IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE SYNUTRA INTERNATIONAL, INC. STOCKHOLDER LITIGATION) Consolidated) C.A. No. 2017-0032-VCL

ORDER GRANTING DEFENDANTS' MOTION TO DISMISS

1. Before the transaction challenged in this litigation, defendant Beams Power Investment Limited ("Beams") owned 63.5% of Synutra International, Inc. (the "Company"). Defendant Xiung Meng controlled Beams, and her husband, defendant Liang Zhang, served as the Company's CEO and Chairman of its board of directors (the "Board"). This putative class action challenges a squeeze-out merger by which Beams, Meng, and Zhang (the "Buyer Group") acquired the remaining equity in the Company for $6.05 per share (the "Merger").

2. The Buyer Group conditioned the Merger on the receipt of a favorable recommendation from a special committee of the Board (the "Special Committee") and the approval of a majority of the disinterested stockholders. Compl. ¶ 53. The members of the Special Committee were defendants Jinrong Chen, Lei Zin, and Yalin Wu. The Special Committee engaged Houlihan Lokey Capital, Inc. as its financial advisor. The Special Committee recommended the Merger, and the disinterested stockholders approved it. *Id.* ¶¶ 79; Opening Br. Ex. C (Form 8-K announcing vote results).

3. The complaint alleges that the Merger resulted from breaches of fiduciary duty by the Buyer Group and the Special Committee. The complaint contends that Houlihan Lokey aided and abetted those breaches. The complaint asserts that to the extent

the Special Committee members did not breach their duties, they aided and abetted the Buyer Group's breaches.

4. The defendants moved to dismiss the complaint pursuant to Court of Chancery Rule 12(b)(6). The Delaware Supreme Court described the governing standard in *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002).

5. The Merger followed the framework approved by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014). Under that framework, the business judgment rule will apply to a squeeze-out merger if "the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote," thereby allowing the merger to "acquire[] the shareholder-protective characteristics of third-party, arm's-length mergers." *Id.* at 644.

> [T]he business judgment standard of review will be applied *if and only if*: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

Id. at 645. "Under that standard of review, the court will defer to the judgments made by the corporation's fiduciaries unless the Merger is so extreme as to suggest waste." *In re Books-A-Million, Inc. S'holders Litig.*, 2016 WL 5874974, at *1 (Del. Ch. Oct. 10, 2016), *aff'd*, 164 A.3d 56 (Del. 2017).

6. Where, as here, the defendants have described their adherence to the *M&F Worldwide* framework "in a public way suitable for judicial notice, such as board

resolutions and a proxy statement," the court will apply the business judgment rule at the motion to dismiss stage unless the plaintiff has "pled facts sufficient to call into question the existence of those elements." *Swomley v. Schlecht*, 2014 WL 4470947, at *20 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT), *aff'd*, 128 A.3d 992 (Del. 2015) (TABLE).

7. The first prong of the framework requires that "the merger is conditioned *ab initio* upon 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." *M&F Worldwide*, 88 A.3d at 644. The plaintiff contends that the Buyer Group did not condition its offer on these elements *ab initio*.

a. A process meets the *ab initio* requirement when the controller announces the conditions "before any negotiations took place." *Swomley*, 2014 WL 4470947, at *21. Using this point in time fulfills the goals of disabling the controller for purposes of the negotiations and ensuring 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." *M&F Worldwide*, 88 A.3d at 644.

b. The Buyer Group first approached the Board by submitting a "preliminary non-binding proposal" on January 14, 2016 (the "Initial Letter"). Compl. ¶¶ 45-46. The Initial Letter offered $5.91 per share and outlined the Buyer Group's proposal. The Initial Letter mentioned a special committee but did not condition a potential transaction on both a favorable committee recommendation and approval by a majority of the disinterested stockholders. *Id.* ¶ 45.

