EFiled: May 14 2018 06:10PM EDT
Filing ID 62029257
Case Number 101,2018

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE SYNUTRA INTERNATIONAL, INC. STOCKHOLDER LITIGATION	)	No. 101, 2018
ARTHUR FLOOD,	)	C.A. No. 2017-0032-VCL
Plaintiff-Below, Appellant	)	On Appeal from the Court of Chancery of the State of Delaware,
v.	)	C.A. No. 2017-0032-JTL
SYNUTRA INTERNATIONAL, INC., LIANG ZHANG, JINRONG CHEN, LEI LIN, YALIN WU, XIUQING MENG, BEAMS POWER MERGER SUB LIMITED, AND HOULIHAN LOKEY CAPITAL, INC.,	)	
Defendants-Below, Appellees.	)	

APPELLEES' ANSWERING BRIEF

POTTER ANDERSON & CORROON LLP
Matthew E. Fischer (#3092)
Matthew R. Dreyfuss (#5885)
1313 North Market Street, 6th Floor
Wilmington, Delaware 19801
(302) 984-6000

OF COUNSEL:

Roger A. Cooper
Rishi N. Zutshi
Vanessa C. Richardson
Hana Choi
CLEARY GOTTLIEB STEEN & HAMILTON LLP
One Liberty Plaza
New York, New York 10006
(215) 225-2000

Attorneys for Defendants-Below, Appellees Jinrong Chen, Yalin Wu, Lei Lin and Synutra International, Inc.

MORRIS NICHOLS ARSHT & TUNNELL LLP
William M. Lafferty (#2755)
John P. DiTomo (#4850)
1201 North Market Street
Wilmington, Delaware 19801
(302) 658-9200

OF COUNSEL:

Lawrence Portnoy
Rebecca L. Martin
DAVIS POLK & WARDWELL LLP
450 Lexington Avenue
New York, New York 10017
(212) 450-4000

Attorneys for Defendants-Below, Appellees Beams Power Investment Ltd., Liang Zhang and Xiuqing Meng

Dated: May 14, 2018

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

NATURE OF PROCEEDING

This is an appeal from the Court of Chancery's order dismissing Plaintiff's verified amended class action complaint (the "Amended Complaint") claiming breach of fiduciary duty and aiding and abetting in connection with the acquisition of Synutra International, Inc. ("Synutra" or the "Company") by controlling stockholder Beams Power Investment Limited ("Beams Power," together with Mr. Liang Zhang and Ms. Xiuqing Meng, the "Buyer Group") (the "Transaction").

Two stockholder lawsuits were filed in the Court of Chancery regarding the Transaction: *Murillo v. Synutra, et al*., C.A. No 12990-VCL (Del. Ch.) and *Flood v. Synutra, et al*., C.A. 2017-0032-VCL (Del. Ch.). Plaintiff Murillo challenged the adequacy of the disclosures in the Company's proxy statement (the "Proxy"), moved to expedite and sought preliminary injunctive relief. The Court of Chancery denied that motion on February 3, 2017, stating that "[t]he controlling stockholder transaction in this case facially followed the MFW framework. The plaintiff has not advanced meaningful challenges to that framework." Hearing Transcript re: Plaintiff's Motion to Expedite and the Court's Ruling at 18:4-7, *Murillo v. Synutra, et al*., C.A. No 12990-VCL (Del. Ch. Feb. 3, 2017). Plaintiff Flood filed the Amended Complaint on February 10, 2017. After the Transaction closed, the *Murillo* and *Flood* actions were consolidated.

On February 2, 2018, after briefing and oral argument, the Court of Chancery dismissed the Amended Complaint with prejudice. *In re Synutra Int'l, Inc.*, 2018 WL 705702 (Del. Ch. Feb. 2, 2018) (cited as "Order"). The Court of Chancery held that the Transaction "followed the framework approved by the Delaware Supreme Court" in *Kahn v. M&F Worldwide Corp*., 88 A.3d 635 (Del. 2014), because the Buyer Group announced the *M&F Worldwide* conditions promptly after submitting its initial proposal and *before* any negotiations occurred. Order ¶¶ 5, 7g. The Court of Chancery also found that Plaintiff failed to plead facts sufficient to call into question the disinterestedness and independence of the members of the Special Committee or their exercise of due of care and that, having failed to plead a claim for breach of fiduciary duty, Plaintiff had likewise failed to plead a claim for aiding and abetting. *Id.* ¶¶ 9-10, 12.

On appeal, Plaintiff does not challenge the Court of Chancery's decisions regarding the Special Committee's independence or ability to say "no" definitively to the Transaction and has likewise abandoned his aiding and abetting claims. And Plaintiff has never alleged any disclosure violations or coercion of the disinterested stockholders, a majority of whom voted to approve the Transaction. The sole issues Plaintiff raises on appeal are (1) whether the *M&F Worldwide* conditions were in place *ab initio*, and (2) whether the Special Committee exercised due care in negotiating and recommending the Transaction.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery correctly held that the Transaction should be subject to business judgment review under *M&F Worldwide* because it was "'conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfill[ed] its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders.'" Order ¶ 7. (quoting *M&F Worldwide*, 88 A.3d at 644). The court observed that *M&F Worldwide* requires these conditions to be in place *ab initio* to "ensur[e] that the controller 'cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move.'" *Id.* ¶ 7a. (quoting *M&F Worldwide*, 88 A.3d at 644). Accordingly, the court held that the Buyer Group satisfied the *ab initio* requirement by announcing the dual conditions shortly after submitting its initial proposal and "before any negotiations took place." *Id.*

Plaintiff now urges this Court to adopt a new "bright-line" rule, Op. Br. at 3, 19, that would preclude business judgment review of a controlling-stockholder transaction if the *M&F Worldwide* conditions are not announced in the very first communication of an initial proposal, even if those conditions are announced before any actual substantive counterparty negotiations take place. This Court has already rejected a very similar argument and should reject it here,

as it is contrary to the rationale this Court announced for the *M&F Worldwide* protections. *See infra* at Argument, Section I.C.1. The Court should also reject Plaintiff's secondary argument that, even if its legal argument fails, the Amended Complaint adequately pleads facts showing that the parties engaged in substantive negotiations before the Buyer Group supplemented its proposal to include the *M&F Worldwide* conditions. As the Court of Chancery determined, this argument is based on conclusory assertions and not supported by well-pleaded facts. *See infra* at Argument, Section I.C.2.

