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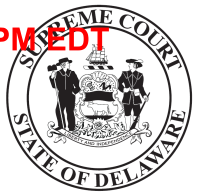

IN THE SUPREME COURT OF THE STATE OF DELAWARE

ALAN KAHN, SAMUEL PILL, IRWIN PILL, RACHEL PILL and CHARLOTTE MARTIN, Plaintiffs-Below, Appellants, v. M&F WORLDWIDE CORP., RONALD O. PERELMAN, BARRY F. SCHWARTZ, WILLIAM C. BEVINS, BRUCE SLOVIN, CHARLES T. DAWSON, STEPHEN G. TAUB, JOHN M. KEANE, THEO W. FOLZ, PHILIP E. BEEKMAN, MARTHA L. BYORUM, VIET D. DINH, PAUL M. MEISTER, CARL B. WEBB and MacANDREWS & FORBES HOLDINGS INC., Defendants-Below, Appellees.	No. 334,2013 Court Below: Court of Chancery of The State of Delaware C.A. No. 6566-CS (Consolidated)

APPELLANTS' OPENING BRIEF

ROSENTHAL, MONHAIT & GODDESS, P.A.
Carmella P. Keener (Bar No. 2810)
919 North Market Street, Suite 1401
Wilmington, DE 19801
(302) 656-4433

FARUQI & FARUQI, LLP
Peter B. Andrews (Del. Bar No. 4623)
20 Montchanin Road, Suite 145
Wilmington, DE 19807
(302) 482-3182

Counsel for
Plaintiffs Below-Appellants

August 9, 2013

OF COUNSEL:

WOLF POPPER LLP
Carl L. Stine
Matthew Insley-Pruitt
845 Third Avenue
New York, NY 10022
(212) 759-4600

FARUQI & FARUQI, LLP
Nadeem Faruqi
Beth A. Keller
369 Lexington Avenue
New York, NY 10017
(212) 983-9330

GARDY & NOTIS, LLP
James S. Notis
Kira German
501 Fifth Avenue
New York, NY 10017
(212) 905-0509

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NATURE OF THE PROCEEDING

Stockholders of M & F Worldwide Corp. ("MFW") brought this class action against the Company's Board of Directors (the "Board"), its controlling stockholder, defendant Ronald O. Perelman ("Perelman"), and his wholly owned holding company, MacAndrews & Forbes Holdings Inc. ("MacAndrews & Forbes" and collectively, the "Defendants"), arising out of Perelman's acquisition of the 57% of MFW's common stock that MacAndrews & Forbes did not already own. (the "Buyout"). A1-33; A102. MacAndrews & Forbes approached the Board with a $24 per share offer in June 2011. A117-119. Three months later, in September 2011, following approval by a special committee (the "Special Committee"), MFW and MacAndrews & Forbes jointly announced an agreement and plan of merger pursuant to which MacAndrews & Forbes would acquire MFW for $25 per share. A126; A1187-1193. Holders of a majority of the publicly held shares approved the transaction. A23; A915-922.

Defendants moved for summary judgment on a single issue of law: whether the business judgment standard of review would apply to a controller freeze-out contingent on the (1) negotiation and approval by a special committee of independent directors fully empowered to reject the transaction; and (2) approval by an uncoerced, fully informed majority of the shares held by the public investors. A48. The Court of Chancery granted summary judgment, holding that the use of

both devices entitled the transaction to review under the business judgment rather than the entire fairness standard, and reasoning that this Court's numerous statements that entire fairness applies to all controller-led buyouts did not control this case. *See In re MFW S'holders Litig*., 67 A.3d 496, 521-24 (Del. Ch. 2013). Further, the Court of Chancery found that under the business judgment standard, summary judgment was appropriate because no material issue of fact was in dispute and Defendants were entitled to judgment as a matter of law. *Id.* at 536. This appeal followed.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in holding that the business judgment standard applies to controller freeze-out mergers where the controller's proposal is conditioned on both special committee approval and a majority-of-the-minority vote. The rule articulated in *Kahn v. Lynch Commc'n Sys.*, 638 A.2d 1110, 1115 (Del. 1994), and its progeny that entire fairness review applies to all controller-initiated freeze-out merger transactions should not be abandoned. A1977-1985. Special committee approval and a majority-of-the-minority vote do not sufficiently protect public stockholders. *Id*.

2. Even if the business judgment standard is to be applied, the Court of Chancery erred in its conclusion regarding the absence of material disputed facts, because the Special Committee was not disinterested and independent, was not effective, and was not fully empowered, and the majority-of-the-minority provision did not afford MFW stockholders sufficient protection and is subject to expert testimony. A1985-1995.

STATEMENT OF FACTS

MFW was a holding company that conducted its operations through indirect wholly owned subsidiaries, Harland Clarke Holdings Co. ("HCHC") and Mafco Worldwide ("Mafco"). A110-112; A204; A2017. Three of MFW's four business segments are operated through HCHC: Harland Clarke Corp. ("Harland Clarke"), which prints bank checks; Harland Clarke Financial Solutions ("Harland Financial"), which provides technology products and services to financial services companies; and Scantron Corp. ("Scantron"), which manufactures scanning equipment used for educational purposes. *Id*.

A. Perelman and MacAndrews & Forbes Controlled MFW

Perelman is Chairman of the MFW Board and the sole owner, Chairman and CEO of MacAndrews & Forbes, which owned 43.4% of the outstanding stock of MFW at the time of the Buyout. A202; A2044. Perleman and MacAndrews & Forbes control MFW, both through voting power and management control.[1] *Id*. Pursuant to a Management Services Agreement, an affiliate of MacAndrews & Forbes provided the services of the Company's CEO and CFO, as well as other

[1] In addition to the members of the Special Committee (discussed below), MFW's Board consisted of individuals who were: current MFW and MacAndrews & Forbes insiders (Barry Schwartz ("Schwartz"), Stephen Taub ("Taub") and Charles Dawson ("Dawson")); were affiliated with Perelman-controlled entities (William Bevins ("Bevins"), John Keane ("Keane"), Theo Folz ("Folz")); or had a long-standing business and personal relationship with Perelman (Bruce Slovin ("Slovin")). A103-107; A2588-2589.

management, advisory, transactional, corporate finance, legal, risk management, tax and accounting services. A2507-2508; A2991-2992.