c. The Board met on January 21, 2016. Before the meeting, the Board "agreed that it would not substantively evaluate" the proposal. Opening Br. Ex. A at 20 (the "Proxy"). During that meeting, Davis Polk & Wardwell LLP ("Davis Polk") "advised the directors as to their fiduciary duties under Delaware law in considering and evaluating the [Initial Letter] and further stated that it would be advisable for [the Board] to consider forming a special committee." Proxy at 21. The Board then formed the Special Committee. *Id.* Neither the complaint nor the plaintiff's briefing challenges the Proxy's account of what occurred at the January 21 meeting.

d. On January 30, 2016, the Buyer Group submitted a letter to the Special Committee (the "Follow-up Letter"). The Follow-up Letter reaffirmed the Buyer Group's initial offer and expressly conditioned the transaction on the approval of the Special Committee and a majority of the minority stockholders. Compl. ¶ 53.

e. Neither the complaint nor the Proxy suggest any meetings or negotiations took place between the Initial and Follow-up Letters, other than the January 21 meeting. The plaintiff only offers unsupported assertions in his Answering Brief that the Buyer Group tacked on the conditions "after the process was underway and gaining significant momentum," "following informal negotiations and Board meetings," and "as an afterthought weeks into the process, after meetings and discussions with the controller were in full swing." Answering Br. at 5, 12, 13.

f. The only arguably substantive event that happened before the Follow-up Letter was that the Company authorized Davis Polk to represent the Buyer Group by waiving any conflict that Davis Polk might have. Davis Polk was the Company's long-time

counsel. Proxy at 20. It would have been preferable, both optically and substantively, for the Buyer Group to retain its own counsel. *See In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *6 (Del. Ch. May 3, 2004) (criticizing controller for having "coopted [the company's] valuable advisors"). That scenario would have given the Special Committee the choice of hiring its own independent counsel or using Davis Polk, if it preferred to take advantage of Davis Polk's knowledge and expertise after considering the firm's potential ties to the Buyer Group. The Special Committee retained Cleary Gottlieb Steen & Hamilton LLP ("Cleary Gottlieb"), a firm fully capable of going head-to-head with Davis Polk. The complaint does not plead facts that would support a reasonable inference that the conflict waiver undercut the Special Committee's effectiveness.

g. The Buyer Group sent the Follow-up Letter just over two weeks after it first proposed the Merger, before the Special Committee ever convened and before any negotiations ever took place. The prompt sending of the Follow-up Letter prevented the Buyer Group from using the *M&F Worldwide* conditions as bargaining chips. The granting of the conflict waiver to Davis Polk did not transform the Follow-up Letter from a pre-negotiation self-disablement into a midstream trade-off. The plaintiff has not pled facts sufficient to call into question compliance with the *ab initio* requirement.

8. The plaintiff also asserts that the Special Committee was not empowered to say no definitively. He alleges that Zhang's "ability to purposefully decrease the share price of the Company and punish minority stockholders" and the Buyer Group's refusal to support a competing bid both impaired the Special Committee's ability to say no. Answering Br. 21.

a. The complaint's allegations about Zhang reframe the reasons why Delaware law historically has been concerned about controlling stockholder squeeze outs and the risk of what has been referred to as inherent coercion. *See Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994). The Delaware Supreme Court has held that the *M&F Worldwide* framework addresses those concerns and affirmed the Court of Chancery's assessment that the framework "best protects minority stockholders." 88 A.3d at 643. The complaint does not contain allegations suggesting that the Buyer Group is any differently situated or more powerful or has acted more oppressively than other controllers such that a different, case-specific approach would be warranted.

b. The parties do not dispute that the Buyer Group made clear, at the outset, in its Initial Letter, that it would not participate in a competing bid. Consequently, "[a]lthough the special committee had the authority to negotiate and say no, it did not have the practical authority to market [the Company] to other buyers." *In re MFW S'holders Litig.*, 67 A.3d 496, 508 (Del. Ch. 2013) (Strine, C.), *aff'd sub nom. M&F Worldwide*, 88 A.3d 635. The Buyer Group "had no duty to sell its block, which was large enough, as a practical matter, to preclude any other buyer from succeeding unless it decided to become a seller." *Id.* (citing *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 844-45 (Del. 1987)). Although the circumstances created an environment wherein "it was unlikely that any potentially interested party would incur the costs and risks of exploring a purchase of" the Company, that did not disable the Special Committee from being able to say no or render the *M&F Worldwide* process ineffective. *Id.*