2. Denied. The Court of Chancery correctly held that Plaintiff could not allege facts to support a reasonable inference that the Special Committee was grossly negligent in recommending approval of the Transaction, where it was undisputed that "the Special Committee held fifteen meetings over ten months," "retained its own [independent] legal and financial advisors," "conducted a market check" involving 25 potential bidders without receiving a competing bid, and negotiated a higher price, which "represented a 58% premium to the Company's unaffected stock price," as well as "revised deal terms" more favorable to the Company. Order ¶ 10h.

Plaintiff's claim that he merely needs to allege "unfair price" in order to survive a motion to dismiss misreads *M&F Worldwide* and is contrary to longstanding precedent. *See infra* at Argument, Section II.C. Furthermore, none

of Plaintiff's allegations—including regarding the Company's earnings announcements, management's revisions to the projections, and the financial advisor's updated valuation analyses—show that the Special Committee was inadequately informed, acted unreasonably, or did not fulfill its obligation to seek the best value reasonably available to the stockholders, let alone state a claim for waste. Thus, dismissal was proper. *See infra* at Argument, Section II.C.1-3.

COUNTERSTATEMENT OF FACTS

A. The Buyer Group Submits A Proposal To Take Synutra Private And Announces The Dual Conditions Set Forth In *M&F Worldwide*

Synutra is a Delaware corporation that is one of the leading infant formula companies in China. A013. On January 14, 2016, Synutra received a preliminary non-binding proposal from the Buyer Group to acquire all of the outstanding shares of Synutra's common stock (the "Common Stock") that the Buyer Group did not already own for $5.91 per share in cash (the "Proposal"), which reflected a substantial premium above the current market price. A151.

Synutra's Board of Directors (the "Board") next met on January 21, 2016. At that meeting, the Board appointed a new independent director, Mr. Yalin Wu, to fill the vacancy left by Ms. Min Zhang (unrelated to Mr. Zhang of the Buyer Group), who had resigned from her position on November 9, 2015. A152. The Board—with Mr. Zhang abstaining—then voted to establish the Special Committee composed of independent directors Ms. Jinrong Chen, Mr. Lei Lin and Mr. Wu to review and evaluate the Proposal. A153. The Special Committee was granted the authority, among other things, to review and evaluate any potential sale transaction involving the Company, retain its own advisors, negotiate the terms of any transaction, and make a recommendation to the Board regarding such transaction, including whether to accept or reject the transaction or consider alternative transactions. *Id*. The Board further resolved that it would not approve

or recommend the Proposal without the favorable recommendation of the Special Committee. *Id*.

The members of the Special Committee were well-qualified and independent: (1) Mr. Wu has extensive experience in financial and strategic consulting, including in his roles as the CEO of Northern Investment & Financial Consultants Ltd. Co., director of Deloitte Corporate Finance (HK) Ltd. and deputy executive CEO of Deloitte Consultants (Shanghai) Ltd.; (2) Ms. Chen serves as an associate professor at the School of Economics and Management of Tsinghua University in Beijing, and also advises or sits on the boards of Bosun Tools Co., Ltd. and Citic Development—Shenyang Commercial Building (Group) Company Ltd., which are listed in China; and (3) Mr. Lin is the founder and chairman of TNS Sinotrust Market Research Consulting (Beijing) Co., Ltd., a marketing research and consulting company, and also sits on the boards of Xiezhong International Holdings Ltd., New Focus Auto Tech Holdings Ltd. and Car Inc., which are listed in Hong Kong. A298-99.

As disclosed to the Board in the Proposal and to stockholders in the Proxy, Davis Polk & Wardwell LLP ("Davis Polk") was engaged by the Buyer Group to act as their U.S. legal counsel. A152. As also disclosed in the Proxy, representatives from Davis Polk who were *not* involved in representing the Buyer Group attended the January 21 meeting as the Company's then-outside U.S.

counsel because the Company had not yet retained other legal counsel. *Id.* Their participation was limited solely to advising the Board on its fiduciary duties under Delaware law and on establishing a special committee—advice that Plaintiff does not challenge. *Id.* As agreed in advance, the Board did not substantively evaluate the Proposal at this meeting, and Davis Polk provided no advice with respect to it. A152-53. The waiver of Davis Polk's conflicts was negotiated and agreed by Ms. Ning Cai, Synutra's Chief Financial Officer on behalf of the Company before the January 21 meeting, and no member of the Buyer Group participated in the Company's decision to have representatives of Davis Polk attend this meeting or to waive conflicts. A152.

On January 30, 2016, before the Special Committee held its first meeting, retained its own legal or financial advisors, or engaged in any discussions or negotiations with the Buyer Group regarding the Proposal, the Buyer Group submitted a letter (the "January 30 Letter") to the Special Committee stating that it would not proceed with the Proposal unless the transaction was (i) approved by a special committee composed entirely of independent directors, and (ii) subject to a non-waivable condition requiring the affirmative vote of a majority of the minority shareholders. A153.

On February 1, 2016, the Special Committee convened for the first time and decided to retain Cleary Gottlieb Steen & Hamilton LLP ("Cleary") as its

independent legal advisor. A153-54. On February 4, 2016, after interviewing several investment banks, the Special Committee engaged Houlihan Lokey Capital, Inc. ("Houlihan") as its independent financial advisor. A155.

Although the Proposal was publicly announced on January 15, 2016, and again on February 2, 2016, no alternative bidder came forward to express interest in pursuing a transaction with Synutra. A103.