Perelman and MacAndrews & Forbes have a history of controlling and overreaching at MFW to enrich themselves at the expense of minority stockholders. In 2001, for example, Perelman caused MFW to purchase a stake in Perelman-owned entity Panavision, Inc. ("Panavision"), thereby increasing Perelman's stake in MFW from 35% to 53%. A2424-2426; A2431. Following litigation, the Panavision transaction was unwound with Perelman paying $10 million in damages. *Id*.

Another transaction involved MFW's proposed acquisition of MacAndrews & Forbes-owned Faneuil, Inc. ("Faneuil"). A2503-2506; A3146-3147. In February 2011, the MFW Board formed a special committee comprised of Viet Dinh ("Dinh"), Carl Webb ("Webb"), Paul Meister ("Meister") and Martha Byorum ("Byorum") to consider acquiring Faneuil. A2975-2976; A3147. By May 2011 – around the time Perelman was gearing up to take MFW private – Dawson informed the special committee that MacAndrews & Forbes was no longer interested in pursuing the transaction. A2980-2986; A3147-3148. Shortly after the

Buyout, however, MFW, which MacAndrews & Forbes then entirely owned, acquired Faneuil on advantageous terms, to Perelman's benefit.[2]

B. The Buyout

In May 2011, Perelman began to explore the possibility of taking MFW private. A202; A2044. Utilizing Perelman's unfettered access to MFW's internal information, MacAndrews & Forbes engaged Moelis & Company ("Moelis") as its financial advisor. On May 31, 2011, weeks before MacAndrews & Forbes transmitted the Buyout proposal to the MFW board, Moelis was provided five-year financial projections for MFW's major business segments, HCHC and Mafco. A204; A2046.

Perelman's interest in acquiring MFW coincided with MFW's May 5, 2011 filing of its Form 10-Q with the SEC, disclosing its first quarter earnings. *See generally,* A2617-2665. The Company's operating income had declined by $22.4 million. A2623. However, this 22.5% decline resulted from acquisitions by the Company during the prior twelve months. A2611-2616; A2627. Following the announcement of its first quarter earnings, MFW's stock price dropped, reaching a two-year low of $16.77 per share on June 10, 2011. A117.

[2] At that time it was revealed that Faneuil would contribute a projected $125 million in revenue and $11 million in adjusted EBITDA in 2012. A3258; A3271. In addition, the acquisition would provide estimated synergies of $4.5 million. *Id*. That the acquisition of Faneuil was delayed until after the Buyout ensured that Perelman and MacAndrews & Forbes alone would enjoy the millions of dollars in revenues and synergies created through the acquisition.

On June 13, 2011, MacAndrews & Forbes sent a letter to MFW's Board proposing to purchase the publicly held shares of MFW for $24 per share, conditioned on approval by a special committee and the holders of a majority of MFW's public shares. A118-119; A204-205; A1151-1152; A2005-2007. The letter stated that MacAndrews & Forbes would neither sell any of its shares nor vote in favor of any alternative transaction. *Id*. The letter was signed by Schwartz – MFW's President and CEO – in his capacity as Executive Vice Chairman and Chief Administrative Officer of MacAndrews & Forbes. A2005-2007. Perelman timed the Buyout perfectly to take advantage of MFW's greatly reduced stock price,[3] and Perelman's handpicked Board, including the directors appointed to MFW's Special Committee, was no obstacle to getting the Buyout approved on terms most favorable to Perelman and MacAndrews & Forbes.

1. The Special Committee Was Not Fully Empowered

With the letter proposing the Buyout, MacAndrews & Forbes included a draft Board resolution forming the Special Committee. A2050; A3001-3002. The draft resolution granted the committee only the power to consider and negotiate the Buyout proposal, with no right to solicit alternative bids, conduct any sort of

[3] Lisa Lee of *Reuters* reported that "Perelman's swoop…is opportunistic – his offer at a 41 percent premium to Friday's closing price only brings his target's valuation back to near where it was in early May. That's a multiple of barely 5.3 times the last 12 months' EBITDA, less than the trading multiple of peer RR Donnelly & Sons." A2614.

market check, or even consider alternative transactions. A24-25; A1159-1160; A3007-3009; A3063-64; A3166.

On June 14, 2011, the MFW Board met to consider the Buyout proposal and MacAndrews & Forbes's draft resolution regarding the Special Committee. A1155-1161; A3004-3005. Directors Byorum, Dinh, Meister, Webb and Slovin agreed to serve on the Special Committee and they adopted MacAndrews & Forbes's proposed resolution in its entirety without any changes. A1155-1161; A2050-2052; A3007-3009. The Special Committee hired Evercore Partners as its financial advisor. A210; A2052.

Although MacAndrews & Forbes owned less than 44% of the Company's stock, at no time did the Special Committee attempt to expand its mandate to consider alternatives to MacAndrews & Forbes's going private proposal. A598; A3063-3064. As a result, the Special Committee failed to establish a process for investigating third-party interest or consider alternatives to the Buyout. A601-607; A3085-3089; A3165-3167. In particular, the Special Committee did not identify potential acquirers of the Company or its assets or business segments, nor did the Special Committee require Company management to alert it or its advisors to any approaches or indications of interest. A2825-2826; A3166. Indeed, the Company

received at least two such inquiries, but did not inform the Special Committee of them.[4] *Id.*

2. The Special Committee Was Not Independent

The members of the Special Committee had personal and/or professional relationships with Perelman and/or MacAndrews & Forbes apart from their directorship of the Company. As originally comprised, the Special Committee consisted of directors Slovin, Meister, Webb, Dinh and Byorum . A2052; A3153-3154. Slovin voluntarily recused himself due to his close relationship with Perelman, which compromised his independence. *Id.*; A570. As demonstrated *infra*, Byorum, Dinh and Webb were likewise conflicted due to significant business and personal entanglements with MacAndrews & Forbes, Perelman and his related business entities, yet remained on the Special Committee.