9. The complaint also challenges the disinterestedness and independence of the members of the Special Committee.

a. A director is interested if he or she receives "a personal financial benefit from a transaction that is not equally shared by the stockholders." *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993) (citation omitted). A director is not independent if his or her decision is based on "extraneous considerations or influences" rather than "the corporate merits of the subject before the board." *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1049 (Del. 2004). A classic example is a close familial relationship. *See, e.g.*, *Harbor Fin. P'rs v. Huizenga*, 751 A.2d 879, 889 (Del. Ch. 1999) (Strine, V.C.) ("Close familial relationships between directors can create a reasonable doubt as to impartiality.").

b. The plaintiff contends that the Buyer Group "w[as] able to handpick the directors" who served on the Special Committee. Answering Br. at 19. A controller's "involvement in selecting each of the directors is insufficient to create a reasonable doubt about their independence." *White v. Panic*, 793 A.2d 356, 366 (Del. Ch. 2000), *aff'd*, 782 A.2d 543 (Del. 2001). Even when "[i]t is reasonable to infer that [the controller] can remove or replace any or all of the directors," that fact "does not by itself demonstrate that [the controller] has the capacity to control outside directors." *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 978 (Del. Ch. 2003) (citing *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984) ("proof of majority ownership of a company does not strip the directors of the presumption[] of independence")), *aff'd*, 845 A.2d 1040 (Del.

2004). Here, the Buyer Group's ability to vote in directors does not render the Special Committee conflicted.

c. The plaintiff next contends that the Company's payment to each member of the Special Committee of $12,500 for each month of service rendered the members interested. Because the deal took just under 11 months, the total compensation amounted to roughly $137,500. Ordinary director compensation, "standing alone, cannot be the basis for asserting a lack of independence." *Robotti & Co., LLC v. Liddtell*, 2010 WL 157474, at *14 (Del. Ch. Jan. 14, 2010). Conditioning compensation on a particular result is problematic, but the complaint does not allege that happened here. *See Books-A-Million*, 2016 WL 5874974, at *10 (declining to find payment for service conflicting where "the payment was not contingent on the success of the Merger"). The grant of particularly excessive transaction-specific compensation might, if strikingly disproportionate to the services provided, support a pleadings-stage inference that a controller was paying off a director. In this case, neither the monthly amount nor the total amount reach that level. The plaintiff has argued that, because the Company operates in China, where compensation generally is lower than in the United States, the amounts paid here should be given greater scrutiny. There is some intuitive appeal to this theory, but there is also logic to the Special Committee's response that directors and other professionals compete in, and are compensated based on, a worldwide marketplace. In this case, the plaintiff did not plead facts sufficient to develop a theory under which director payments might become excessive under a country-specific theory.

d. The plaintiff spent the most time attacking the appointment of Wu to the Board. The seat that Wu took had long been vacant, and the Board appointed Wu at the same meeting that it formed the Special Committee. Compl. ¶ 51. Wu "was referred by a personal friend to Mr. Zhang as a potential candidate as an independent director of the Company." *Id.* ¶ 52 (quoting Proxy at 20). The plaintiff suggests that the Buyer Group was trying to "pack the Committee" to make approval of the transaction more likely. The Delaware Supreme Court has held that a "charge that a director was nominated by or elected at the behest of those controlling the outcome of a corporate election" does not rebut the presumption that a director is independent. *Aronson*, 473 A.2d at 816. The timing and circumstances of Wu's appointment do not, without more, support the reasonable inference that Wu was conflicted.