B. The Company Fails To Meet Forecasts And The Special Committee's Market Check Attracts No Other Bidders

On April 22, 2016, the Special Committee received an initial draft of financial projections from Ms. Cai; those projections were updated on May 27, 2016 (the "May Projections") to reflect changes in the exchange rate and refinements to capital expenditure estimates, revised projected volume of certain products and updated assumptions about expenses.[1] A158.

On May 28, 2016, the Special Committee instructed Houlihan to meet with management of the Company to discuss the May Projections and other financial information relating to the Company. *Id.* In late May 2016, management provided Houlihan with preliminary estimates of financial results for the fiscal year

[1] Plaintiff complains that the Buyer Group sent a draft of the merger agreement on April 7, 2016. *See* Op. Br. at 7. But Plaintiff omits the fact that the Special Committee determined that "it would be premature to engage with the Buyer Group on the terms of the merger agreement" before it received preliminary financial analyses from Houlihan and did not respond to this draft. *See* A158.

ended March 31, 2016 and advised Houlihan that the Company's financial performance in April and May 2016 was trailing prior projections. *Id.*

On June 12, 2016, the Special Committee and Houlihan reviewed financial discussion materials ("June Discussion Materials") relating to the proposed transaction. A159. The Special Committee observed that the closing price of the Common Stock on June 10, 2016 was $4.06, and after discussion with Houlihan, the Special Committee decided that the offer price of $5.91 merited further consideration. *Id.* The next day, the Company announced its results for the fiscal year ending on March 31, 2016, which showed that the Company had failed to meet its revenue and net income forecasts for a fourth consecutive quarter. *Id.*

On July 20, 2016, the Special Committee instructed Houlihan to conduct a pre-signing market check. Houlihan contacted 25 potential bidders, including 13 strategic buyers and 12 financial investors. A160. None of the potential bidders expressed interest in pursuing a transaction with Synutra. A161.

On August 9, 2016, the Company released its quarterly results for the fiscal quarter ended June 30, 2016, which showed that the Company again failed to meet forecasts. *Id.* Houlihan informed the Special Committee that management would provide revised financial projections (the "August Projections"), reflecting the latest financial results. *Id.* The Special Committee and Houlihan discussed the

key drivers behind the revision of the projections, including the low sales of newly launched liquid milk products and delays at the Company's French facility. *Id.*

On September 8, 2016, the Special Committee and Houlihan reviewed and discussed updated financial analyses (the "September Discussion Materials"). *Id.* The September Discussion Materials included: (i) a comparison of the May Projections and August Projections; (ii) preliminary selected companies analysis; (iii) preliminary selected transactions analysis; and (iv) preliminary discounted cash flow analysis. *Id.* Even though the analyses showed that the offer price of $5.91 was either at the high end of or within each of the preliminary implied per share equity value reference ranges, the Special Committee decided to request that the Buyer Group increase the offer price. A161-62.

C. The Special Committee Obtains A Better Price And Favorable Deal Terms, Then Votes To Recommend The Transaction

Despite Synutra's declining financial performance and the lack of interest from other potential bidders, the Special Committee negotiated an increase in the purchase price to $6.05. A162. The price offered a premium to Synutra's minority stockholders, representing a 58% premium to the closing price on January 14, 2016, the last trading day before the first public announcement of the Transaction, and a 31% and a 20% premium, respectively, to the 30- and 60-day volume-weighted averages. A167. The Special Committee also negotiated more

favorable deal terms, including a 30-day post-signing go-shop and a reduction in the termination fee from 3.5 percent to 2.5 percent. A162-65.

After failing to achieve the financial results forecasted in the May Projections, the Company again failed to meet forecasts for the second quarter reflected in the August Projections. A165. The Company provided updated projections (the "Company Projections"), which the Special Committee and Houlihan reviewed at a meeting on November 17, 2016. *Id.* The Special Committee and Houlihan discussed the differences between the August Projections and the Company Projections, and the key drivers behind the differences, including the Company's repeated failure to achieve forecasts, adverse changes in foreign exchange rates and continued delays at the Company's French facility. *Id.*

On November 17, 2016, the Special Committee held a meeting at which Houlihan reviewed and discussed its updated financial analyses based on the Company Projections and rendered an oral opinion, later confirmed in writing, that the $6.05 per share consideration to be received by the Company's minority shareholders in the Transaction was fair, from a financial point of view, to those stockholders. A166. After a comprehensive discussion of the merger agreement and Houlihan's financial analyses and opinion, the Special Committee unanimously resolved to recommend approval of the Transaction to the Board. *Id.* Later that day, based upon the unanimous recommendation of the Special

Committee, the Board adopted resolutions approving the terms of the merger agreement and resolved to recommend the adoption of the merger agreement to Synutra's stockholders, and the parties executed the merger agreement. *Id.*

D. The Company Provides Full Disclosure In The Proxy And The Fully-Informed, Uncoerced Minority Stockholders Approve The Transaction

On December 9, 2016, Synutra filed a Preliminary Proxy Statement with the SEC. Plaintiff Murillo filed his complaint on December 15, 2016, which was amended on January 5, 2017. Plaintiff Murillo also filed a motion for expedited proceedings and for a preliminary injunction, claiming that Synutra allegedly failed to disclose certain material information to stockholders. On January 23, 2017, Synutra filed an amended proxy statement with the SEC that contained supplemental disclosures intended to moot certain disclosure claims. After briefing by the parties and a hearing on February 3, 2017, the Court of Chancery denied Plaintiff Murillo's motion and declined to expedite the case.

Plaintiff Flood filed his original complaint on January 17, 2017 and the Amended Complaint on February 10, 2017. Plaintiff Flood did not challenge the adequacy of the disclosures in the Proxy, move to expedite or seek preliminary injunctive relief.