3. The Special Committee Obtains a $1 Price Increase and Approves the Buyout

Two months after being presented with the acquisition proposal, the Special Committee approved the Buyout for $25 per share, just $1 above the $24 per share

[4] MFW received a series of indications of interest for a potential sale – the Special Committee was informed of none of them. *See, e.g.*, A2825; A3166 (email from Open Gate Capital, regarding public announcement of proposal, "Wanted to know if that somehow implied that portions of the business are up for sale and, if so, that they would be interested."); A2825-2826 (email from Eigen Capital, noting that the private equity firm has "a particular interest in the food ingredient sector and thought it would be a good idea to introduce ourselves, in particular, should M & F consider divesting its licorice operations.").

originally offered in June 2011 and deemed inadequate by the Special Committee. A222-224; A2834; A3084.

On September 12, 2011, the Company announced that it had entered into a definitive merger agreement by which MFW would be merged with and into a subsidiary of MacAndrews & Forbes, with all outstanding shares of common stock of MFW not owned by MacAndrews & Forbes converted into the right to receive $25 in cash per share, in a transaction valued at $482 million. A102; A126; A1187-1193. Though touted as representing a 22% one-day premium to the Company's closing share price on September 9, 2011, the merger consideration was a substantial discount to the Company's other recent trading prices. A224; A2614-2616.

C. Procedural History

After the initial announcement of the Buyout in June 2011, three proposed class action lawsuits were filed in the Delaware Court of Chancery. A1-33.

On June 18, 2012, following discovery as to liability-related matters but not damages, Defendants made an early motion for summary judgment. A34-93. Contrary to repeated Supreme Court instructions that a going-private transaction by a controlling stockholder is subject to an entire fairness standard of review (*Kahn*, 638 A.2d at 1115), Defendants asked the Court of Chancery to evaluate the Buyout under the less exacting business judgment standard suggested in *dicta* in *In*

re Cox Commc'ns S'holders Litig., 879 A.2d 604, 644 (Del. Ch. 2005). A48-49. The business judgment standard, they argued, was applicable here because the Buyout was purportedly conditioned on two procedural protections that, together, replicate an arm's length merger – approval by a properly empowered, independent special committee and a majority-of-the-minority vote. A34-93.

Plaintiffs opposed Defendants' motion, contending that under *Kahn v. Lynch*, entire fairness was the appropriate standard of review. A1928; A1973-1977. Plaintiffs further argued that even if the Court were to follow the *Cox* approach, the Buyout was still subject to entire fairness review because the record demonstrates material factual disputes as to whether the Special Committee was independent and fully empowered, and whether the majority-of-the-minority condition was effective, which would have required a highly fact-specific inquiry involving expert testimony. A1985-1993.

D. The Decision Below

On May 29, 2013, the Court of Chancery granted Defendants' motion. *In re MFW S'holders Litig*., 67 A.3d 496 (Del. Ch. 2013). The Court of Chancery held that the business judgment rule applied where a merger was subject from the outset to: (1) negotiation and approval by a special committee of independent directors fully empowered to reject the transaction; and (2) approval by an uncoerced, fully informed majority of the minority investors. It determined that it was free to reach

that conclusion, despite statements in Supreme Court decisions that the entire fairness standard applies to all controller freeze-out mergers, because such statements were merely non-binding *dictum* and this Court had never decided a case in which a controller freeze-out merger had been subject to both a special committee and majority-of-the-minority requirements. *MFW*, 67 A.3d at 500. Further, the Court of Chancery concluded that there was no material issue of fact as to the independence and effectiveness of the Special Committee or any aspect of the approval of the Buyout by a majority of the public stockholders. *Id.* at 510.

ARGUMENT

I. THE COURT BELOW ERRED IN DETERMINING THAT BUSINESS JUDGMENT APPLIES TO CONTROLLER FREEZE-OUT MERGERS WHERE THE CONTROLLER'S PROPOSAL IS CONDITIONED ON SPECIAL COMMITTEE APPROVAL AND A MAJORITY-OF-THE-MINORITY VOTE

A. Question Presented

Did the Court of Chancery err in holding that business judgment, not entire fairness, is the proper standard of review in cases where a controller conditions an offer to acquire the remaining shares of the company it controls upon approval of a special committee of independent directors and approval of a majority of the unaffiliated stockholders? A1973-1985.

B. Scope of Review

This Court's review of the trial court's determination of summary judgment "is *de novo*, not deferential, both as to the facts and the law." *Williams v. Geier*, 671 A.2d 1368, 1375 (Del. 1996). On a summary judgment record, the Court draws its "own inference in making factual determinations and in evaluating the legal significance of the evidence." *Id.*; *see also Alaska Electrical Pension Fund v. Brown*, 941 A.2d 1011, 1015 (Del. 2007).

C. Merits of the Argument

1. This Court Has Reaffirmed the Continuing Viability of *Kahn v. Lynch's* Dictate that Entire Fairness Applies in All Going Private Freeze-Out Mergers

In 1994, following numerous cases that were divided over the proper standard of review in controlling stockholder transactions, this Court, in *Kahn v. Lynch*, 638 A.2d 1110 (Del. 1994), stated the following simple, bright-line rule: "A controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness." *Id.* at 1115 (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983)). The Court went on to explain: "Entire fairness remains the proper focus of judicial analysis in examining an interested merger irrespective of whether the burden of proof remains upon or is shifted away from the controlling or dominating shareholder, because the unchanging nature of the underlying 'interested' transaction requires careful scrutiny." *Id.* at 1116. Explaining this "unchanging nature," and the rationale for this bright-line rule, the Court stated:

> The controlling stockholder relationship has the potential to influence, however, subtly, the vote of [ratifying] minority stockholders in a manner that is not likely to occur in a transaction with a noncontrolling party.
>
> Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder.... Consequently, in a merger between the corporation and its controlling stockholder – even one negotiated by disinterested, independent

> directors – no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm's length negotiation.

