistics used ranges below the mean and median for all metrics observed without any explanation. (A085.) Again, the Special Committee accepted this rather blatant effort to depress the implied value of the Company. This strongly indicates that the Special Committee failed to exercise due care. *M&F Worldwide*, 88 A.3d at 646, n.14.

* * * *

For the foregoing reasons, the trial court erred in finding that Plaintiff did not demonstrate that the Special Committee failed to fulfill its duty of care in the process, and thus erred in applying business judgment as the standard of review. The proper standard of review was entire fairness, and the motion to dismiss should have been denied.

CONCLUSION

The trial court's ruling contravenes the precedent articulated by this Court in *M&F Worldwide*. Appellant respectfully requests that the Court reverse the trial court's decision.

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Dated: April 12, 2018

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