IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE ZHONGPIN INC.	:	**CONSOLIDATED**
STOCKHOLDERS LITIGATION	:	**C.A. No. 7393-VCN**

MEMORANDUM OPINION

Date Submitted: July 24, 2014
Date Decided: November 26, 2014

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NOBLE, Vice Chancellor

Plaintiffs brought their Verified Amended Consolidated Class Action Complaint (the "Complaint") on behalf of themselves and all other similarly situated public stockholders of Zhongpin Inc. ("Zhongpin" or the "Company"), in connection with a going-private merger (the "Merger") that closed on June 27, 2013. The Merger represented the culmination of a sales process that commenced with a proposal (the "Proposal") from Xianfu Zhu ("Zhu"), Zhongpin's CEO and chairman of its board, to purchase the outstanding Company shares that he did not own for $13.50 per share in cash.

Plaintiffs contend that Zhu, who owned approximately 17.3% of Zhongpin's common stock, was a controlling stockholder under Delaware law, and therefore owed fiduciary duties to the Company. The Merger was negotiated and approved by a special committee (the "Special Committee"), and was ultimately approved by a slim majority of unaffiliated stockholders. Plaintiffs argue that although the Special Committee members were disinterested in the Merger, they were beholden to Zhu due to their financial interests. Therefore, the process of negotiating the Merger was allegedly flawed and Zhu's alleged power over Zhongpin rendered the Special Committee's authority illusory. Plaintiffs allege that the Merger consideration, which was identical to Zhu's initial offer in his Proposal, was unfair to Zhongpin's public stockholders. The Complaint asserts claims for breach of fiduciary duties against Zhu and all other members of Zhongpin's board of

directors (the "Board" or the "Individual Defendants"). The Individual Defendants have filed two separate motions to dismiss pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim.

I. BACKGROUND

Before the Merger, Zhongpin was a publicly-traded Delaware corporation engaged in meat and food processing and headquartered in Changge City, Henan Province, People's Republic of China.[1]

A. *Zhu's Proposal*

On March 27, 2012, Zhongpin announced that Zhu had submitted a preliminary, nonbinding Proposal to acquire all of the outstanding shares of Zhongpin's common stock not currently owned by him in a going-private transaction for $13.50 per share in cash. At this time, Zhu owned approximately 17.3% of Zhongpin's common stock. Zhu informed the Board that he was "interested only in acquiring the common stock of the Company that [he did] not already own, and that [he did] not intend to sell [his] stake in the Company to a third party."[2] He intended to "immediately commence discussions with potential sources of financing (both debt and equity) and with certain stockholders of the

[1] The facts set forth herein are drawn from the Complaint.
[2] Compl. ¶ 24.

Company, and [would possibly] make agreements with them relating to possible investments in the Acquisition."[3]

B. *The Special Committee and Zhongpin's Board*

To respond to the Proposal, Zhongpin's Board established a three-member Special Committee to

> (a) review, evaluate and negotiate the terms of the Proposal or any alternative transaction, including negotiating the definitive agreement or agreements; (b) advise the Board whether the Proposal or any alternative transaction was advisable and fair to, and in the best interests of, the Company and its unaffiliated stockholders; and (c) reject or approve the Proposal or any alternative transaction, or recommend rejection or approval of the Proposal or any alternative transaction to the Board.[4]

The Special Committee consisted of Raymond Leal ("Leal"), Yaoguo Pan ("Pan"), and Xiaosong Hu ("Hu," and with Leal and Pan, the "Special Committee Directors"). Leal, a former professor in the fields of mathematics, finance, and accounting, had served on Zhongpin's Board since June 2007. His professional experiences included providing financial advice to clients of regional investment banks, managing the mergers and acquisitions practice for Sun Trust Banks, and holding management positions in New York Stock Exchange-listed energy and

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[3] *Id.* ¶ 25. Zhongpin stockholders owning approximately 26% of the Company's outstanding common stock (the "Rollover Holders") ultimately partially financed the Merger by rolling their equity into the surviving entity. The Rollover Holders entered into a voting agreement to vote their shares in favor of the Merger and against any alternative transaction. Individual Defendants Zhu and Baoke Ben were Rollover Holders.

[4] *Id.* ¶ 26.

power companies. He was chairman of the Audit Committee, and a member of the Compensation and Nominating Committees. Leal was paid $45,000 annually for his Board-related services.

Pan had also served as a Company director since 2007, and was a member of the Audit and Nominating Committees, and chaired the Compensation Committee. He received $30,000 annually for his service. Professionally, Pan has been a researcher for Chinese government institutions since the 1980s. His research focuses on the meat industry, food nutrition, and rural policy.

Hu joined Zhongpin's Board in June 2011. For over two decades, he has taught and researched at the Food Science and Engineering College of the China Agricultural University. He also serves in an array of academic and governmental organizations, mostly related to agriculture and food science. Hu chaired Zhongpin's Nominating Committee and sat on its Audit and Compensation Committees. Like Pan, Hu was paid $30,000 annually.