The Company filed the final Proxy on March 9, 2017. The Proxy contained more than 22 pages describing the background of and reasons for recommending the Transaction, more than 9 pages disclosing Houlihan's analysis,

and annexes of additional documents totaling more than 55 pages. On April 28, 2017, a majority of the unaffiliated stockholders voted to approve the Transaction.

On April 25, 2017, Plaintiff Flood moved for Consolidation and Appointment of Lead Plaintiff and Lead Counsel. The Court of Chancery granted Plaintiff Flood's motion for consolidation on August 7, 2017.

E. The Court Of Chancery Dismisses The Consolidated Complaint

On August 31, 2017, Defendants filed their motions to dismiss. On February 2, 2018, after briefing and argument, the Court of Chancery dismissed the Amended Complaint in its entirety. The Court of Chancery concluded that the Transaction satisfied the *ab initio* requirement because the Buyer Group publicly disabled itself "before the Special Committee ever convened and before any negotiations ever took place." Order ¶ 7g. The Court of Chancery also concluded that "[t]he complaint's allegations, considered individually and in the aggregate, do not support an inference of gross negligence [by the Special Committee]." *Id.* ¶ 10h. Because Plaintiff failed to plead facts supporting a reasonable inference that Defendants' process did not meet the elements of the *M&F Worldwide* standard, the Court of Chancery applied business judgment review and dismissed the Amended Complaint with prejudice. *Id.* ¶¶ 5, 11-14.

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY HELD THAT THE CONTROLLER SATISFIED THE *AB INITIO* REQUIREMENT BY SELF-DISABLING BEFORE ANY NEGOTIATIONS BEGAN

A. Question Presented

Did the Court of Chancery correctly hold that the dual *M&F Worldwide* protections were in place *ab initio* because the Buyer Group conditioned the Transaction on the approval of both the Special Committee and a majority of the minority stockholders before any negotiations took place?

B. Scope Of Review

The scope of this Court's review is *de novo*. Although well-pleaded allegations must be accepted as true, the Court will not "credit conclusory allegations that are not supported by specific facts or draw unreasonable inferences in the plaintiff's favor." *Norton v. K-Sea Transp. Partners L.P.*, 67 A.3d 354, 360 (Del. 2013).

C. Merits Of The Argument

The business judgment rule applies where "the controlling stockholder conditioned its offer upon the [] Board agreeing, *ab initio*, to both procedural protections, *i.e.*, approval by a Special Committee and by a majority of the minority stockholders." *M&F Worldwide*, 88 A.3d at 646. The Court of Chancery correctly held that "[a] process meets the *ab initio* requirement when the controller announces the conditions 'before any negotiations [have taken] place.'" Order ¶ 7a

(quoting *Swomley v. Schlecht*, 2014 WL 4470947, at *21 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT), *aff'd*, 128 A.3d 992 (Del. 2015) (TABLE)). That holding is consistent with this Court's explicit rationale for the *ab initio* requirement—which is to prevent the controller from using the *M&F Worldwide* conditions as bargaining chips later in the negotiations—and with subsequent case law interpreting that requirement. Because Plaintiffs failed to plead any facts suggesting that the Buyer Group announced the *M&F Worldwide* dual protections *after* negotiations with the Special Committee began, the Court of Chancery correctly applied the business judgment rule and dismissed the Complaint. *Id.* ¶¶ 7, 11-14.

Nonetheless, Plaintiff asks this Court to reverse the Court of Chancery's decision based on two flawed arguments. First, Plaintiff asks the Court to adopt a new categorical rule under which the business judgment review would never be available unless the *M&F Worldwide* conditions are announced in the very first communication of any initial proposal or offer. Under Plaintiff's proposed new rule, "negotiations" would be deemed as a matter of law to commence with that first communication, and courts would not be permitted to consider any additional facts regarding subsequent actions or statements made by the parties. *See* Op. Br. at 16-19. This Court has already rejected a very similar argument made by the plaintiffs in the *Swomley* appeal and should reject this latest

invitation to declare such an inflexible categorical rule, which would undermine the Court's rationale for announcing the *M&F Worldwide* framework—to encourage controllers to self-disable. Second, Plaintiff claims in the alternative that the Court of Chancery erred by failing to recognize that the Amended Complaint pleads that the parties in fact engaged in substantive negotiations between the Proposal and the January 30 Letter. *See id.* 19-22. Because this argument is entirely conclusory and not supported by well-pleaded facts, it too should be rejected.

1. Plaintiff's Formalistic Interpretation Of The *Ab Initio* Requirement Contravenes Both Case Law And The Policy Underlying The *M&F Worldwide* Protections

The Court of Chancery's holding that the *ab initio* requirement is satisfied "when the controller announces the conditions 'before any negotiations [take] place,'" Order ¶ 7a (citing *Swomley*, 2014 WL 4470947, at *21), is consistent with this Court's explicit rationale for the *ab initio* requirement: to prevent the controller from using those conditions as bargaining chips "late in the process" to exercise undue influence in the negotiations, and thus more closely approximate a third-party arm's-length merger. *M&F Worldwide*, 88 A.3d at 644; *see also In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 643 n.83 (Del. Ch. 2005) (noting that the *ab initio* requirement exists so that "a controller would not be able to throw in a Minority Approval Condition as alternative consideration

to more cash or stock"); *In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016) (controller sufficiently disables itself when it agrees on the dual conditions "up front, before any negotiations begin"); *In re Orchard Enters. Inc. S'holders Litig.*, 88 A.3d 1, 24 (Del. Ch. 2014) (same). Here, as the Court of Chancery recognized, "[t]he prompt sending of the Follow-up Letter prevented the Buyer Group from using the *M&F Worldwide* conditions as bargaining chips." Order ¶ 7g.

