
CORPORATE LAW — MERGERS AND ACQUISITIONS — *MFW* CONDITIONS ARE IN PLACE “BEFORE ANY SUBSTANTIVE ECONOMIC NEGOTIATIONS” IN CONTROLLING SHAREHOLDER TRANSACTIONS. — *Flood v. Synutra International, Inc.*, 195 A.3d 754 (Del. 2018) (en banc).

Controlling shareholders owe minority shareholders fiduciary duties.¹ Accordingly, to receive the benefit of the highly deferential business judgment rule, a controlling shareholder transaction must meet the two conditions from *Kahn v. M&F Worldwide Corp.*² (*MFW* Conditions), which require that the transaction must be conditioned *ab initio* — from the beginning — on both (1) the approval of an independent special committee and (2) the “uncoerced, informed vote of a majority of the minority [share]holders.”³ Recently, in *Flood v. Synutra International, Inc.*,⁴ the Delaware Supreme Court held that the controlling shareholder satisfied *MFW*’s *ab initio* requirement and was entitled to the business judgment rule so long as *MFW* Conditions were in place “before any substantive economic negotiations.”⁵ The court ably fulfilled its judicial role by ruling in a manner consistent with the historical progression of case law and sensitive to the functional mechanics and practical realities of dealmaking. Nevertheless, the court missed an important opportunity to more clearly define “before any substantive economic negotiations,” which should center on the beginning of negotiations about price per share and account for procedural and temporal elements in the negotiation process. Furthermore, judicial line-drawing is complex, and the court’s threshold may actually conflict with the holding of the case itself.

Liang Zhang and affiliated entities controlled 63.5% of Synutra International Inc.’s (“Synutra”) stock.⁶ In January 2016, Zhang sent an initial letter without *MFW* Conditions proposing to take Synutra private by acquiring the rest of the stock at \$5.91 per share.⁷ Zhang retained Davis Polk — Synutra’s corporate counsel — to assist with the proposed merger, and Synutra’s CFO agreed to waive Davis Polk’s conflicts of interest.⁸ One week after Zhang’s initial proposal, the Board met to

¹ *S. Pac. Co. v. Bogert*, 250 U.S. 483, 487–88 (1919); *see also* *Zahn v. Transamerica Corp.*, 162 F.2d 36, 43 (3d Cir. 1947); Daniel Wilson, *Desirable Resistance: Kahn v. M&F Worldwide and the Fight for the Business Judgment Rule in Going-Private Mergers*, 17 U. PA. J. BUS. L. 643, 643 (2015) (noting that controlling shareholder power is difficult to check).

² 88 A.3d 635 (Del. 2014).

³ *Id.* at 642.

⁴ 195 A.3d 754 (Del. 2018) (en banc).

⁵ *Id.* at 760, 766.

⁶ *Id.* at 757.

⁷ *Id.*

⁸ *Id.*

form a special committee and receive advice from Davis Polk on its fiduciary duties, but did not discuss the substance of Zhang's proposal.⁹

Two weeks after the initial offer, Zhang sent a second letter to the special committee reaffirming his interest, proposing the same price, and conditioning his offer on the *MFW* Conditions.¹⁰ After receiving Zhang's second letter, the special committee hired Houlihan Lokey as its independent financial advisor and Cleary Gottlieb as its independent legal advisor.¹¹ According to the court, price negotiations did not begin until seven months after Zhang included the *MFW* Conditions.¹² In September 2016, the parties agreed to a price of \$6.05 per share, which was a 58% premium to Synutra's stock trading price when the offer was made public.¹³ Minority shareholders challenged the transaction, arguing that because Zhang's initial offer did not include the *MFW* Conditions, the transaction should be subject to the entire fairness standard — a rigorous standard of judicial review where the defendant must prove fair price and fair dealing¹⁴ — rather than the highly deferential business judgment rule — a difficult-to-rebut presumption that the directors were informed, acted in good faith, and had the honest belief that the action was in the company's best interest.¹⁵

Vice Chancellor J. Travis Laster, writing for the Delaware Court of Chancery, found that the *MFW* Conditions were satisfied and that, consequently, the business judgment rule applied.¹⁶ Relying on this standard, Vice Chancellor Laster granted Synutra's motion to dismiss.¹⁷ The Chancery Court provided that “[a] process meets the *ab initio* requirement when the controller announces the conditions ‘before any negotiations took place,’”¹⁸ which “ensur[es] 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.’”¹⁹ Zhang's second letter prior to “any negotiations” or a special committee

⁹ See *id.* at 757–58.

