

DELAWARE RESOLVES AMBIGUITY INVOLVING TAKE-PRIVATE TRANSACTIONS

In its recent decision in *Arthur Flood v. Synutra International, Inc., et al.*, No. 101, 2018 opinion (Del. Oct. 9, 2018), the Delaware Supreme Court clarified when an acquisition of a company by a controlling stockholder will be subject to business judgment rule review, as opposed to the more stringent entire fairness standard. Business judgment rule review applies if, prior to the start of substantive economic negotiations, the controlling stockholder conditions its buyout offer on both approval by an independent special committee and the vote of a majority of the minority stockholders.

BACKGROUND

The Delaware Supreme Court first established in *Kahn v. M&F World Wide Corp.*, 88 A.3d 635 (Del. 2014) that a buyout by a controlling shareholder conditioned ab initio (i.e., “from the beginning”) on approval by an independent, adequately empowered special committee and the uncoerced, informed vote of a majority of the minority shareholders would receive the benefit of the business judgment rule standard of review. The ruling’s central objective, the Court explained, was to incentivize controlling shareholders to voluntarily propose procedural protections that are favorable to minority investors in exchange for the more deferential standard of review. The Court’s ruling in *MFW*, however, raised questions as to what part of the transaction should be considered the “beginning” for purposes of this standard.

In *Synutra*, Liang Zhang, the majority shareholder of Synutra, proposed a buyout in a non-binding letter to the company. This initial letter did not include the requisite conditions laid out in *MFW*. Two weeks later, after the formation of a special committee, Zhang submitted a second proposal that included the *MFW* conditions. Zhang delivered the second proposal before the special committee had engaged its own counsel and before any major negotiations, including with respect to price, had begun. The deal ultimately closed with approvals by both the special committee and a majority of the minority shareholders and the plaintiff subsequently filed suit and the defendants moved to dismiss.

The plaintiff argued that the *MFW* standard should be interpreted as a bright line rule that requires the controlling shareholder to include the procedural protections in “its ‘first offer’ or else lose out on the business judgment rule.” The Court rejected such a rigid reading of the rule and held that the *MFW* ab initio requirement is satisfied if the required conditions are included early in the process and before there has been any “economic horse trading.” The Court reasoned that the key concern of *MFW* is “ensuring that controllers could not use the conditions as bargaining chips during economic negotiations” and that this central concern is addressed as long as the conditions are made clear before the negotiations take place.

The Court offered further clarity on the *MFW* decision by explicitly overruling a footnote added as dicta to that ruling. The footnote suggested that the complaint there could have survived a motion to dismiss despite complying with the *MFW* requirements due to the sufficiency of the price reached by the special committee’s negotiations. The Court confirmed that that compliance with the *MFW* procedural protections does allow a complaint to be dismissed at the pleading stage.

OUR VIEW

The result in *Synutra* is consistent with a long line of Delaware jurisprudence that demonstrates a general reluctance in mandating how directors should fulfill their fiduciary duties. For example, in *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Nov. 2015), the court stated that no “court can tell directors exactly how to accomplish [their fiduciary duties] because they will be facing a unique combination of circumstances.” While in *C&J Energy Services, Inc. v. City of Miami General Employees*, 107 A.3d 1049 (Nov. 2015), the Court reiterated its stance that there is “no single blueprint” to satisfy a board’s *Revlon* duties. By again declining to impose a bright-line rule on how directors should comply with their fiduciary duties in *Synutra*, the Court continues to implicitly recognize that every deal is unique, and every board faces a unique set of challenges. While this may give rise to some close cases, the “Court of Chancery is expert in the adjudication of corporate law cases.”

Ultimately, the ruling in *Synutra* provides valuable guidance to dealmakers who wish to take advantage of the deference afforded by the business judgment rule and also underscores the importance of being well-advised and acting prudently starting early in the process of any contemplated transaction.



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