Notably, this Court has already rejected a very similar argument to the one made by Plaintiff here. In *Swomley*, plaintiffs argued that the *ab initio* element was not satisfied because the controller's initial proposal hedged on whether the majority-of-the-minority condition would be waivable, which was confirmed to be non-waivable at a later board meeting before any negotiations began. *See* Appellants' Op. Br. at 31, *Swomley v. Schlecht*, 128 A.3d 992 (Del. 2015) (No. 180, 2015) ("the Merger was not conditioned upon a non-waivable [majority of the minority vote] *from the outset*") (emphasis in original); Appellants' Reply Br. at 18, *Swomley v. Schlecht*, 128 A.3d 992 (Del. 2015) (No. 180, 2015) ("[t]he [controller] did not have [the majority of the minority requirement] in place when they first approached the Board on May 29, and therefore the unified standard is not satisfied."). This Court, however, rejected that argument, affirming the lower

court's decision "for the reasons stated in its August 27, 2014 bench ruling." *Swomley v. Schlecht*, 128 A.3d 992 (Del. 2015) (TABLE).

Plaintiff attempts to distinguish *Swomley* by highlighting that the controller in that case was "part of the Board making [the] resolution [that implemented the dual conditions]." Op. Br. at 20. But the key similarity remains: in both cases the *M&F Worldwide* conditions were in place after the initial communication with the controller but before negotiations began, satisfying the *ab initio* requirement.[2]

Moreover, despite Plaintiff's contention that the "clear implication" of *M&F Worldwide*'s *ab initio* requirement is that "negotiations begin at the initial offer," Op. Br. at 19, neither this Court nor any other has adopted such a rule.[3] To

[2] Plaintiff also asserts that the "*Swomley* plaintiffs essentially waived" the *ab initio* argument. Op. Br. at 20. To the contrary and as noted above, plaintiffs briefed the issue and raised it again on appeal. *See* Pl.'s Answering Br. in Opp'n to Mot. to Dismiss, *Swomley v. Schletcht*, 2014 WL 2987736 (Del. Ch. June 27, 2014) (arguing that the *ab initio* requirement should be interpreted "literally" and that it was not met because the initial term sheet from the controller did not include the dual conditions).

[3] Neither of the Court of Chancery decisions on which Plaintiff purports to rely—*In re Sauer-Danfoss, Inc. S'holder Litig.*, 2013 WL 6735054 (Del. Ch. Oct. 23, 2013) (TRANSCRIPT) or *In re Martha Stewart Living Omnimedia, Inc.*, 2017 WL 3568089 (Del. Ch. Aug. 18, 2017)—instituted a bright-line rule requiring the controller to self-disable in its very first communication of any offer to the company. Indeed, the court in *Sauer-Danfoss* noted that insisting the *M&F Worldwide* conditions must be "in the very first letter" may be "an overstatement" of the requirement. *In re Sauer-Danfoss*, 2013 WL 6735054, at 78.

the contrary, Delaware courts have regularly rejected such rigid and technical approaches to the law, and the Court should refuse to do so here as well. *C.f. In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 698 (Del. Ch. 2005) (noting that the common law of fiduciary duties should not "become a prisoner of narrow definitions or formulaic expressions"), *aff'd*, 906 A.2d 27 (Del. 2006); *Fairthorne Maint. Corp. v. Ramunno*, 2007 WL 2214318, at *7 (Del. Ch. July 20, 2007) (rejecting plaintiff's "overly formalistic" reading of section 215 of the DGCL). As the Court of Chancery correctly recognized, negotiations require the actions of more than one party to a transaction and involve substantive discussions and deliberations about the terms of the proposed transaction. The communication of a preliminary proposal by itself does not guarantee that substantive negotiations will take place. When negotiations actually begin must be determined based on the specific facts of the case at hand. *See Swomley*, 2014 WL 4470947, at *21.

Plaintiff suggests that "expanding the meaning of *ab initio* to anything beyond the initial offer will invite abuse and become a source of constant litigation." Op. Br. at 19. But Delaware courts have extensive experience analyzing the factual complexities often presented in transactions involving controllers and have recognized the risks of abdicating that duty in favor of bright-line rules. *See Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera*, 119 A.3d 44, 61 (Del. Ch. 2015) ("Delaware law does not contain bright-line tests for

determining independence but instead engages in a case-by-case fact specific inquiry based on well-pled factual allegations."); *TCG Sec., Inc. v. S. Union Co.*, 1990 WL 7525, at *6 n.3 (Del. Ch. Jan. 31, 1990) ("[C]reation of such a bright line test is contrary to the stated wisdom that disclosure questions must be determined on a case-by-case basis"). In any event, the requirement that the *M&F Worldwide* conditions be in place before any substantive negotiations between the parties take place provides sufficient guidance for controllers—and the courts—to determine whether a controller has self-disabled before either of the conditions can be used as bargaining chips.

2. Plaintiff's Alternative Claim That Negotiations Occurred Between The Proposal And The January 30 Letter Is Not Supported By Well-Pleaded Facts

This Court should also reject Plaintiff's argument that even if his *per se* legal argument is rejected, the *ab initio* requirement still was not satisfied because the parties allegedly did engage in substantive negotiations between the date of the Proposal and the January 30 Letter. Those allegations are not supported by well-pleaded facts and are directly contradicted by the facts set forth in the Proxy. Thus, the Court of Chancery correctly held that the *M&F Worldwide* safeguards were in place here, as in *Swomley*, "before anything really started." *Swomley*, 2014 WL 4470947, at *21. This Court should conclude the same.

When the Special Committee received the January 30 Letter, it had yet to hold an initial meeting[4], retain legal or financial advisors, or communicate with the Buyer Group to discuss the terms of the Transaction. *See* A066-67, A153-55. These facts show that negotiations did not begin until *after* the Buyer Group self-disabled on January 30, 2016. A153; *see also* Order ¶ 7d. In rejecting Plaintiff's argument below, the Court of Chancery specifically found that "[n]either the complaint nor the Proxy suggest any meetings or negotiations took place between the [Proposal] and [January 30 Letter], other than the January 21 meeting." Order ¶ 7e.