The Special Committee Directors were compensated for their work in connection with the Merger. As the Special Committee's chair, Leal received a one-time fee of $30,000 and $5,000 per month until either a transaction was completed or his total fees equaled $100,000. Pan and Hu received one-time payments of $25,000 and $3,000 each per month until a transaction was completed or they had received $70,000 in fees. This compensation was not contingent on

completion of the Merger or the Special Committee's recommendation of the Merger to the Board.

Zhongpin's full five-member Board included the Special Committee Directors, as well as Zhu and Baoke Ben ("Ben"). Zhu was the Chairman of the Board and Zhongpin's CEO from January 2006 until at least the completion of the Merger, and was paid $180,000 annually. He was also Zhongpin's largest stockholder. Ben had served as a Company director since June 2007, and as the Executive Vice President and Secretary of the Company since January 2002. His annual compensation was $120,000. Before the Merger, Ben owned approximately 2.4% of Zhongpin's outstanding common stock. After the Merger, he remained a Zhongpin director.

C. *The Special Committee's Process*

On May 10, 2012, the Special Committee retained Barclays Bank PLC ("Barclays") as its independent financial advisor in connection with evaluating the Proposal and potential alternative transactions.[5] On September 12, 2012, Zhongpin provided Barclays with management forecasts covering 2012 through 2016 (the "May Management Projections"), along with a draft merger agreement from Zhu. Zhongpin's management had prepared its forecasts in May 2012, and Zhu had reviewed them.

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[5] The Special Committee also retained an independent legal advisor.

On September 28, after consulting with its advisors, the Special Committee decided to conduct a pre-signing market check before executing any merger agreement. The Special Committee also decided to meet with Zhu to learn more about the Proposal's financing and Zhu's plans for Zhongpin.

When the Special Committee met with Zhu and Ben on October 11, 2012, it asked Zhu whether he would be interested in selling his shares to a third-party acquirer. Zhu reaffirmed the position he took in his Proposal that he was unwilling to sell his shares to any third party; he was a buyer but not a seller.

The following week, Zhu's financial advisor, Credit Suisse (Hong Kong) Limited ("Credit Suisse"), informed Barclays that Zhongpin's management had revised the May Management Projections to reflect decreases in the Company's projected revenues, profits, and gross margins based on the Company's preliminary third quarter financial reports. Zhongpin's management provided the revised projections (the "October Management Projections") to Barclays. Like the May Management Projections, Zhu had reviewed the new forecasts during their preparation. After receiving the October Management Projections, the Special Committee met telephonically with Feng Wang ("Wang"), Zhongpin's Chief Financial Officer, to discuss the process undertaken and assumptions made in creating the October Management Projections, the rationale for the revisions, and management's expectations regarding Zhongpin's business.

Days later, the Special Committee met telephonically with both Ben and Wang to discuss the revised projections further. Ben and Wang confirmed that poor third quarter results necessitated downward revisions to earlier forecasts. Worsening macroeconomic conditions in China and increasing competitive pressures in Zhongpin's industry caused the poor results.

On October 19, Barclays launched the market check process, with November 9, 2012, set as a deadline for preliminary proposals. Zhu initially acquiesced in the Special Committee's requests that he not enter into any exclusivity arrangements with potential investors and remain open to partnering with interested third parties.

On November 2, 2012, Barclays asked Zhu to increase his Proposal price, but he refused. By November 6, Barclays had contacted a total of seventeen private equity firms and five potential strategic buyers. Five interested parties had executed confidentiality agreements. Although Barclays continued negotiating with Zhu regarding price, Zhu stood by his offer of $13.50 per share in cash.

On November 8, Barclays informed the Special Committee that a potential strategic acquirer ("Bidder A") might make a proposal, but that the offer would likely be submitted after the November 9, 2012, deadline. On November 15, Bidder A submitted a non-binding offer to acquire all of Zhongpin's outstanding stock not owned by Zhu at $15.00 per share ("Bidder A's Proposal"), conditioned

on Zhu's participation in the transaction as a rollover stockholder and his agreement to remain Zhongpin's Chairman and CEO.

Zhu immediately made it clear that he would not remain CEO if Bidder A purchased a majority interest in Zhongpin and that he would not roll over his equity in connection with Bidder A's Proposal. On November 17, he informed the Special Committee that he was considering withdrawing his Proposal unless the Special Committee approved it within the next several days. Zhu also indicated that he was now unwilling to engage in discussions with any third-party investors regarding financing a transaction because he had secured funding.

The Special Committee authorized Barclays to ask Bidder A whether it would be interested in a transaction without Zhu's participation. Bidder A was amenable to such a transaction, but only if the rest of Zhongpin's management remained in place and Bidder A obtained a majority equity stake.