¹⁰ *Id.* at 758.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 759.

¹⁴ See *Wilson*, *supra* note 1, at 647–48, 652; see also *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) (highlighting that entire fairness includes both procedural and substantive fairness). See generally Guhan Subramanian, *Fixing Freezouts*, 115 YALE L.J. 2, 11 (2005).

¹⁵ *Synutra*, 195 A.3d at 760; *Wilson*, *supra* note 1, at 647 (“[T]he main effect of the [business judgment rule] is to insulate corporations from liability.”). The court will not disturb director decisions attributable “to any rational business purpose.” *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

¹⁶ See *In re Synutra Int'l, Inc.*, No. 2017-0032, 2018 WL 705702, at *2 (Del. Ch. Feb. 2, 2018).

¹⁷ *Id.* at *2, *6.

¹⁸ *Id.* at *2 (quoting Oral Argument on Defendants' Motion to Dismiss and the Court's Ruling at 71, *Swomley v. Schlecht*, No. 9355, 2014 WL 4470947, at *21 (Del. Ch. Aug. 27, 2014)).

¹⁹ *Id.* (quoting *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014)).

meeting thus prevented him “from using the [*MFW* Conditions] as bargaining chips.”²⁰ While Synutra authorized Davis Polk to represent Zhang prior to the second letter, the court did not find gross negligence or impaired committee effectiveness.²¹ The plaintiffs appealed, arguing that the Chancery Court misapplied *MFW* by (1) allowing for the business judgment rule when the controller included the *MFW* Conditions after the first offer and (2) requiring a gross negligence standard for the special committee.²²

The Delaware Supreme Court affirmed. Writing for the majority, Chief Justice Strine held that the *ab initio* requirement is satisfied — and the business judgment rule applies — so long as the *MFW* Conditions are in place “before any substantive economic negotiations.”²³ The court relied on three separate justifications in reaching its decision: (1) precedent, (2) ordinary meaning, and (3) *MFW*’s intent.

In declining to adopt a rigid definition of *ab initio*, the court first emphasized that the flexible reading was consistent with the Chancery Court’s holding in *Swomley v. Schlecht*,²⁴ which the Delaware Supreme Court affirmed.²⁵ In *Swomley*, the Chancery Court “held that *MFW*’s ‘*ab initio*’ requirement was satisfied even though ‘the controller’s initial proposal hedged on whether the majority-of-the-minority condition would be waivable or not’” because the controller included the *MFW* Conditions “before any negotiations.”²⁶

Next, the court highlighted that a strict reading of “beginning” contradicts its use in everyday speech.²⁷ In reaching this conclusion, the court referenced the definition of beginning as “the first part” or “a rudimentary stage or early period.”²⁸ The court noted that “[a]n ordinary person would conclude” Zhang included the *MFW* Conditions “in the beginning stages of the process that led to the merger.”²⁹

Even more important, the court noted, is that a broad reading of *ab initio* better aligns with *why MFW* requires conditions early in the process.³⁰ *MFW* targets concerns raised by *Kahn v. Lynch Communications Systems, Inc.*,³¹ which shifted the burden of proof on entire fairness from

²⁰ *Id.* at *3.

²¹ *See id.* at *2, *5–6.

²² *Synutra*, 195 A.3d at 756.

²³ *Id.* at 760.

²⁴ No. 9355, 2014 WL 4470947 (Del. Ch. Aug. 27, 2014).

²⁵ *Synutra*, 195 A.3d at 763.

²⁶ *Id.* at 761 (quoting *Swomley*, 2014 WL 4470947, at *17–18).

²⁷ *Id.*

²⁸ *Id.* at 761 n.56 (quoting *Beginning*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/beginning> [<https://perma.cc/R67P-J7DH>]); *see also id.* at 762 (providing examples, including “the first few chapters” of a novel).

²⁹ *Id.* at 762.

³⁰ *See id.* at 762–63.

³¹ 638 A.2d 1110 (Del. 1994); *see Synutra*, 195 A.3d at 762.

the controller to the plaintiff if *either* an independent committee of directors *or* an informed majority of the minority shareholders approved.³² Given the transactional risk of conditioning on a minority vote, the practical effect of *Lynch* was shareholders conditioning on special committees alone, leaving the minority “either without a say or with a say at the potential expense of additional consideration that might have been extracted by tougher economic bargaining.”³³ Therefore, *MFW* was primarily concerned with “ensuring that controllers could not use the conditions as bargaining chips during economic negotiations” by allowing review of transactions under the deferential business judgment rule only if both protections are established up front.³⁴ The purpose of *ab initio*, the court stated, “require[s] the controller to self-disable before the start of substantive economic negotiations.”³⁵ Accordingly, Davis Polk’s conflict waiver did not preclude the business judgment rule because the special committee “did not engage in any *substantive* negotiation of Zhang’s offer” before it hired independent advisors.³⁶ The court held that Zhang’s second letter containing the *MFW* Conditions prevented him from using them as bargaining chips, and that because the special committee’s work occurred after Zhang conditioned his offer, Zhang was entitled to the business judgment rule standard of review.³⁷