10. Turning from the structure and composition of the Special Committee to what its members did, the complaint contends that the Special Committee failed to fulfill its duty of care in negotiating a fair price. The plaintiff cites a combination of factors that he claims add up to a care issue.

a. First, the plaintiff argues that the committee secured a "woefully inadequate price." Answering Br. 23. In support, the complaint points to allegations that support a reasonable inference that the stock was trading in a trough, including a series of negative announcements by Zhang leading up to the Merger that resulted in the stock reaching a low a day before the Initial Letter. *See* Compl. ¶¶ 39-41, 43. Doubtless there are 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. For purposes of a due care claim, however, the question is whether the Special Committee knew about the information and took it into account. "Due care in the decisionmaking context is *process* due care only." *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000). The complaint does not support a reasonable inference that the Special Committee did not know about these announcements or the Company's stock price.

b. The plaintiff next challenges the Special Committee's and Houlihan Lokey's reliance on the Company's management projections. He notes that Ning Cai, the Company's CFO, prepared the projections. The plaintiff argues that "[g]iven her allegiance to Zhang, the ability of Zhang to fire Cai, and the hope for her continued employment following the [Merger], Cai had an interest in valuing the Company as low as reasonably possible." Answering Br. at 24-25. The plaintiff further pleads that beginning in April 2016 and continuing through November 2016, Company management repeatedly revised their projections downward, despite positive developments for the business. *See* Compl. ¶¶ 6, 9, 12, 59, 67, 75-77. The defendants point out that both the Proxy and the complaint cite business factors explaining the downward adjustments, but at the pleading stage, the pattern carries some weight. At the same time, the risk that management may shade information out of loyalty to the controller is another problem endemic to controlling stockholder squeeze outs (similar problems affect management buyouts). The *M&F Worldwide* framework regards a committee armed with independent advisers followed by a majority-of-the-minority vote as sufficient protection against this risk, absent misconduct

amounting to fraud. *See, e.g.*, *In re Dole Food Co. S'holder Litig.*, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015). The complaint does not plead fraud.

c. Third, the plaintiff cites Davis Polk's switch from representing the Company to representing the Buyer Group and notes that, even after starting to represent Buyer Group, the firm advised directors during the Board's meeting on January 21 regarding their fiduciary duties and the formation of a special committee. Compl. ¶ 48. Both the Company and the Special Committee retained independent counsel before the process advanced any further. Proxy at 20-21. As noted, the Special Committee hired Cleary Gottlieb, and the Company hired Wilson Sonsini Goodrich & Rosati, P.C. Having Davis Polk act temporarily as counsel for both sides was an artless misstep, but not one that would support a breach of the duty of care.

d. Fourth, the plaintiff criticizes Houlihan Lokey for presenting the Special Committee in the middle of the process with a high-level valuation that sensitized the range of possible discounted cash flow values across a "wide-spread range" of variables, resulting in outcomes ranging from $1.70 and $20.03. Compl. ¶ 63. According to the complaint, this page allegedly "conveyed a clear message that Houlihan Lokey could bless any price agreed upon by the Special Committee." *Id.* Chancellor Allen once described a banker's range of $208 to $402 as "a range that a Texan might feel at home on." *Paramount Commc'ns Inc. v. Time, Inc.*, 1989 WL 79880, at *13 (Del. Ch. July 14, 1989), *aff'd*, 571 A.2d 1140 (Del. 1989). Contrasted with the *Time* analysis on a percentage basis, Houlihan Lokey's sensitivities would accommodate the range of a ballistic missile.