Id. at 1116-17 (quoting *Citron v. E.I. Du Pont de Nemours & Co.,* 584 A.2d 490, 502 (Del. Ch. 1990)) (brackets in original). This Court was not equivocal in its holding: "Once again, this Court holds that the ***exclusive*** standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness." *Id.* at 1117 (citing *Weinberger*, 457 A.2d at 710-11) (emphasis added).[5]

In *Americas Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012) (hereinafter, "*Southern Copper*"), this Court, sitting *en banc,* again reaffirmed the continuing viability of the entire fairness standard in controlling stockholder transactions. *See id.* at 1239 ("When a transaction involving self-dealing by a controlling shareholder is challenged, the applicable standard of judicial review is entire fairness, with the defendants having the burden of persuasion."); *id.* at 1240, *quoting Kahn v. Tremont Corp.*, 694 A.2d at 428 (citation omitted) ("Accordingly, '[r]egardless of where the burden lies, when a controlling shareholder stands on both sides of the transaction the conduct of the parties will be viewed under the

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[5] *See also Emerald Partners v. Berlin*, 726 A.2d 1215, 1221-22 (Del. 1999) (entire fairness review where Chairman/CEO of one party to a merger was the sole owner of the other party); *Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997) ("Entire fairness remains applicable even when an independent committee is utilized because the underlying factors which raise the specter of impropriety can ***never*** be completely eradicated and still require careful judicial scrutiny." (emphasis added)).

more exacting standard of entire fairness as opposed to the more deferential business judgment standard.'"); *id.* at 1242, *citing Kahn v. Tremont*, at 428-29 ("Delaware has long adhered to the principle that the controlling shareholders have the burden of proving an interested transaction was entirely fair.").

The decision below states, however, that this Court's broad language requiring entire fairness review for ***all*** controller freeze-out mergers is *dictum* and, therefore, inapplicable. *MFW*, 67 A.3d at 502, 521-24. The Court of Chancery noted that none of this Court's decisions affirming the continuing viability of *Kahn v. Lynch* precisely addressed a case where a controller's proposal included the stated conditions of both approval by a special committee and a majority-of-the-minority vote. *Id*. Plaintiffs submit that the Court of Chancery's assessment of this Court's prior rulings is flawed.

This Court recognizes its "institutional role, and the public need for guidance in future cases." *New Castle County Dep't of Land Use v. Univ. of Del*., 842 A.2d 1201, 1211 (Del. 2004). Thus, for example, if the *en banc* Court in *Southern Peru* had meant to tell the world that the law of Delaware had changed, it could have said so. Alternatively, the Court could have simply passed on the issue by noting that the defendants conceded the standard of review was entire fairness. Instead, the Court explicitly reaffirmed the viability of *Kahn v. Lynch*, and declined even to acknowledge its criticism through passing reference to cases like *Cox.* As

this Court has provided no exceptions to *Kahn's* bright-line rule, entire fairness should continue to be the standard of review in controller freeze-out merger cases, regardless of the protections proposed by the controller or negotiated by a special committee. The Court of Chancery erred in failing to apply the entire fairness standard prescribed by this Court.

2. Entire Fairness Should Continue to Be the Standard of Review in Controller Freeze-Out Merger Cases

There is no reason to believe that the original rationale for requiring entire fairness review is any less compelling today than it was nineteen years ago when the Court decided *Kahn v. Lynch*. Vice Chancellor Noble, in *In re Atlas Energy Resources, LLC, Unitholder Litig.*, 2010 WL 4273122, at *10 (Del. Ch. Oct. 28, 2010), explained that entire fairness review of controller freeze-out mergers continues to be necessary to protect minority stockholders:

> [T]he instruction of *Lynch* and its more recent progeny that, in the context of a negotiated merger, "protective device[s] such as independent committee approval or majority-of-the-minority stockholder approval cannot alter the standard of review," is well established. ***This is so because, regardless of the safeguards a board may employ to protect the interest of the minority, such a merger is characterized by what this Court has termed "inherent coercion." A controlling party has advantages over the minority with regard to information, timing, and the ability to "influence, however subtly, the vote of [the ratifying] minority." Because a parent's merger with its subsidiary is "entirely suffused with the parent's coercive power," a court must review the transaction under entire fairness to assure that the parties "are assiduous in fulfilling their fiduciary duties.***"

(Footnotes omitted; brackets in original; emphasis added.) Vice Chancellor Noble recognized the unfair advantages a controller has over public stockholders in terms of information and timing. *Id.* A respected scholar agreed:

> [Controllers] can gain from pushing the limit of the corporate opportunities doctrine and delaying the development of lucrative business ventures in the period before a freezeout. They will gain from manipulating dividend policy in their interest in the period before a freezeout... In all likelihood, the controller has a variety of mechanisms that would succeed in forcing down the trading price of the minority's stock. In a world without a fair price duty, the controller can then take advantage of this depressed stock price to compel a freezeout.

Faith Stevelman, *Going Private at the Intersection of the Market and the Law,* 62 Bus. Law 775 (May 2007) (footnotes and citations omitted).[6] Professor Steven Davidoff, who, with Professor Matthew Cain, had studied all 103 management buyouts from 2003 to 2009,[7] agreed with Professor Stevelman based on their findings that third-party bids were at a higher premium than those initiated by management, even if an independent committee of directors was used: "[T]ransactions initiated by third-party bidders were associated with premiums that were 12.8 percent higher, on average, than those initiated by management…. These findings appear to bear out the hypothesis that management can use its

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[6] In fact, here, there was just such manipulation as described above in connection with the proposed acquisition of Faneuil. *See supra* at 5-6 and n.2.