The majority also rejected the plaintiff’s argument that the special committee failed to act with due care. The court affirmed the Chancery Court’s use of the “high standard of gross negligence” to ascertain due care violations,³⁸ rejecting what it viewed as the plaintiff’s invitation to “question whether the Special Committee’s sufficiently diligent efforts resulted in a negotiated price that was fair.”³⁹ As applied to the facts in this case, the majority cited “extensive” special committee deliberations in finding no gross negligence and hence no due care violation.⁴⁰

Justice Valihura dissented, arguing that the court should adopt a bright-line rule requiring the *MFW* Conditions in the first written proposal.⁴¹ In support, the dissent characterized the intervening events in the two weeks between the first and second offers as potentially substantively impacting “the functioning and quality of the [special committee’s] work.”⁴² A bright-line rule, the dissent argued, would help the

³² See *Lynch*, 638 A.2d at 1117; see also *Synutra*, 195 A.3d at 762.

³³ *Synutra*, 195 A.3d at 762.

³⁴ *Id.*

³⁵ *Id.* at 763.

³⁶ *Id.* at 765 (emphasis added).

³⁷ See *id.* at 764.

³⁸ *Id.* at 768.

³⁹ *Id.* at 767.

⁴⁰ *Id.* at 768.

⁴¹ *Id.* (Valihura, J., dissenting).

⁴² *Id.* at 779.

court avoid a “factual morass”⁴³ or “fact-intensive inquiry,”⁴⁴ especially at the pleading stage.

The majority’s flexible reading of *ab initio* better reflects judicial sensitivity for *MFW*’s place in the progression of case law encouraging transaction structures protective of minority shareholder rights. This practical reading also more faithfully effectuates *MFW*’s intent to reduce frivolous litigation. Nevertheless, the court missed an opportunity to provide clearer guidance on the definition of “before any substantive economic negotiations” — as negotiations over price per share — and on the scope of *ab initio* — as near the beginning in time and process. Even with further guidance, however, the substantive economic negotiation threshold remains problematic because Zhang’s initial offer appears to pass this threshold despite the court’s holding to the contrary.

The court’s ruling was faithful to the historical progression of case law in this field, which indicates judicial sensitivity to consistency and stability and the wisdom of deferring to the business judgment of corporate boards through deferential review standards when controlling transactions include certain minority protections.⁴⁵ While courts recognize that “directors are better equipped than the courts to make business judgments,”⁴⁶ this presumption is rebuttable, and when controlling shareholders are involved the court may not apply the business judgment rule absent additional protections.⁴⁷ In 1983, the Delaware Supreme Court clarified that challenges to controller transactions would be reviewed under the entire fairness standard.⁴⁸ A decade later, the court reaffirmed entire fairness as the standard but added that the

⁴³ *Id.*

⁴⁴ *Id.* at 770.

⁴⁵ While the courts have historically emphasized the protection of minority shareholders, some scholars argue the law should also recognize a controller’s rights to pursue their “idiosyncratic vision” and make managerial decisions. *See, e.g.,* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 595–97 (2016).

⁴⁶ *Gries Sports Enters. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 963 (Ohio 1986); *see also id.* at 964 (noting that the directors’ judgment “will be respected by the courts”); *see also, e.g.,* *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (“The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a).”). The General Corporation Law of Delaware states that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided.” DEL. CODE ANN. tit. 8, § 141(a) (West 2016).

⁴⁷ *See* Wilson, *supra* note 1, at 643–45. *But cf.* Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 509 (2002).