On November 21, 2012, Zhu informed the Special Committee that continued delay in signing a merger agreement would seriously jeopardize his financing. The next day, Barclays informed the Special Committee that Credit Suisse had signaled Zhu's willingness to raise his offer price to $13.75 per share in order to get a deal done. However, Barclays noted that it could not render an opinion on the fairness of a $13.75 per share price. The next day, Zhu made clear that he in fact would not increase his bid from $13.50, which was his best and final offer.

Soon thereafter, Barclays terminated its engagement as the Special Committee's financial advisor, and reported that it could not render an opinion on the Proposal. Because the Special Committee believed that any further delay in signing a merger agreement with Zhu would put his financing at risk, it unanimously determined at its November 23, 2012, meeting that the merger agreement (the "Merger Agreement") with Zhu was advisable and fair to Zhongpin's unaffiliated stockholders. In reaching this conclusion, the Special Committee considered its process in negotiating the Merger Agreement, certain deal provisions it had extracted from Zhu, and its belief that completing a merger would be preferable to continuing as a stand-alone company. Among its provisions, the Merger Agreement included (i) a non-waiveable "majority of the minority" voting requirement, (ii) a 60-day go-shop provision that allowed the Company to actively solicit proposals from third parties after entering into the Merger Agreement, and (iii) the grant of a right to Zhongpin to terminate the Merger Agreement at any time and for any reason during the go-shop period with no termination fee. Despite its inability raise the $13.50 per share price, the Special Committee advised the Board to approve the transaction and recommend it to Zhongpin's stockholders.

On November 26, 2012, Zhongpin announced that, after receiving a unanimous recommendation from the Special Committee, it had entered into the

Merger Agreement with Zhu, Golden Bridge Holdings Limited ("Parent"), and Golden Bridge Merger Sub Limited ("Merger Sub"). Zhu wholly owned Parent and Merger Sub. When the Merger was consummated, Zhongpin would become a wholly-owned subsidiary of Parent.

D. *The Go-Shop Period and Final Merger Agreement*

The 60-day go-shop period commenced as soon as the Board entered into the Merger Agreement. On December 10, the Special Committee engaged Cowen and Company (Asia) Limited ("Cowen") and Duff & Phelps, LLC ("Duff & Phelps") as joint independent financial advisors. Cowen and Duff & Phelps did not actively launch the go-shop process until December 24, at which point they contacted potential strategic and financial buyers. On January 12, 2013, Bidder A indicated that it was not interested in pursuing any transaction that was not supported by Zhongpin's management, and that it may not be interested even if Zhu changed his mind and agreed to participate as its partner.

On January 14, the Merger Agreement was amended to extend the go-shop period, as well as the period during which the Company could terminate the Merger Agreement for any reason, until February 8, 2013. By January 25, Cowen and Duff & Phelps had contacted fifty-five private equity firms and Duff & Phelps had contacted twenty-eight strategic investors. None of these potential investors submitted a proposal or executed a confidentiality agreement.

Although the Merger Agreement had been signed approximately two months earlier, Cowen and Duff & Phelps asked Zhu to increase the Merger consideration. Zhu was unsurprisingly unwilling to raise his price or to cooperate with Bidder A or any other potential partner.

On February 8, 2013, after receiving no superior offer during the go-shop period, Cowen and Duff & Phelps rendered fairness opinions, opining that $13.50 per share was fair consideration from a financial point of view. On the same date, Zhongpin announced amendments to the Merger Agreement, including removal of the go-shop provision, removal of the Company's right to terminate the Merger Agreement at any time for any reason, and reduction of the Company's termination fee from $5,000,000 to $4,750,000. The Special Committee unanimously accepted the terms of the amended Merger Agreement, which was subsequently approved by the Board. The amended Merger Agreement was executed on February 8, 2013.

On June 27, 2013, Zhongpin's stockholders voted in favor of the Merger Agreement. Approximately 51.3% of Zhongpin's common stock held by unaffiliated stockholders was voted for the Merger.

E. *Procedural Posture*

Plaintiffs filed the Complaint on September 16, 2013. The Complaint asserts two counts for breaches of fiduciary duties. Plaintiffs bring Count I against

all of the Individual Defendants. Plaintiffs allege that the Individual Defendants placed Zhu's, and consequently their own, personal interests ahead of those of Zhongpin's stockholders. The Individual Defendants allegedly engaged in a sales process that avoided competitive bidding and advantaged Zhu. Plaintiffs assert Count II against Zhu. They allege that Zhu was a de facto controlling shareholder who owed fiduciary duties to Zhongpin. He allegedly breached his duties by completing a self-dealing transaction that was not entirely fair to the public stockholders.