It does not follow, however, that Houlihan Lokey was advertising complicity, nor is the one page sufficient to call into question Houlihan Lokey's overall body of work.

e. The duty of care requires that directors "inform themselves, prior to making a business decision, of all material information reasonably available to them." *Aronson*, 473 A.2d at 812. "[T]he standard for determining 'whether a business judgment reached by a board of directors was an informed one' is gross negligence." *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66 (Del. 1989) (quoting *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985)).

f. In the civil context, the Delaware Supreme Court has defined gross negligence as "a higher level of negligence representing 'an extreme departure from the ordinary standard of care.'" *Browne v. Robb*, 583 A.2d 949, 953 (Del. 1999), *cert. denied*, 499 U.S. 952 (1991) (quoting W. Prosser, *Handbook of the Law of Torts* 150 (2d ed. 1955)). It refers to a decision "so grossly off-the-mark as to amount to reckless indifference or a gross abuse of discretion." *Solash v. Telex Corp.*, 1988 WL 3587, at *9 (Del. Ch. Jan. 19, 1988) (internal quotation marks and citations omitted). Gross negligence "involves a devil-may-care attitude or indifference to duty amounting to recklessness." *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *4 (Del. Ch. Aug. 26, 2005); *accord Gelfman v. Weeden Inv'rs, L.P.*, 859 A.2d 89, 114 (Del. Ch. 2004). To establish gross negligence, a plaintiff must plead and prove that the defendant was "recklessly uninformed" or acted "outside the bounds of reason." *Albert*, 2005 WL 2130607, at *4; *accord McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008) ("Delaware's current understanding of gross

negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason.").

g. Raising questions such as "whether the special committee could have extracted another higher bid" or "whether the special committee was too conservative in valuing [the company's] future prospects" does not plead a violation of the duty of care. *MFW*, 67 A.3d at 516. "A committee can satisfy its duty of care by negotiating diligently with the assistance of advisors. A committee goes one better when it takes the additional step of gathering additional information through a market canvass." *Books-A-Million*, 2016 WL 5874974, at *18.

h. The complaint's allegations, considered individually and in the aggregate, do not support an inference of gross negligence. The Special Committee held fifteen meetings over ten months. It retained its own legal and financial advisors, and their independence is undisputed. With the help of those advisors, the Special Committee conducted a market check, which included contacting thirteen potential strategic buyers and twelve potential financial buyers. Proxy at 38. The Special Committee negotiated the price up to $6.05. While that price represented an increase of only 2% over the Buyer Group's initial offer, it represented a 58% premium to the Company's unaffected stock price and a premium of approximately 31% and 20%, respectively, to its 30- and 60-day averages. Proxy at 35. In addition, the Special Committee negotiated revised deal terms, including a reduced termination fee and the inclusion of a go-shop provision. Proxy at 30.

11. Because the plaintiff has not pled facts sufficient to call into question the Merger's compliance with the *M&F Worldwide* framework, the business judgment rule

applies. The plaintiff does not allege that either the Buyer Group or the Special Committee committed waste. In any event, "the vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful." *Singh v. Attenborough*, 137 A.3d 151, 152 (Del. 2016) (ORDER) (footnote omitted).

12. Having failed to plead a claim for breach of fiduciary duty, the plaintiff likewise has failed to plead a claim for aiding and abetting. *Malone v. Brincat*, 722 A.2d 5, 14-15 (Del. 1998).

13. At oral argument, the plaintiff asked, for the first time, that any dismissal be without prejudice. Under Court of Chancery Rule 15(aaa),

> a party that wishes to respond to a motion to dismiss under Rule[] 12(b)(6) . . . by amending its pleading must file an amended complaint . . . no later than the time such party's answering brief . . . is due to be filed. In the event a party fails to timely file an amended complaint . . . and the Court thereafter concludes that the complaint should be dismissed under Rule 12(b)(6) . . . , such dismissal shall be with prejudice (and in the case of complaints brought pursuant to Rules 23 or 23.1 with prejudice as to the named plaintiffs only) unless the Court, for good cause shown, shall find that dismissal with prejudice would not be just under all the circumstances.

Ct. Ch. R. 15(aaa). The plaintiff offered nothing to support a finding of good cause.

14. The motions to dismiss are granted. The complaint is dismissed. The dismissal is with prejudice as to the named plaintiff.

Vice Chancellor J. Travis Laster
Dated: February 2, 2018