⁴⁸ *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (“The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.”). This decision solidified prior legal developments. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (clarifying the relationship between the entire fairness standard and the business judgment rule); *see also* Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 118–19 (Del. 1952); *Gottlieb v. Heyden Chem. Corp.*, 91 A.2d 57, 58 (Del. 1952); Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 415–23 (2013).

burden of proof could be shifted if the transaction was approved by *either* “an independent committee of directors or an informed majority of minority shareholders.”⁴⁹ This choice meant that parties were reluctant to seek minority shareholder approval because of “the leverage such a vote bestows.”⁵⁰ The Chancery Court began exploring whether controller transactions should be reviewed under the business judgment rule when approved by *both* the independent committee *and* a majority of minority shareholders.⁵¹ The court noted two central justifications: incentivizing transaction planners to use a deal structure that is beneficial for minority shareholders and providing defendants with a meaningful way to dismiss nonmeritorious cases before trial.⁵² However, even with the burden-shifting framework, pretrial dismissal remained “virtually impossible.”⁵³ Accordingly, in 2013 the court held that a controlling transaction conditioned from the outset on approval by both a special committee and informed vote of a majority of the minority shareholders will be reviewed under the business judgment rule.⁵⁴ One year later, the Delaware Supreme Court affirmed these conditions as part of a multifactor test, ensuring that a controlling shareholder does not use the inclusion of the minority shareholder vote as leverage during economic negotiations.⁵⁵

Furthermore, the court’s ruling was responsive to the functional realities and practical mechanics of dealmaking and negotiations.⁵⁶ If a party recognizes that they have failed to include the *MFW* Conditions after the initial offer but “before any substantive economic negotiations,” they would have little incentive to add the provisions if still subject to

⁴⁹ Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994); *see also* Subramanian, *supra* note 14, at 13–15; Wilson, *supra* note 1, at 655–56.

⁵⁰ Robert S. Reder, *Chancery Court Again Grants Early Dismissal of Litigation Challenging Control Stockholder-Led Buyout*, 72 VAND. L. REV. EN BANC 11, 12 (2018); *see also* Subramanian, *supra* note 14, at 16–17 (noting that after *Lynch* “controllers have no further incentive to provide a [majority-of-the-minority] condition”).

⁵¹ *See, e.g., In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 606 (Del. Ch. 2005); *In re Siliconix Inc. S’holders Litig.*, No. CIV. A. 18700, 2001 WL 716787, at *7 (Del. Ch. June 19, 2001).

⁵² *Cox Commc’ns*, 879 A.2d at 606–07; *see also In re MFW S’holders Litig.*, 67 A.3d 496, 502–04, 535–36 (Del. Ch. 2013). The court has recognized that “every case has settlement value” absent the possibility of an effective motion to dismiss. *Id.* at 534.

⁵³ Johnson, *supra* note 48, at 419.

⁵⁴ *See MFW S’holders Litig.*, 67 A.3d at 535; Johnson, *supra* note 48, at 420–21.

⁵⁵ Kahn v. M&F Worldwide Corp., 88 A.3d 635, 645 (Del. 2014); *see Reder, supra* note 50, at 12–13; Wilson, *supra* note 1, at 662–63; *see also* Nicholas R. Rodriguez, Kahn v. M&F Worldwide Corp.: *Risking Too Much on Ab Initio Conditions*, 10 J. BUS. & TECH. L. 113, 127 (2015) (“[T]he court, finding its roots in *Lynch*, was properly motivated by a desire to protect the minority stockholder.”). *MFW* and *Synutra* may be part of a line of cases expanding protections and insulating transactions from scrutiny. *See, e.g., Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 5–6 (Del. 2017); *DFC Glob. Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346, 349 (Del. 2017); *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 306 (Del. 2015).

⁵⁶ The Delaware Supreme Court would later emphasize the “pragmatic approach” of *Synutra*. *Olenik v. Lodzinski*, No. 392, 2018, 2019 WL 1497167, at *8 (Del. 2019).

the entire fairness standard. As the case history illustrates, parties are unlikely to include the minority approval protection unless receiving the deferential business judgment rule. In *Synutra*, the court stated that substantive economic negotiations had not occurred.⁵⁷ Given the prompt follow-up letter with the *MFW* Conditions and lack of facts indicating that the controller used the conditions as bargaining chips, the two-week delay did not harm minority shareholders, while the inclusion of the *MFW* Conditions benefited them with a more optimal deal structure.⁵⁸ A standard so rigid that it does not allow slight, insubstantial variance could reasonably diminish widespread adherence.⁵⁹

The court acted faithfully within its judicial role but missed an important opportunity to more clearly define “before any substantive economic negotiations.”⁶⁰ While the far end of the term could reasonably be inferred — negotiations about the price per share — it is unclear what else would constitute a substantive economic negotiation in the court’s view. In *Synutra*, one can infer that the court did not consider anything between the first and second letters — namely the Davis Polk conflict waiver — to be substantive economic negotiations. Because deals do not follow a clear, consistent progression, events preceding negotiations are not standardized, and negotiations are not formally declared, it would be difficult to apply a substantive economic negotiation standard to any aspect except one that goes to the heart of such transactions: negotiation over price per share.⁶¹ A clear, workable definition for substantive economic negotiations as price per share would reduce this confusion.