On September 26, 2013, Zhu and Ben moved to dismiss the Complaint. The next day, Leal, Pan, and Han filed a separate motion to dismiss. Zhu and Ben argue that Count I should be dismissed because (i) the business judgment rule applies to the Board's approval of the Merger, (ii) Plaintiffs cannot rebut the presumption of the business judgment rule, and (iii) even if entire fairness review applies, Plaintiffs cannot show unfairness to Zhongpin's unaffiliated stockholders. Further, they argue that Count I must be dismissed because Zhongpin's certificate of incorporation exculpates the directors for breaches of their duty of care, and Plaintiffs have not adequately pled that a majority of the Board breached its duty of loyalty or acted in bad faith. Zhu argues that Count II must be dismissed because he was not a controlling stockholder, so his 17.3% ownership of Zhongpin stock imposed no fiduciary duties on him.

Leal, Pan, and Hu argue that the Complaint fails to adequately allege either a breach of the duty of loyalty or care against the Special Committee Directors. They assert that the Complaint alleges no facts sufficient to support an inference that the Special Committee Directors were either interested or not independent, lacked real power, or were grossly negligent in negotiating the Merger.

Plaintiffs argue that due to his significant influence over Zhongpin's management and affairs, Zhu was a de facto controlling stockholder, and the Merger should be reviewed under the entire fairness framework. Allegedly, the Merger was not entirely fair because the Special Committee was not independent, its process was flawed, and the Merger consideration was not entirely fair.

Plaintiffs contend that the Special Committee Directors were beholden to Zhu because they were generously compensated for their work in connection with the Merger and one can infer that their annual directors' fees were substantial when compared to average incomes in China. However, Plaintiffs make no allegation that Zhu nominated any of the Special Committee Directors to the Board.

II. ANALYSIS

A. *Standard of Review*

"To plead a case sufficient to withstand a motion to dismiss with regard to a stockholder who has transacted with the corporation, the plaintiff must merely plead facts raising an inference that the defendant stockholder is a controller and

that the transaction was not entirely fair to the [minority]."[6] "The pleading standards governing the motion to dismiss stage of a proceeding in Delaware . . . are minimal" and a motion to dismiss will be denied unless "the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof."[7] The Court "accept[s] all well-pleaded factual allegations in the Complaint as true, accept[s] even vague allegations in the Complaint as 'well-pleaded' if they provide the defendant notice of the claim, [and] draw[s] all reasonable inferences in favor of the plaintiff . . . ."[8] While a plaintiff may ultimately be unable to prove its claims upon a more developed factual record, this contingency does not warrant dismissal of a complaint.[9]

B. *Have Plaintiffs Pleaded Facts Raising an Inference that Zhu is a Controller?*

If Zhu were not a controlling stockholder, the Court's review of the Merger would initially proceed under the business judgment framework.[10] However, if Zhu controlled Zhongpin, the Court scrutinizes the Merger under the entire fairness

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[6] *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 2014 WL 4418169, at *10 (Del. Ch. Sept. 10, 2014).
[7] *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011).
[8] *Id.*
[9] *Id.*
[10] Plaintiffs argue that if the Court finds the facts alleged in the Complaint insufficient to raise an inference that Zhu is a controller, then the Court should consider whether the Complaint adequately alleges that Zhu, along with the other Rollover Holders, was part of a control group. Because Plaintiffs plead facts from which one can reasonably conceive that Zhu was a controller, Plaintiffs' alternative argument need not be considered.

standard, unless all of the necessary conditions of *Kahn v. M & F Worldwide Corp.*[11] were met, reviving the business judgment presumption.[12]

A stockholder who owns less than 50% of a corporation's outstanding stock is presumptively not a controlling stockholder.[13] However, Delaware law recognizes that a stockholder can achieve controlling status with less than 50% ownership, in which case "a plaintiff must allege domination by [the] minority shareholder through actual control of corporate conduct."[14] A plaintiff cannot rely on conclusory allegations that a minority stockholder possessed control; rather, a complaint must contain well-pled facts showing that the minority stockholder "exercises 'such formidable voting and managerial power that [it], as a practical matter, [is] no differently situated than if [it] had majority voting control.'"[15] "[T]here is no absolute percentage of voting power that is required in order for there to be a finding that a controlling stockholder exists."[16] Instead, the Court

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[11] 88 A.3d 635 (Del. 2014).

[12] The Supreme Court decided *M & F Worldwide* on March 14, 2014. *M & F Worldwide*'s guidance on structuring a squeeze-out merger to receive business judgment review was thus unavailable during the negotiation and execution of the Merger.

[13] *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989).

[14] *Id.*

[15] *In re Morton's Rest. Gp., Inc. S'holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013) (quoting *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006)).