[7] *See* Matthew Cain & Steven M. Davidoff, *Form Over Substance? The Value of Corporate Process and Management Buy-outs,* http://papers.ssrn.com/sol3/ papers.cfm?abstract_id=1653492 (5th Annual Conference on Empirical Legal Studies, 2010) ("Cain & Davidoff").

knowledge of the company and position to obtain lower premiums."[8] At least under *Kahn v. Lynch,* the more exacting entire fairness review likely induces controllers to pay higher prices than if the same transaction were merely subject to business judgment review.[9]

The Court of Chancery reasoned that together independent special committees and majority-of-the-minority conditions are a "potent combination of procedural protections," *MFW*, 67 A.3d at 526, but that controllers have no incentive to condition an offer on both protections because the use of either will suffice to shift the burden of proving entire fairness onto the plaintiffs. However, while the use of either or both of these protections might be sufficiently beneficial to shift the entire fairness burden to the plaintiffs, these protections – either separately or together – are not sufficiently beneficial to abandon entire fairness protection for minority stockholders.[10]

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[8] Steven Davidoff, *The Management Buyout Path of Less Resistance,* N.Y. Times, June 12, 2013, http://dealbook.nytimes.com/2013/06/12/the-management-buyout-path-of-less-resistance/.

[9] *See* Guham Subramanian, *Post-Siliconix Freeze-Outs: Theory, Evidence and Policy,* http://lsr.nellco.org/harvard_olin/472 (Harvard Law School John M. Olin Center of Law, Economics and Business Discussion Paper Series, Paper 472, 2004) (showing, among other things, that post-*Siliconix* Delaware controller freeze-out mergers provide greater premiums than tender offers). While Professor Subramanian ultimately favors Chancellor Strine's proposed new structure, the article's stated purpose was "facilitating freezeouts" (*id.* at 7), which should not be the primary purpose of an analysis here where fiduciary relationships are being considered.

[10] Should this Court determine that having both protections would be meaningful, it could incentivize a controller to condition his offer from the outset on both protections simply by requiring both, rather than just one, to be offered to shift the entire fairness burden to the

As to special committees, the Court in *In re Cox Commc'ns S'holders Litig.*, 879 A.2d at 619 explained: "[B]oards are rarely comprised of independent directors whose own financial futures depend importantly on getting the best price and, history shows, are sometimes timid, inept, or . . ., well, let's just say worse." (Ellipsis in original.) *Cox* reasoned that the possible ineptitude and timidity of directors under these circumstances support the idea of requiring both a special committee and a majority-of-the-minority condition: "For a variety of obvious reasons (*e.g.*, informational asymmetries, the possibility that the outside directors might be more independent in appearance than in substance, or might lack the savvy to effectively counter the controller), the integrity-enforcing utility of a [majority-of-the-minority condition] seems hard to dispute." *Id.* at 619 (footnote omitted).[11]

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plaintiff. Furthermore, this Court in *Southern Copper* stated that where the standard is entire fairness, dealmakers will be incentivized to include special committees with independent directors and majority-of-the-minority voting conditions because these best practices help establish a fair process and fair price. 51 A.3d at 1244.

[11] Among scholars, skepticism abounds as to the actual "independence" of board members and several scholars have concluded that independence is too easily presumed under Delaware law:

> [W]e think that independence is too easily presumed or accepted in Delaware law. The broader problem is structural bias: Nominally disinterested and independent directors are nevertheless inclined – because of a desire to retain their board seats, because they share a mindset and common interests with other executives, and/or because of their ties with these particular directors – not to exercise independent and critical judgment as to matters involving their peers.

Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions,* 36 Del. J. Corp. L. 903, 926 (2011); *accord* Nicola Faith Sharpe, *The Cosmetic Independence of Corp. Boards,* 34 Seattle U. L. Rev. 1435, 1449 (2011) ("[S]tructural bias and groupthink may constrain [a] director's

Importantly, however, the protections afforded by a majority-of-the-minority vote provision have been overstated by the Court of Chancery. Empirically, there is no evidence that an independent special committee and a majority-of-the-minority requirement are sufficiently effective so as to make the entire fairness standard unnecessary. The Court of Chancery's opinion listed fewer than ten proposed transactions in which stockholders either voted down or threatened to reject a buyout since 2007. *MFW*, 67 A.3d at 99-100, n.167. In their 2010 study, Professors Davidoff and Cain concluded that while "transactions approved by a special committee of independent directors provide target shareholders with a 14% higher offer premium on average,... ***there is no relation between offer premiums and the presence or absence of a majority of minority condition.***" Cain & Davidoff at 24 (emphasis added).

Moreover, a majority-of-the-minority condition is not necessarily a referendum on fairness given the market dynamics of merger arbitrageurs. Upon the announcement of all transactions – controller freeze-out or otherwise – a significant block of all public shares of target companies are typically sold to arbitrageurs who largely bank on collecting the few pennies per share of low-risk profits they get when the spread between the trading price and deal price closes

independent judgment… [B]oard members form close relationships that make it unlikely that a director will voice an opinion that runs contrary to the position taken by the majority of other board members. Directors value their close relationships and will work to maintain them even at the expense of optimal decision-making.").

upon completion of the transaction.[12] This group of new owners will approve the transaction for the simple reason that if the transaction fails, they will suffer losses when the stock price returns to pre-announcement levels. The Court of Chancery recently recognized this pattern and its effect. *See, e.g.*, *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 95 n.312 (Del. Ch. 2011) ("the offer would likely succeed in achieving greater than 50% support from Airgas's stockholders, which largely consist of merger arbitrageurs and hedge funds who would gladly tender into Air Products' offer."); *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 814 (Del. Ch. 2007) ("A new prospective record date would ... allow arbitrageurs to buy additional shares at below the Merger price that could be voted. Because those shares could be bought at a price lower than the Merger price, arbitrageurs could make a profit by buying, voting for the Merger, and cashing in on the difference.").