Plaintiff alleges in purely conclusory terms that substantive negotiations took place on January 21, but the Court of Chancery correctly rejected that argument, finding that "[n]either the complaint nor the plaintiff's briefing challenges the Proxy's account of what occurred at the January 21 meeting." *Id.* ¶ 7c. According to the Proxy, at that meeting, the Board filled a director vacancy with a well-qualified candidate and established the Special Committee. A152-53.[5]

---

[4] Notably, Plaintiff omits any reference to the Special Committee's initial meeting on February 1, 2016 in his Opening Brief, presumably because the fact that the Special Committee only convened for the first time *after* the January 30 Letter so fundamentally undermines Plaintiff's argument that the Buyer Group and the Special Committee engaged in negotiations before the January 30 Letter.

[5] The Proxy is incorporated by reference into the Amended Complaint. *See In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022, 1026 (Del. Ch. 2012).

Moreover, as stated in the Proxy, the Board "agreed that it would *not* substantively evaluate the January 14 Proposal at this meeting." A152 (emphasis supplied).

Finally, the Court of Chancery noted that "[t]he only arguably substantive event that happened before the [January 30] Letter was that the Company authorized Davis Polk to represent the Buyer Group by waiving any conflict that Davis Polk might have," and it specifically found that Plaintiff did not plead facts "that would support a reasonable inference that the conflict waiver undercut the Special Committee's effectiveness" in any way. Order ¶ 7f. Even if the conflicts waiver was "substantive," which it was not, the negotiation of a conflicts waiver does not constitute a negotiation *between the parties to the Transaction*. The Court of Chancery rightly concluded that the event had no significance to the operation of the Transaction: "The granting of the conflict waiver to Davis Polk did not transform the [January 30] Letter from a pre-negotiation self-disablement into a midstream trade-off." *Id.* ¶ 7g. In short, Plaintiff has not alleged any well-pleaded facts from which this Court could infer that negotiations between the Special Committee and the Buyer Group actually began before the Buyer Group agreed to the *M&F Worldwide* conditions in its January 30 Letter.

II. THE COURT OF CHANCERY CORRECTLY HELD THAT PLAINTIFF FAILED TO PLEAD THAT THE SPECIAL COMMITTEE WAS GROSSLY NEGLIGENT

A. Question Presented

Did the Court of Chancery correctly hold that Plaintiff failed to plead that the Special Committee was grossly negligent in recommending the Transaction after holding 15 meetings over 10 months, considering detailed financial analyses from an undisputedly independent financial advisor, contacting 25 potential bidders without receiving a competing bid, and negotiating more favorable deal terms and a higher price that represented a 58% premium above the unaffected stock price?

B. Scope Of Review

Defendants agree that the scope of this Court's review is *de novo.* Although well-pleaded allegations must be accepted as true, the Court will not "credit conclusory allegations that are not supported by specific facts or draw unreasonable inferences in the plaintiff's favor." *Norton*, 67 A.3d at 360.

C. Merits Of The Argument

Plaintiff does not appeal the Court of Chancery's findings that (i) the Special Committee was empowered to say no definitively, Order ¶ 8, or (ii) all of the members of the Special Committee were disinterested and independent. *Id.* ¶ 9. Rather, his challenge is limited to the Court of Chancery's determination that

the Special Committee met its duty of care in negotiating the Transaction. Op. Br. at 23. This argument should be rejected.

In order to survive a motion to dismiss on a duty of care claim, a plaintiff must allege facts supporting a reasonable inference that the directors were grossly negligent. *In re Books-A-Million Inc. S'holders Litig.*, 2016 WL 5874974, at *17 (Del. Ch. Oct. 10, 2016), *aff'd*, 164 A.3d 56. As this Court has explained, gross negligence is "a higher level of negligence representing 'an extreme departure from the ordinary standard of care.'" *Browne v. Robb*, 583 A.2d 949, 953 (Del. 1990) (citations omitted). To establish gross negligence, as Plaintiff concedes, he "must plead and prove that the defendant was 'recklessly uninformed' or acted 'outside the bounds of reason.'" *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *4 (Del Ch. Aug. 26, 2005) (citations omitted). The Court of Chancery correctly ruled that the standard was not met here. Order ¶ 10h.

The facts set forth in the Amended Complaint and the Proxy make clear that the Special Committee followed a robust process. Plaintiff does not dispute that the Special Committee:

- convened 15 meetings over 10 months;
- retained undisputedly independent financial and legal advisors;
- considered detailed financial analyses from its financial advisor;

- contacted 13 potential strategic buyers and 12 potential financial buyers without receiving any competing bid;
- demanded and obtained a price increase; and
- negotiated more favorable deal terms, including a reduced termination fee and a go-shop provision.

See A151-67. There can be no question under prior precedents that the process here was reasonable and appropriate. *M&F Worldwide*, 88 A.3d at 653 (affirming that due care was exercised when "the special committee met frequently and was presented a rich body of financial information relevant to whether and at what price a going private transaction was advisable"); *Books-A-Million*, 2015 WL 5874974, at *18 (dismissing a duty of care claim where the special committee had numerous meetings, negotiated over five months, and obtained a sale price higher than the initial offer).

Based on a misreading of a footnote in *M&F Worldwide*, Plaintiff now asserts that merely pleading that the Transaction price was unfair is sufficient to survive a motion to dismiss. Op. Br. at 4, 23-25. That footnote, however, simply noted that the plaintiff in that case pled highly particularized factual allegations about "the sufficiency of the price [that] call[ed] into question the adequacy of the Special Committee's negotiations"). *M&F Worldwide*, 88 A.3d at 645 n.14. In contrast, Plaintiff's allegations here, as shown below, are merely conclusory, and courts have repeatedly held that similar "price" allegations do not

state a duty of care claim. *See e.g.*, *Swomley*, 2014 WL 4470947, at **10-13, 21-22 (dismissing complaint based on conclusory allegations that the company's assets were not fairly valued, the sale was badly timed and inputs used in valuation analyses were intentionally depressed); *Books-A-Million*, 2016 WL 5874974, at *18-19 (dismissing complaint based on conclusory allegations of flawed valuation analysis and inadequate price); *c.f. Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) ("Due care in the decisionmaking context is *process* due care only.") (emphasis in original).