Moreover, when the court does provide a clear definition, it should include temporal and procedural elements in that definition. The court notes that price negotiations did not commence until seven months after Zhang’s second offer.⁶² “The beginning” cannot reasonably extend to the seventh month in an eight-month transaction. However, the court also found it worth noting that “Zhang disabled before the Special Committee had hired its advisors” or completed its work,⁶³ perhaps implying that had Zhang failed to condition his offer before these processes the business judgment rule would not apply. Thus, “beginning” may extend beyond

⁵⁷ See *Synutra*, 195 A.3d at 758.

⁵⁸ See *id.* at 764–67.

⁵⁹ See generally Cass R. Sunstein, *Problems with Rules*, 83 CALIF. L. REV. 953, 994–95 (1995) (arguing that rigid rules lead to their disregard or underenforcement, and providing examples).

⁶⁰ The lack of clarity lends itself to unnecessary litigation. See, e.g., *Olenik*, 2019 WL 1497167, at *1, *10 (applying *Synutra*’s guidance on the *MFW* timing issue to find that the facts may support a reasonable inference that the defendant “engaged in substantive economic negotiations” before the *MFW* Conditions were in place); *Synutra*, 195 A.3d at 756 (suggesting that the issues in *Synutra* had already been clarified in *Swomley*).

⁶¹ See generally Cathy Hwang, *Deal Momentum*, 65 UCLA L. REV. 376 (2018); Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 634–39 (2016).

⁶² See *Synutra*, 195 A.3d at 758–59.

⁶³ *Id.* at 764.

mere temporal placement, perhaps including procedural elements defined by the “beginning” of the special committee’s process.⁶⁴ To protect minority shareholders and resolve the threshold’s apparent tension with the plain meaning of *ab initio*, the court should consider clarifying that “before any substantive economic negotiations” extends to both temporal and procedural elements.

However, even this broad definition of substantive economic negotiations may conflict with the holding in *Synutra*, since Zhang’s initial letter included a price per share offer. Recently, in applying the new *Synutra* framework, the Chancery Court noted that “negotiations begin when a proposal is made by one party which, if accepted . . . would constitute an agreement between the parties regarding the contemplated transaction.”⁶⁵ Negotiators often consider terms, conditions, prices, dates, numbers, and liabilities “substantive” issues.⁶⁶ Accordingly, Zhang’s initial proposal appears to be a “substantive economic negotiation.” It is possible that the court collapsed the first and second letters into one initial offer to determine that the *MFW* Conditions were in place from the initial offer.⁶⁷ However, in the absence of language indicating that the court intended to collapse the transaction, this tension between the holding and the substantive economic negotiations threshold remains problematic and indicative of the messy realities of dealmaking and difficulties of judicial line-drawing.

The majority smartly recognized in *Synutra* that the correct outcome was to apply the business judgment rule. In reaching this result, however, the court problematically left key terms undefined and in potential conflict with the holding of the case. The majority’s desire for a flexible, practical standard and the dissent’s desire for a bright-line rule are not completely irreconcilable. The court should clarify and reevaluate what is meant by “before any substantive economic negotiations” to mitigate future litigation and provide transaction planners with clearer guidance while still encouraging the use of the *MFW* Conditions and the benefits they bring.

⁶⁴ See *Olenik*, 2019 WL 1497167, at *8 (noting that in *Synutra* the controller’s first offer was “quickly followed” by the *MFW* Conditions). Financial and legal advisors “are critical in ensuring that the independent directors remember their proper role.” Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 BUS. LAW. 679, 684 (2015).

⁶⁵ *Olenik v. Lodzinski*, C.A. No. 2017-0414, 2018 WL 3493092, at *15 (Del. Ch. July 20, 2018), *aff’d in part, rev’d in part, and remanded*, *Olenik*, 2019 WL 1497167. This definition comports with the common understanding of negotiation.

⁶⁶ See generally ROGER FISHER & WILLIAM URY, *GETTING TO YES* 160, 173–74 (Bruce Patton ed., 3d ed. 2011). The first offer is the “starting point” that can anchor the negotiation. GUHAN SUBRAMANIAN, *DEALMAKING: THE NEW STRATEGY OF NEGOTIACTIONS* 16 (2010).

⁶⁷ Concerns about the initial offer “anchoring” the negotiation to the initial price may be smaller than if the gap between the two offers were longer.