The entire fairness standard is of particular importance where the controller has, like here, refused to allow consideration of other offers or alternative transactions. Clearly, a more effective method of determining and obtaining a fair

[12] Public shareholders do not necessarily sell before the vote based on a belief that the price is fair. After the buyout announcement, share price will cluster around the announced price (as it did here) for possibly months with reduced or no responsiveness to market conditions or the performance of the Company, as the deal is negotiated and a shareholder vote approaches. Because a controlling shareholder controls the progress and timing of the negotiations with independent directors, he can elongate the process, increasing the pressure for public shareholders to sell rather than wait for the opportunity to vote against a transaction, thereby increasing the arbitrageurs' holdings. Moreover, shareholders know that in all but a small number of cases the deal is consummated at the announced price, particularly where, as in this case, no large minority shareholders exist and/or fight the deal.

price would be an open process in which the special committee is permitted to seek and consider alternative buyers and transactions. Where the special committee lacks such latitude, it must rely on investment bankers' judgments and calculations as to a range of fair value, as to which bankers understandably differ. At the very least, the controller's refusal to allow competitive offers or transactions justifies a rule requiring the controller to demonstrate the entire fairness of both the price and the manner in which it was reached.

The decision below attempts to support the application of business judgment because the entire fairness standard purportedly creates an "incentive structure" resulting "in frequent payouts of attorneys' fees but without anything close to a corresponding record of settlements or litigation results where the minority stockholders got more than the special committee had already secured." *MFW*, 67 A.3d at 109-10. While in the eight years since *Cox* was decided, entire fairness continued as the standard in all controller-led freeze-out mergers, an important circumstance that led the Court in *Cox* to propose a change of standards has itself changed. After *Cox* discredited the proposed settlement in that case, *Cox*, 879 A.2d at 606 ("if a controller and a special committee ignore a prematurely filed suit and conclude final merger terms, there should be no presumed entitlement to a fee by the plaintiffs"), the number of such settlements began to dwindle. And it appears that those settlements came to a complete halt with the decision in *In re*

Revlon, Inc. S'holders Litig., 990 A.2d 940, 947 (Del. Ch. 2010), where the Court was highly critical of lead counsel and replaced them because, *inter alia*, of what the Court believed to be a settlement that followed the *Cox* pattern.[13]

Thus, *Cox*-type settlements can be discouraged without infringing upon the protections afforded to public stockholders by addressing such settlements at the court-approval stage. Indeed, the Court of Chancery's power to regulate attorneys' fees and plaintiff leadership structures, together with plaintiffs' lawyers' concern for their reputation in the legal community, are sufficient to remedy this purported consequence of the application of the entire fairness standard.[14]

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[13] Strong evidence that this dynamic has changed is reflected in the increased number of entire fairness cases that are currently being litigated post-closing in the Chancery Court, including, very recently, the settlement of one such case for over $42 million. *See In re CNX Gas Corp. S'holder Litig.,* Consol. C.A. No. 5377-VCL (July 9, 2013), Notice of Pendency of Class Action, Proposed Settlement of Class Action and Settlement Hearing, at website of claims administrator: http://www.abdataclassaction.com/Cases.aspx.

[14] The decision below asserted that one of the benefits of applying the business judgment standard to controller led freeze-outs is that a suit challenging a transaction that requires both a majority-of-the-minority condition and a special committee would no longer have the settlement value arising from the difficulty in obtaining dismissal on the pleadings of an entire fairness claim. *MFW*, 67 A.3d at 504. However, the same benefit may be obtained without any change in the applicable standard of review if the Chancery Court refuses to approve *Cox*-type settlements.

II. THERE WERE MATERIAL ISSUES OF FACT REGARDING THE INDEPENDENCE OF THE SPECIAL COMMITTEE AND WHETHER THE MAJORITY-OF-THE-MINORITY PROVISION WAS EFFECTIVE IN THIS CASE

A. Question Presented

Assuming that this Court approves the Court of Chancery's proposed new structure, did the Court err in holding that Defendants met their burden of showing that the Buyout was approved by a fully empowered and independent special committee and that the majority-of-the-minority provision was effective? A1985-1995.

B. Standard and Scope of Review

This Court's review of the trial court's determination of summary judgment "is *de novo*, not deferential, both as to the facts and the law." *Williams*, 671 A.2d at 1375. On a summary judgment record, the Court draws its "own inference in making factual determinations and in evaluating the legal significance of the evidence." *Id.*; *see also Alaska Electrical*, 941 A.2d at 1015.

C. Merits of Argument

The record here demonstrates that even assuming the application of the business judgment standard, material factual disputes exist as to whether the Buyout replicated arm's-length dealings.

1. The Special Committee Was Not Independent

"Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984); *see also Rales v. Blasband*, 634 A.2d 927, 935 (Del. 1993). Independence is a "fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?" *Beam ex rel. Martha Stewart Living Omnimedia v. Stewart*, 845 A.2d 1040, 1049-50 (Del. 2004) ("*Martha Stewart*"). Thus, doubt regarding a director's independence "might arise either because of financial ties, familial affinity, a particularly close or intimate personal or business affinity or because of evidence that in the past the relationship caused the director to act non-independently vis à vis an interested director." *Id.* at 1051.