In any event, even if Plaintiff were correct on the legal issue (which he is not), as discussed below, none of Plaintiff's allegations support the reasonable inference that the Special Committee acted with gross negligence. Order ¶ 11.[6] Therefore, the Court of Chancery's decision should be affirmed.

1. Consideration Of Revised Projections Reflecting Updated Financial Results Does Not Show Gross Negligence By The Special Committee

Plaintiff contends that the Special Committee was grossly negligent because it considered management projections that were revised downwards during the 10-month process. Op. Br. at 25-28. Plaintiff concedes, however, that those revisions were made after the Company repeatedly underperformed the

[6] As the Court of Chancery observed, "[P]laintiff does not allege that either the Buyer Group or the Special Committee committed waste." *Id.* ¶ 11.

projections. *See* Op. Br. at 9; A026, A029, A159, A161, A165. Plaintiff does not argue that any of the data in the projections was incorrect or flawed, nor does Plaintiff argue that it is wrong for management to take into account updated projections that reflect the Company's performance over three fiscal quarters. Instead, Plaintiff argues that "the continuing downward revisions conflicted with reality," based on the erroneous and unsupported contention that management purportedly disregarded the opening of the Company's new French facility, Op. Br. at 27, and the impact of regulatory changes in China. *Id.* at 28.

This claim, however, is directly contradicted by the Proxy, which expressly states that the Company not only considered these developments in preparing the projections—but also made positive assumptions about them. *See* A191 (noting that "tightened PRC regulations over infant formula products would not adversely affect the Company's business" and "the Company's new

manufacturing facilities in France would commence operation and generate revenues in line with the management's expectation").[7]

Plaintiff similarly contradicts other information disclosed in the Proxy without pleading any specific factual basis for doing so when he asserts that the Special Committee accepted the updated projections "without question" and "did not assess whether the Company's lowered projections were appropriate." Op. Br. at 25-26. In fact, as the Proxy describes in detail, the Special Committee and Houlihan "discussed the key drivers" behind the revisions and "considered whether the [revised projections] would be appropriate" to be used in Houlihan's valuation analysis. A161, A165-66.

Further, Plaintiff fails to pleads any facts to support his bald assertions that the projections were intentionally lowered to "mak[e] the price seem fair," Op. Br. at 27, and that the valuation models were subject to "intentional manipulation." *Id*. at 33. As the Proxy disclosed, the Buyer Group's initial offer price of $5.91

[7] Plaintiff also fails to plead facts to support its contention that management depressed projections by ignoring the "temporary nature" of the delays in launching its French manufacturing facility. Houlihan's analysis, filed along with the Proxy, explicitly notes that EBITDA projections for fiscal year 2017 were not utilized in certain valuation analysis because, in light of those delays, "the Company management does not feel the current fiscal year results are representative of the Company's future earnings potential." Schedule 13E-3, Ex. (c)(5) p.4, 20 (*available at* https://www.sec.gov/Archives/edgar/data/1293593/000157104916020493/t1602958_ex99-c5.htm).

was already at the high end of, or within, each of the implied references ranges in Houlihan's first valuation analyses before the projections were revised in November and before the special committee negotiated the price up to $6.05.[8] *See* A161-62. In any event, the fact that the Company repeatedly underperformed the projections is logically inconsistent with Plaintiff's argument that management "dubiously depressed" those projections. Op. Br. at 33.

Plaintiff's reliance on *Gesoff v. IIC Industries, Inc.*, 902 A.2d 1130 (Del. Ch. 2006) and *In re Emerging Communications., Inc. Shareholders Litigation*, 2004 WL 1305745 (Del. Ch. May 3, 2004) is misplaced. Both cases involved special committees that were not independent, informed or fully empowered. In *Gesoff v. IIC Industries*, the special committee consisted of a "sole member" who "had no real authority to choose either his own lawyer or his own financial advisor." 902 A.2d at 1138-39. In *In re Emerging Communications*, the three directors serving on the Special Committee were "[l]ocated on different continents and separated by a time difference of 14 hours" and were deprived of

[8] Plaintiff inaccurately describes that the $6.05 merger price was "just below the midpoint of the range" of values in Houlihan's DCF analysis. Op. Br. at 26. Although the price was below the arithmetic mean of the DCF valuation range, it exceeded the $5.90 midpoint of the range when applying the middle discount rate and middle perpetual growth rate. *See* Schedule 13E-3, Ex. (c)(5) p. 27 (*available at* https://www.sec.gov/Archives/edgar/data/1293593/000157104916020493/t1602958_ex99-c5.htm).

"essential" projections because they were deliberately withheld by management. 2004 WL 1305745, at **6, 35. Plaintiff does not—and cannot—allege similar circumstances here.

Finally, all of the projections were fully disclosed to the unaffiliated minority stockholders and a majority of these stockholders made a fully-informed decision to vote in favor of the Transaction. *See* A191-96. As the Court of Chancery correctly decided, the "*M&F Worldwide* framework regards a committee armed with independent advisors followed by a majority-of-the-minority vote as sufficient protection" against the risk of management shading information out of loyalty to the controller, "absent misconduct amounting to fraud. The complaint does not allege fraud." Order ¶ 10b.

2. The Earnings Announcements Do Not Show Gross Negligence By The Special Committee

Plaintiff's allegation that Zhang intentionally made negative announcements is both unsupported and would not, in any event, be sufficient to plead gross negligence by the Special Committee.