[16] *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006).

considers whether or not a stockholder's voting power and managerial authority, when combined, enable him to control the corporation.[17]

This inquiry is not a formulaic endeavor and depends on the particular circumstances of a given case. The Court has acknowledged that in one of its most "aggressive finding[s] that a minority blockholder was a controlling stockholder[,] . . . the blockholder not only held 35% of the company's stock, but he was the company's visionary founder, CEO, and chairman."[18] Despite only holding 35% of the company's stock, the blockholder "exercised more power than a typical CEO" because of his "influence over even the ordinary managerial operations of the company."[19] Under those circumstances, the Court held, in its post-trial opinion, that the minority blockholder was a controlling stockholder because he could control the corporation as a practical matter, if he so desired.[20]

Here, Plaintiffs do not need to prove that Zhu was a controlling stockholder in order to withstand the motions to dismiss. Rather, Plaintiffs must plead facts raising the inference that Zhu could control Zhongpin. Zhu only owned 17.3% of Zhongpin's shares of outstanding common stock. When combined with the holdings of the Rollover Investors, the buyout group only owned approximately 26% of the shares outstanding. This Court has granted a defendant's motion to

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[17] *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 553 (Del. Ch. 2003).
[18] *In re Morton's*, 74 A.3d at 665 (describing the facts in *In re Cysive*).
[19] *Id.* at 665-66 (internal quotation marks omitted).
[20] *Id.* at 666.

dismiss when plaintiffs made "the striking argument that [a blockholder], as owner of 17% of [a corporation's] stock before the Merger, was a controlling stockholder of [the corporation]."[21] However, in that case, the plaintiffs' argument was so striking because it rested solely on the fact that the blockholder was the corporation's largest single shareholder without providing any "authority for why, absent actual exercise of control, an otherwise minority holder should be considered a controller simply because it is the largest holder."[22] While most owners of 17% of a corporation's stock are not controllers, a plaintiff may argue that given the circumstances of a particular case, such a sizeable stockholder actually exercises control.[23]

Plaintiffs rely on statements made in Zhongpin's Annual Report on Form 10-K, filed on March 18, 2013, (the "10-K"), to show that Zhu could control Zhongpin as a practical matter. The 10-K explicitly states:

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[21] *Hokanson v. Petty*, 2008 WL 5169633, at *8 (Del. Ch. Dec. 10, 2008).

[22] *Id.*

[23] The Individual Defendants assert that *In re Alloy, Inc. S'holder Litig.*, 2011 WL 4863716 (Del. Ch. Oct. 13, 2011), provides the most analogous precedent for this case. *In re Alloy* granted a motion to dismiss in the context of a going-private transaction where two board members, who were corporate officers with collective stock ownership of 15%, rolled over their equity. However, the Court did not rule out the possibility that a mere 15% stockholder could ever be considered a controller; rather, "collective stock ownership of 15% do[es] not, without specific allegations of domination, create an inference that [a stockholder] controlled the board." *Id.* at *8. By implication, the Court recognized that under some circumstances, a 15% stockholder may control a board.

> Our largest shareholder has significant influence over our management and affairs and could exercise this influence against your best interests.
>
> At March 11, 2013, Mr. Xianfu Zhu, our founder, Chairman and Chief Executive Officer and our largest shareholder, beneficially owned approximately 17.3% of our outstanding shares of common stock, and our other executive officers and directors collectively beneficially owned an additional 4.2% of our outstanding shares of common stock. As a result, pursuant to our By-laws and applicable laws and regulations, our controlling shareholder [Zhu] and our other executive officers and directors are able to exercise significant influence over our company, including, but not limited to, any shareholder approvals for the election of our directors and, indirectly, the selection of our senior management, the amount of dividend payments, if any, our annual budget, increases or decreases in our share capital, new securities issuance, mergers and acquisitions and any amendments to our By-laws. Furthermore, this concentration of ownership may delay or prevent a change of control or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us, which could decrease the market price of our shares.[24]

The 10-K further states that Zhongpin "rel[ies] substantially on [Zhu], and our Executive Vice President, [Ben], to manage our operations. . . . The loss of any one of [our key personnel], in particular Mr. Zhu or Mr. Ben, would have a material adverse effect on our business and operations."[25]

Based on the Complaint, and the reasonable inferences that flow from it, one can reasonably conceive that Zhu could "control the corporation, if he so wishe[d]."[26] While the 10-K does not conclusively demonstrate Zhu's status as a

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[24] Compl. ¶ 67.
[25] *Id.* ¶ 68.
[26] *In re Cysive*, 836 A.2d at 553.

controller under Delaware law, it does, along with the other allegations in the Complaint, support the inference that Zhu exercised significantly more power than would be expected of a CEO and 17% stockholder.[27]

The Court has recognized several attributes of controlling stockholders, including "the power to elect directors . . . and to adopt or reject fundamental transactions proposed by directors."[28] Voting power gives latent control to a stockholder, even if he does not exert active control as "a direct participant in

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[27] Zhu and Ben argue that Plaintiffs make no allegations that Zhu used his 17.3% stake in Zhongpin to force the Special Committee to accept his Proposal. However,

> it cannot be that the mere fact that [Zhu] did not interfere with the [Special Committee] is a reason to conclude that he is not a controlling stockholder. A controlling stockholder . . . may, one hopes, conduct herself admirably by electing independent directors in the first place and giving them due authority and respect in the context of a particular transaction, such as a management buy-out. That good conduct is evidence of fiduciary compliance and fair dealing. It cannot rationally be the basis for determining the judicial standard of review that applies, if one accepts the premise upon which the *Lynch* [inherent coercion] doctrine is based. That premise is that controlling stockholders possess such potent retributive capacity that the entire fairness standard must apply regardless of the presence of . . . an effective special committee . . . . In the presence of . . . indicia that the controlling stockholder did not abuse its power, the only consequence is a burden shift, leaving the plaintiff free to prevail if it can show an unfair economic outcome.