At the outset, the Court of Chancery observed that members of the Special Committee were considered independent under New York Stock Exchange ("NYSE") rules. *See MFW*, 67 A.3d at 510. While it noted that NYSE independence is not outcome determinative, the Court of Chancery nevertheless relied heavily on this factor in assessing director independence. *Id.* This Court,

however, has not followed NYSE rules in determining director independence and their application goes against longstanding Delaware precedent.[15]

Like Slovin, Webb (who was classified as an independent director under NYSE rules) had a longstanding and lucrative business partnership with Perelman that commenced in 1983 and continued until 2002. A107; A122-124; A726-730. Webb was introduced to Perelman by Schwartz, who was advising on the acquisition of a failed thrift by Perelman and Webb's long-time business partner, Gerald J. Ford. *Id*. Perelman, Webb and Ford then participated in several substantial transactions (including acquisitions of thrifts and financial institutions), which ultimately culminated in a $5 billion sale of assets to Citibank in 2002 resulting in Webb making a significant amount of money. *Id*.[16] Yet the Court of Chancery, agreeing that Webb is "seriously rich," held that "Webb is independent, because his current relationship with Perelman would likely be economically inconsequential to him." *MFW*, 67 A.3d at 514. This conclusion ignores both

[15] *Compare Aronson*, 473 A.2d at 815 *with* NYSE Rule 303A.02(a), which does not take into account interpersonal relationships. Thus, under NYSE Rules, MacAndrews & Forbes could label Slovin an independent director even though he had an extensive business and personal relationship with Perelman, who once likened Slovin to a "brother." A105; A2494-2496.

[16] Webb did not inform any of the other members of the Special Committee of his past business dealings with Perelman and MacAndrews & Forbes, assuming that they already knew of his extensive business association with Perelman. A122; A124; A3157; A2822-2824. Thus, the Special Committee was either unaware of the relationships or simply chose to ignore them.

Webb's longstanding relationship with Perelman outside of the purely economic context[17] as well as Perelman's role in the creation of Webb's wealth.[18]

The Court of Chancery also erred in finding that Dinh was independent. Dinh was not only a founding member of a law firm that represented MacAndrews & Forbes and another Perelman-related entity, Scientific Games Corp. ("Scientific Games"), in 2009 through 2011, but Dinh personally oversaw this work. A3014-3014; A3017-3018. The Court of Chancery concluded that the fees that Dinh earned through his legal work for Perelman were immaterial because the amount did not run afoul of the NYSE's per se prohibition, and would likely not fund the total cost of employing a junior associate at Dinh's firm for a year. *MFW*, 67 A.3d at 512-13. The Court of Chancery ignored the attorney-client nature of Dinh's

[17] The Court of Chancery has held that director independence should not be considered in purely economic terms. Rather, human behavior is guided by "an array of other motivations," not all of which are "greed or avarice." *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003) ("Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement. . . . think of motives like love, friendship, and collegiality . . .") (footnote omitted).

[18] The Court of Chancery's reliance on this Court's holding in *Martha Stewart Living Omnimedia* in this regard is misplaced. *MFW*, 67 A.3d at 514. The business relationships at issue in *Martha Stewart* are highly distinguishable because none of them involved a joint venture worth billions of dollars. *See* 845 A.2d at 1047. Likewise, that case was informed by its procedural posture – a motion to dismiss under Chancery Court Rule 23.1 – not the more searching review required here where Defendants bear the burden of proving the independence of the Special Committee and that the committee functioned independently. *See id.* Indeed, this Court held that "the procedural distinction relating to the diametrically-opposed burdens and the availability of discovery into independence may be outcome determinative on the issue of independence." *Id.* at 1055. The Court observed that "Unlike the demand-excusal context, where the board is presumed to be independent, the SLC has the burden of establishing its own independence by a yardstick that must be 'like Caesar's wife' – 'above reproach.'" *Id.* (citation omitted).

relationship with Perelman as legal counsel to Perelman-controlled entities or the possibility that Dinh may receive future work from Perelman, in assessing whether Dinh could truly negotiate against Perelman's interests. The Court cannot resolve the factual dispute as to whether Dinh can negotiate against his client who wants to pay as little as possible in the Buyout while acting with undivided loyalty to MFW public stockholders.[19]

The Court of Chancery also did not give due consideration to Dinh's relationship with Schwartz. Dinh is a tenured professor of law at Georgetown University Law Center, where Schwartz sits on the Board of Visitors, and Dinh has

[19] While the Court of Chancery focused on NYSE rules, the applicable legal ethics rules do not consider the amount paid to counsel in applying conflict of interest rules. Under Del. Prof. Cond. R. 1.7, Dinh could not represent a party adverse to MacAndrews & Forbes or Scientific Games no matter how financially limited his representation was for those clients. The Court of Chancery thus erred in holding that no issue of material facts remained concerning a lawyer's independence when negotiating against his client. *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342 (Del. Ch. 1998), *rev'd in part on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), is therefore distinguishable on several grounds. First, the plaintiffs in that case had the burden under Chancery Court Rule 23.1, as in *Martha Stewart*. Second, the issue in that case was whether directors could exercise independent business judgment regarding approval of an employment agreement and thus the Court concluded that, based on those specific facts, plaintiffs did not carry the burden of proving that a $50,000 consulting fee earned and paid a year after that director approved the employment agreement was material. 731 A.2d at 360. In contrast, here, Dinh was expected to actively negotiate against a client to whom he owed fiduciary duties and who had retained him repeatedly and even shortly before he became a member of the Special Committee. In *Kahn v. Dairy Mart Convenience Stores, Inc.*, C.A. No. 12489, 1996 WL 159628 (Del. Ch. Mar. 29, 1996), the Court of Chancery held that material issues of fact remained regarding director independence where the court inferred "that the [consulting] arrangement was beneficial" and that, while "[i]t may be that the value of the consulting arrangement was so *de minimis* that it could not have influenced [the director's] ability to consider the LBO proposal impartially…[,] that conclusion cannot be drawn as a matter of law on this record…. That question can be resolved only after a trial." *Id.* at *6 (citation omitted).

known Schwartz personally since about 2006. A2960-61; A3022. Although the Court of Chancery held that Dinh's relationship with Schwartz was immaterial because Dinh was a tenured professor prior to knowing Schwartz and was not involved in fundraising (*MFW*, 67 A.3d at 513), similar claims were specifically rejected in *Oracle*. 824 A.2d 929-30. Indeed, though the Court of Chancery concluded that Schwartz's request following the Buyout for Dinh to join the Revlon, Inc. board (A2965-2966) was immaterial because the offer came after Dinh's service on the Special Committee, this fact illustrates the ongoing personal relationship between Schwartz and Dinh.