As a threshold matter, Plaintiff's claim that Zhang "primed" the Company for a lowball bid by making "pessimistic press releases", A019, Op. Br. at 30, is based solely on out-of-context quotations from two earnings releases, and is flatly contradicted by Plaintiff's quotations of other "optimistic" statements "about [the Company's] prospects" from the same press releases elsewhere in his

Opening Brief. Op. Br. at 12, 27. Specifically, although Plaintiff, for purposes of this contention, relies on certain negative language in two earnings releases from August 10, 2015 ("August Announcement") and November 9, 2015 ("November Announcement"), *see* A058-59, in the *very same* earnings releases, Zhang also announced positive results and expressed optimism about the Company's prospects—statements which Plaintiff himself quotes for other purposes.[9] *See* August Announcement[10] ("[W]e were pleased with our meaningful gross margin expansion. . . ."; "[O]perating income and net income increased by 34% and

[9] *See* Op. Br. at 27 ("In fact, Synutra 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.'"). Additionally, Plaintiff incorporated these public filings into the Amended Complaint "by referring to and relying on them in [his] briefs" and therefore, "those documents may be considered for the purposes of the motion to dismiss." *In re Sirius XM S'holder Litig*., 2013 WL 5411268, at *4 (Del. Ch. Sept. 27, 2013); *see also In re Gardner Denver, Inc*., 2014 WL 715705, at *2 (Del. Ch. Feb. 21, 2014) ("allegations largely predicated upon documents not presented to the Court in the pleadings should not escape the Court's review under Rule 12(b)(6) by the plaintiff's merely alleging 'selected and misleading portions' of those documents.") (quoting *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 70 (Del. 1995)).

[10] Synutra International, Inc., Current Report (Form 8-K) (August 10, 2015) (*available at* https://www.sec.gov/Archives/edgar/data/1293593/000095010315006378/0000950103-15-006378-index.htm).

22%."); November Announcement[11] ("[W]e believe our service and quality differentiation strategy will prove successful, and we are well-positioned to benefit from larger trends in the milk formula industry over the long-term. . . ."; "The production method used in our French facility will allow us to streamline our manufacturing processes and reduce costs."). The Court should reject Plaintiff's attempt to quote selectively from these releases to create a misimpression. *See In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 498 (Del. Ch. 2010) (rejecting plaintiffs' argument that the board was biased in favor of the acquirer because plaintiffs "selectively quote[d]" from banker books to create such impression, which was unlikely when "viewed in the proper context").

In any event, Plaintiff fails to articulate how this unsupportable theory that Zhang deliberately depressed the stock price is even relevant to showing gross negligence by the Special Committee. As the Court of Chancery correctly noted, the relevant question is "whether the Special Committee knew about the information and took it into account." Order ¶ 10a. Nowhere does Plaintiff allege that the Special Committee did not know about the earnings releases or the fluctuations in the Company's stock price. *Id.*

---

[11] Synutra International, Inc., Current Report (Form 8-K) (November 9, 2015) (*available at* https://www.sec.gov/Archives/edgar/data/1293593/000095010315008744/0000950103-15-008744-index.htm).

3. Plaintiff's Quibbles With Houlihan's Analysis Do Not Show Gross Negligence By The Special Committee

Plaintiff further argues that the Special Committee was grossly negligent because, in Plaintiff's own judgment, the "discount rate range used by Houlihan [in its DCF analysis] is unreasonably high." Op. Br. at 31. Plaintiff then launches into an "independent analysis" to come up with its own WACC range. *See id.* at 31-32. It is well settled, however, that disagreement with a financial advisor's valuation or methodology does not state a duty of care claim against the Special Committee. *See Books-A-Million*, 2016 WL 5874974, at *19 ("The plaintiffs also argue about inputs in Houlihan Lokey's valuation analysis. [That does not] support[] an inference of gross negligence."); *see also Swomley*, 2014 WL 4470947, at *12-13, *21-22 (plaintiff's allegation that the financial advisor used inflated discount rate and depressed EBITDA multiples "to reach a preordained conclusion" does not constitute a duty of care claim). In fact, all three cases that Plaintiff cites—*Hintmann v. Fred Weber, Inc.*, 1998 WL 83052 (Del. Ch. Feb. 17, 1998), *In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485 (Del. Ch. 1991), and *Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963 (Del. Ch. Feb.

10, 2004)—concern post-trial analyses of valuation disputes and do not even address a duty of care claim. *See* Op. Br. at 31-32.[12]

For all these reasons, the Court of Chancery correctly determined that the Special Committee satisfied its duty of care.

[12] Plaintiff's throwaway claim that Houlihan's selected companies analysis used ranges below the mean and median "without any explanation," Op. Br. at 33, is simply false, because the Proxy expressly disclosed the basis for Houlihan's selection of the valuation ranges used in that analysis. *See* A179.

CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the Court of Chancery and dismiss the Amended Complaint with prejudice.

POTTER ANDERSON & CORROON LLP

/s/ Matthew E. Fischer
Matthew E. Fischer (#3092)
Matthew R. Dreyfuss (#5885)
1313 North Market Street, 6th Floor
Wilmington, Delaware 19801
(302) 984-6000

OF COUNSEL:

Roger A. Cooper
Rishi N. Zutshi
Vanessa C. Richardson
Hana Choi
CLEARY GOTTLIEB STEEN & HAMILTON LLP
One Liberty Plaza
New York, New York 10006
(215) 225-2000

Attorneys for Defendants-Below, Appellees Jinrong Chen, Yalin Wu, Lei Lin and Synutra International, Inc.

MORRIS NICHOLS ARSHT & TUNNELL LLP

/s/ John P. DiTomo
William M. Lafferty (#2755)
John P. DiTomo (#4850)
1201 North Market Street
Wilmington, Delaware 19801
(302) 658-9200

OF COUNSEL:

Lawrence Portnoy
Rebecca L. Martin
DAVIS POLK & WARDWELL LLP
450 Lexington Avenue
New York, New York 10017
(212) 450-4000

Attorneys for Defendants-Below, Appellees Beams Power Investment Ltd., Liang Zhang and Xiuqing Meng

Date: May 14, 2018