Id. at 552-53.

[28] *Weinstein Enters., Inc. v. Orloff*, 870 A.2d 499, 507 (Del. 2005) (citing Deborah A. DeMott, *The Mechanisms of Control*, 13 CONN. J. INT'L L. 233, 236 (1999)).

operational decisions or in the formulation of strategic policy."[29] However, as the disjunctive proposition laid out in *Kahn v. Lynch* makes clear, one may be a controller by virtue of owning a majority interest *or* exercising control over a corporation's business affairs.[30] Actual control over business affairs may stem from sources extraneous to stock ownership, and the Court does not take an unduly restrictive view of the avenues through which a controller obtains corporate influence. Again, a dominating stockholder relationship can "exist in the absence of controlling stock ownership."[31]

The Complaint supports inferences that Zhu possessed both latent and active control of Zhongpin. The 10-K implies that Zhu possessed latent control; as a result of his stock ownership, he could exercise significant influence over shareholder approvals for the election of directors, mergers and acquisitions, and amendments to Zhongpin's bylaws.[32] The 10-K also cites his stock ownership as a

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[29] *Id.*

[30] *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113 (Del. 1994).

[31] *Citron*, 569 A.2d at 70. In this case, one can infer that Zhu's dominance over Zhongpin left the Company with no practical alternatives other than to accept his Proposal. Zhongpin acknowledged in its 10-K that losing Zhu would constitute a material adverse effect, and Zhu made clear that he would not cooperate with any third-party acquirer.

[32] This Court has recognized that the threat of "inherent coercion" is present when a controlling stockholder stands on both sides of a transaction due to the "risk . . . that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the controlling shareholder." *In re Cysive*, 836 A.2d at 552 n.31 (describing the notion of inherent coercion as identified in *Lynch*). The facts alleged in the Complaint imply that Zhu had at least the power

possible impediment to a potential acquirer's submission of a competing bid for the Company, with the effect of delaying or preventing a change in control. Plaintiffs have pled that Bidder A was only interested in a transaction in which Zhu, or at least the rest of Zhongpin's management, participated. Further, the fact that the Company received no bids during the go-shop period may imply that Zhu's grip on Zhongpin discouraged all potential acquirers from attempting to obtain control of the Company, just as the 10-K warned.

Zhu also apparently possessed active control over Zhongpin's day-to-day operations. The Company relied so heavily on him to manage its business and operations that his departure from Zhongpin would have had a material adverse impact on the Company. Despite the fact that Zhu's ownership interest was much smaller than a typical controller's, Plaintiffs plead indicia of domination, sufficient to raise an inference that Zhu exercised control over Zhongpin.[33]

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to retaliate. Further, "the attributes that the *Lynch* doctrine is designed to address [are] reinforced when one takes into account the fact that [Zhu was] Chairman and CEO of [Zhongpin], and a hands-on one, to boot." *See id.* at 552.

[33] As should be clear from the Court's analysis, determining whether a stockholder exerts control is a case-specific exercise. Whether or not a particular CEO and sizeable stockholder holds more practical power than is typical should not be decided at the motion to dismiss stage if a plaintiff pleads facts sufficient to raise the inference of control. To ignore real-world indicia of a stockholder's actual power would depart from this Court's precedent.

C. *Does Entire Fairness or Business Judgment Review Apply?*

"A controlling or dominating shareholder standing on both sides of a transaction . . . bears the burden of proving its entire fairness," which requires a demonstration of both fair dealing and fair price.[34] The burden of proof on the issue of fairness may shift to the plaintiff upon approval of the transaction by an independent committee of directors or an informed majority-of-the-minority vote.[35] When only one of these structural devices is implemented, entire fairness remains the standard of review.[36] The application of entire fairness "normally will preclude dismissal of a complaint" on a motion to dismiss.[37]

However, in *M & F Worldwide Corp.*, the Supreme Court acknowledged that the business judgment standard of review applies to controller buyouts

> *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.[38]

M & F Worldwide has the potential to "provide[e] transactional planners with a basis to structure transactions from the beginning in a manner that, if

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[34] *Lynch*, 638 A.2d at 1115.
[35] *Id.* at 1117.
[36] *Id.*
[37] *Orman v. Cullman*, 794 A.2d 5, 21 n.36 (Del. Ch. 2002).
[38] *M & F Worldwide Corp.*, 88 A.3d at 645.