Finally, the Court of Chancery erred in its finding that Byorum was not conflicted because, in combination, Byorum's social and professional interactions with Perelman demonstrate that material questions remain regarding Byorum's ability to function independently. Byorum had a business relationship with Perelman from 1991 to 1996 through her executive position at Citibank. A3143-3145. This work included financing investments for Perelman's and Webb's partnership. *Id.* In addition to her Citibank relationship with Perelman and other senior MacAndrews & Forbes officers and MFW directors, Byorum testified that she has been to Perelman's house and attended dinners that Perelman hosted. A3145-46. Byorum also performed advisory work for Scientific Games in 2007 and 2008 as a senior managing director of Stephens Cori Capital Advisors

("Stephens Cori"), a contact initiated by Byorum and for which Stephens Cori received a $100,000 retainer fee. A3144; A3155-3156. Stephens Cori also performed follow-up work on the Scientific Games engagement in 2011. A1167; A3155-3156.

At the very least, the materiality of these relationships and arrangements should not be decided on summary judgment. *See e.g., Dairy Mart*, 1996 WL 159628, at *6; *see also Kahn v. Tremont Corp.*, 694 A.2d at 430; *In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *32 (Del. Ch. May 3, 2004) (evaluating trial evidence to determine whether the timing of majority freeze-out was coercive).[20]

2. The Special Committee Was Not Fully Empowered

The Special Committee was not empowered to consider an alternative transaction or seek other buyers and, as a result of its narrow mandate, the Special Committee did not approach any other potential buyers and did not have a process for receiving and reviewing alternative proposals. A601-607; A1159-1160; A3063-3064; A3166. These facts demonstrate that the Special Committee did not

[20] In addition, the actions of these directors confirm that they were overly deferential to Perelman. First, they achieved only a nominal $1 per share increase above Perelman's opening offer. A2834; A3084. Second, these same individuals let Perelman run over them before as demonstrated by their deferential examination of whether MFW should acquire Faneuil. A2980-2986; A3147-48; A3251-3285. Perelman also demonstrated his control over the entire Board as exemplified by his use of MFW (instead of McAndrews & Forbes) to submit a bid for Warner Music Group's Recorded Music Division substantially without Board involvement shortly prior to the Buyout. A1909-1911; A3149-3150.

replicate the function of an arm's-length negotiation, and raises material issues of fact that cannot be resolved on summary judgment. *See, e.g., Dairy Mart*, 1996 WL 159628, at *8 (denying summary judgment and holding that "[i]t is undisputed that [the controller] told the committee that he would veto any proposal other than his own… That effectively precluded the committee from pursuing many of the alternatives normally available to an independent, disinterested board. That circumstance alone has been found sufficient to deprive a special committee's decision of any burden shifting effect."); *Emerging Commc'ns*, 2004 WL 1305745, at *6 (rejecting defendants' contention that a special committee was effective if it had the power to say no and holding that "[t]he weakness was in the bargaining position of the Special Committee in relation of [the controller] who was not prepared to support or accept any alternative business transaction other than the Privatization.").

Further, while MacAndrews & Forbes's proposal stated its expectation that "We will not move forward with the transaction unless it is approved by [] a special committee" and that "the transaction will be subject to a non-waivable condition requiring the approval of a majority of the shares of the Company not owned by MacAndrews & Forbes or its affiliates" (A1151-52), the Special Committee made no attempt to formalize those conditions through a standstill or other agreement that the Special Committee could enforce. MacAndrews &

Forbes was able, at any time, to bypass the Special Committee by making a unilateral tender offer directly to MFW stockholders or by using its voting power to effect a long-form merger. Thus, analogous to the facts in *Kahn v. Lynch*, the Special Committee negotiated knowing that if it did not agree to a price acceptable to MacAndrews & Forbes, MacAndrews & Forbes could commence a hostile tender offer at a lower price.

3. The Issue of Efficacy of the Majority-of-the-Minority Provision Here Is Highly Factual and the Subject of Expert Testimony

The Court of Chancery also erred in concluding that the majority-of-the-minority provision was an effective mechanism to overcome the controller conflict. As provided above, it is likely that by the time of the stockholder vote, a significant number of MFW's public shares were held by arbitrageurs. Thus, it is doubtful that the majority-of-the-minority condition here provided any protection to public stockholders seeking a fair price for their shares. However, the issue is highly factual and, if necessary, will be the subject of expert testimony at trial. It is not an issue that should have been decided on summary judgment.

CONCLUSION

For all of the foregoing reasons, the Court of Chancery erred in dismissing this action. Appellants respectfully submit that this Court should reverse and remand.

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ROSENTHAL, MONHAIT & GODDESS, P.A.

/s/ *Carmella P. Keener*

Carmella P. Keener (Bar No. 2810)
919 North Market Street, Suite 1401
Wilmington, DE 19801
(302) 656-4433

FARUQI & FARUQI, LLP
Peter B. Andrews (Del. Bar No. 4623)
20 Montchanin Road, Suite 145
Wilmington, DE 19807
(302) 482-3182

Counsel for
Plaintiffs Below-Appellants

OF COUNSEL:

WOLF POPPER LLP
Carl L. Stine
Matthew Insley-Pruitt
845 Third Avenue
New York, NY 10022
(212) 759-4600

FARUQI & FARUQI, LLP
Nadeem Faruqi
Beth A. Keller
369 Lexington Avenue
New York, NY 10017
(212) 983-9330

GARDY & NOTIS, LLP
James S. Notis
Kira German
501 Fifth Avenue
New York, NY 10017
(212) 905-0509