
October 16, 2018

Delaware Supreme Court Clarifies That “*ab initio*” for MFW Purposes Means before the Start of Substantive Economic Negotiations

In *Flood v. Synutra International, Inc.*, the Delaware Supreme Court affirmed the Court of Chancery’s holding that the controlling shareholder satisfied MFW’s “*ab initio*” requirement by conditioning the deal on the required procedural protections before substantive economic negotiations had begun, even if that was not until his second offer letter. Therefore, the business judgment rule applied to the transaction, leading to the dismissal of plaintiff’s claims. In the majority opinion written by Chief Justice Strine, the court stated that determining when substantive economic negotiations begin is imprecise and could lead to close cases.

Background

Liang Zhang and his affiliates owned 63.5% of Synutra International, Inc. In January 2016, Mr. Zhang sent a letter to the board of Synutra proposing to buy the remaining shares of the company at \$5.91 per share. The letter did not include as preconditions to the offer the MFW procedural protections (*i.e.*, that the transaction be conditioned “*ab initio*” on (1) approval by an independent, fully empowered special committee and (2) approval by an uncoerced and fully informed vote of a majority of the minority shareholders). One week after receipt of the letter, the board formed a special committee to consider the offer. Two weeks after the initial offer, Mr. Zhang sent a second proposal with the same economic terms, but this time conditioning his offer on the MFW procedural protections. After receiving the second proposal, the special committee retained independent legal and financial counsel. After an eight-month long process, the parties agreed to a price of \$6.05 per share. Plaintiff brought fiduciary duty and related claims challenging the transaction, and the defendants moved to dismiss.

Analysis

In affirming the Chancery Court’s dismissal of plaintiff’s claims and holding that business judgment review applied, the decision’s key takeaways are as follows:

- *As long as the controller conditions his or her proposal on MFW’s procedural protections before any substantive economic negotiations, the transaction satisfies the “ab initio” requirement.* The court explained that “*ab initio*” is not a bright line and includes, not only the literal start of the transaction, but also the early stages of a multi-stage process up until substantive economic negotiations commence. Here, when Mr. Zhang sent his second proposal (which contained the conditions required

by *MFW*), the special committee had not yet retained independent legal or financial counsel. Indeed, only after seven months of diligence, including by its financial advisors, did the special committee begin negotiating with Mr. Zhang over price. The court also held that substantive economic negotiations did not commence when the company waived the conflicts of its corporate counsel, allowing it to represent Mr. Zhang in connection with the transaction. The court noted that the key purpose of *MFW* was to ensure that controllers could not use the *MFW* conditions as “bargaining chips” during economic negotiations, and because Mr. Zhang’s second proposal was made prior to commencing substantive economic negotiations, the “*ab initio*” requirement was satisfied.

- *Due care claims must be based on a defect in the special committee process, not merely on the committee’s ability to procure a fair price.* Here, Synutra’s special committee was comprised of independent directors, and the committee received extensive advice and information from its independent legal and financial counsel. Accordingly, the special committee acted with due care. The court thus dismissed the plaintiffs claim that the Special Committee was grossly negligent merely because price was ostensibly inadequate.

Justice Valihura, in a rare dissent from the majority opinion, argued that “*ab initio*” should be applied as a bright line test to mean the initial formal written proposal, especially since the controller determines the timing of when to commence the transactional process. The dissent was wary of the imprecise, fact-intensive definition of “*ab initio*” adopted by the majority, especially as applied at the pleadings stage of litigation.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:



Matthew W. Abbott
Partner
New York Office
+1-212-373-3402
mabbott@paulweiss.com



Scott A. Barshay
Partner
New York Office
+1-212-373-3040
sbarshay@paulweiss.com



Ariel J. Deckelbaum
Partner
New York Office
+1-212-373-3546
ajdeckelbaum@paulweiss.com



Ross A. Fieldston
Partner
New York Office
+1-212-373-3075
rfieldston@paulweiss.com



Justin G. Hamill
Partner
New York Office
+1-212-373-3189
jhamill@paulweiss.com



Stephen P. Lamb
Partner
Wilmington Office
+1-302-655-4411
slamb@paulweiss.com



Jeffrey D. Marell
Partner
New York Office
+1-212-373-3105
jmarell@paulweiss.com



Taurie M. Zeitzer
Partner
New York Office
+1-212-373-3353
tzeitzer@paulweiss.com

Counsel Frances F. Mi, law clerk Mark S. Zwany and legal consultant Cara Grisin Fay contributed to this memorandum.

Our M&A Group

The Paul, Weiss M&A Group consists of more than 30 partners and over 100 counsel and associates based in New York, Washington, Wilmington, London, Toronto, Tokyo, Hong Kong and Beijing. The firm's Corporate Department consists of more than 60 partners and over 200 counsel and associates.

Our M&A Partners

[Matthew W. Abbott](#)

[Edward T. Ackerman](#)

[Scott A. Barshay](#)

[Angelo Bonvino](#)

[Jeanette K. Chan](#)

[Ellen N. Ching](#)

[Ariel J. Deckelbaum](#)

[Ross A. Fieldston](#)

[Brian P. Finnegan](#)

[Adam M. Givertz](#)

[Neil Goldman](#)

[Bruce A. Gutenplan](#)

[Justin G. Hamill](#)

[David M. Klein](#)

[David K. Lakhdhir](#)

[Stephen P. Lamb](#)

[John E. Lange](#)

[Brian C. Lavin](#)

[Xiaoyu Greg Liu](#)

[Jeffrey D. Marell](#)

[Alvaro Membrillera](#)

[Judie Ng Shortell](#)

[Kelley D. Parker](#)

[Carl L. Reisner](#)

[Kenneth M. Schneider](#)

[Robert B. Schumer](#)

[John M. Scott](#)

[Tarun M. Stewart](#)

[Ramy J. Wahbeh](#)

[Steven J. Williams](#)

[Betty Yap](#)

[Kaye N. Yoshino](#)

[Tong Yu](#)

[Taurie M. Zeitzer](#)