properly implemented . . . [will improve] the benefit-to-cost ratio of litigation challenging controlling stockholders for investors in Delaware corporations . . . as suits will not have settlement value simply because there is no feasible way for defendants to get them dismissed on the pleadings."[39] However, in affirming this Court's decision, the Supreme Court made clear that "[i]f a plaintiff [] can plead a reasonably conceivable set of facts showing that any or all of those enumerated conditions did not exist, that complaint would state a claim for relief that would entitle the plaintiff to proceed and conduct discovery."[40]

M & F Worldwide explicitly held that business judgment review applies to controller buyouts "where the merger is conditioned *ab initio* upon both the

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[39] *In re MFW S'holders Litig.*, 67 A.3d 496, 504 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

[40] *M & F Worldwide Corp.*, 88 A.3d at 645. Although the Supreme Court affirmed this Court's grant of summary judgment after extensive discovery, it explicitly noted that the complaint would have survived a motion to dismiss under the new standard because plaintiffs' "allegations about the sufficiency of the price call[ed] into question the adequacy of the Special Committee's negotiations, thereby necessitating discovery on all of the new prerequisites to the application of the business judgment rule." *Id.* at 645 n.14. The allegations regarding price included: (i) the financial ratios implied by the controller's offer were well below those for recent similar transactions, (ii) the final merger price was two dollars per share lower than the trading price approximately two months earlier, (iii) the company's share price was depressed due to short-term factors at the time of the controller's offer, and (iv) commentators considered the merger price to be low. *Id.* In this case, the Complaint alleges that the Merger Consideration was not entirely fair. Compl. ¶¶ 81-87. Because the Merger was not conditioned upfront on an uncoerced majority-of-the-minority vote, it is unnecessary to consider whether Plaintiffs' specific allegations challenging the sufficiency of the Merger price would have otherwise prevented dismissal of the Complaint before allowing Plaintiffs discovery.

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."[41]

> [W]hen these two protections are established up-front, a potent tool to extract good value for the minority is established. From inception, the controlling stockholder knows that it cannot bypass the special committee's ability to say no. And, the controlling stockholder knows it 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.[42]

In this case, Zhu's Proposal did not include a majority-of-the-minority provision at the outset. The provision was included in the final Merger Agreement only after the parties had negotiated and agreed to a $13.50 per share price. This transactional structure, where the majority-of-the-minority provision came in at the tail end of the sales process, does not satisfy *M & F Worldwide*'s strict guidance. Therefore, entire fairness is the appropriate standard of review.[43]

D. *Have Plaintiffs Pleaded Facts Raising an Inference that the Merger Was Not Entirely Fair?*

To withstand a motion to dismiss under entire fairness review, "the Court must determine whether Plaintiffs' allegations suggest that the merger was not entirely fair; that is, that the merger was not characterized by fair price and fair

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[41] *M & F Worldwide Corp.*, 88 A.3d at 644.
[42] *Id.* (quoting *MFW*, 67 A.3d at 528).
[43] As noted, *supra* note 12, *M & F Worldwide* was not decided until after the Merger.

dealing."[44] In considering whether Plaintiffs have raised an inference that the Merger was unfair, it is unnecessary to decide whether the Special Committee was truly independent. If the Special Committee were independent, its approval of the Merger would shift the burden of proof on the issue of fairness to the Plaintiffs. However, regardless of which side bears the burden of proof, the Complaint adequately alleges unfair dealing and unfair price to survive a motion to dismiss.

The question of unfair dealing implicates "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[45] Plaintiffs point to the 10-K to argue that third parties were unlikely to bid for Zhongpin without Zhu's cooperation, which he would not provide. The Plaintiffs allege that the Special Committee had no real power because Zhu's unwillingness to work with third parties precluded the Board from considering any viable alternatives to Zhu's Proposal. Further, although the Special Committee authorized Barclays to negotiate on price, it did not provide Barclays with firm counter-offers to present to Zhu.[46] The Special Committee first approved the Merger Agreement without receiving a fairness opinion from Barclays, which had resigned. Further, Zhu

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[44] *In re Atlas Energy Res., LLC*, 2010 WL 4273122, at *11 (Del. Ch. Oct. 28, 2010).
[45] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).
[46] Compl. ¶¶ 39, 46.

conditioned his acceptance of the majority-of-the-minority provision on the Special Committee's acceptance of his price.

The Plaintiffs also allege that "$13.50 per share was unfair and failed to account for the Company's undeniable growth potential."[47] Plaintiffs cite data from *Bloomberg* to argue that the Merger compared unfavorably to comparable transactions.[48] They also argue that $13.50 per share represented a 42% discount to the three-year high for Zhongpin's stock,[49] and cite valuation methodologies that place $13.50 below even the low end of valuation ranges for the Company's stock.[50]

Plaintiffs' allegations of unfair dealing and price sufficiently meet the "reasonably conceivable" standard of a motion to dismiss.

E. *Does the Exculpatory Provision in Zhongpin's Charter Mandate Dismissal?*

Zhongpin's certificate of incorporation contained an exculpatory provision authorized by 8 *Del. C.* § 102(b)(7), barring claims against the Company's directors for breaches of their duty of care as long as they did not act disloyally or in bad faith. The Individual Defendants argue that since the Plaintiffs seek only money damages, the Complaint must be dismissed if it fails to state a non-exculpated claim, *i.e.*, a claim alleging breach of the duty of loyalty or bad faith

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[47] *Id.* ¶ 82.
[48] *Id.* ¶ 83.
[49] *Id.* ¶ 84.
[50] *Id.* ¶¶ 85-87.

conduct. The Individual Defendants' argument fails because "'when entire fairness is the applicable standard of judicial review, a determination that the director defendants are exculpated from paying monetary damages can be made only *after the basis* for their liability has been decided,' . . . upon a fully-developed factual record and a determination of whether the transaction was entirely fair."[51]

In re Cornerstone Therapeutics Inc. Stockholder Litigation involved a controlling stockholder freeze-out merger subject to entire fairness review *ab initio*.[52] A § 102(b)(7) charter provision protected the company's directors from monetary liability for breaches of their duty of care. The disinterested director defendants who negotiated and approved the merger moved to dismiss the complaint against them due to the lack of any "particularized pleadings . . . that, if true, raise an inference that [the directors] breached a non-exculpated duty."[53] Although the plaintiffs alleged no specific wrongdoing by the disinterested directors, the Court refused to dismiss the complaint against them because plaintiffs "sufficient[ly] [pled] that a stockholder controlled the corporate machinery; that it used that machinery to facilitate a transaction of which it thus stood on both sides; that the transaction was not entirely fair to the minority; and

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[51] *In re Cornerstone*, 2014 WL 4418169, at *12 (quoting *Emerald P'rs v. Berlin*, 787 A.2d 85, 94 (Del. 2001) (emphasis in original)).
[52] *Id.* at *5.
[53] *Id.* at *10.

that the Director Defendants negotiated or facilitated the unfair transaction."[54] Such a pleading was sufficient to withstand a motion to dismiss; the Court did not need to consider whether the plaintiffs adequately alleged the director defendants' inability to act in the best interests of the minority.[55]

As discussed *supra*, Plaintiffs have sufficiently pled Zhu's status as a controlling stockholder, subjecting the Merger to entire fairness review. They have also pled facts supporting an inference that the Merger was not entirely fair to Zhongpin's unaffiliated stockholders.[56] Therefore, the disinterested Special Committee Directors, who were protected by a § 102(b)(7) provision, cannot prevail on a motion to dismiss, despite Plaintiffs' failure to plead a non-exculpated claim for breach of fiduciary duty against them with particularity.[57] Although *In re Cornerstone* questioned the merit of forcing disinterested directors to face the same pleading standard as interested fiduciaries in cases subject to entire fairness, the

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[54] *Id.* at *12.

[55] *Id.*

[56] As noted, particularized pleadings that the Individual Defendants breached a non-exculpated duty is not necessary at this stage. Zhu's relationship with Zhongpin and the Board (together with the allegations suggesting the absence of fairness) raises the possibility that the Individual Defendants breached those duties.

[57] Because of its irrelevance to this analysis, the Court does not consider whether the Plaintiffs have sufficiently pled facts raising an inference that the Special Committee Directors were not independent.

Court's examination of precedent left it with no other choice.[58] Therefore, regardless of whether the Complaint states a non-exculpated claim, it is sufficiently pled to survive a motion to dismiss.[59]

III. CONCLUSION

Plaintiffs have pled facts raising an inference that Zhu was a controller and that the transaction was not entirely fair to the unaffiliated stockholders. The Complaint is therefore sufficiently pled to survive a motion to dismiss under the entire fairness standard. Further, regardless of whether a non-exculpated fiduciary breach was sufficiently alleged against the Special Committee Directors, their motion to dismiss must fail. For these reasons, both Zhu and Ben's Motion to Dismiss and Leal, Pan, and Hu's Motion to Dismiss are denied.

An implementing order will be entered.

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[58] *In re Cornerstone*, 2014 WL 4418169, at *10-12 ("I am not free to make a policy determination here, because controlling precedent requires me to deny the Motion to Dismiss under these circumstances.").

[59] Zhu and Ben's reliance on *In re Morton's* to argue that Plaintiffs must plead a breach of a non-exculpated duty to survive a motion to dismiss is misplaced. Unlike here, the Court in *In re Morton's* explicitly found that the transaction at issue was not subject to entire fairness because the plaintiffs failed to offer any well-pled facts supporting an inference that the transaction involved a controlling stockholder. 74 A.3d at 664. Here, *In re Cornerstone*'s reasoning controls.