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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE MFW SHAREHOLDERS LITIGATION) Consolidated C.A. No. 6566-CS

REDACTED VERSION
FILED OCTOBER 11, 2012

PLAINTIFFS' BRIEF IN OPPOSITION TO DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT

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
James P. McEvilly, III (Del. Bar No. 4807)
20 Montchanin Road, Suite 145
Wilmington, DE 19807
(302) 482-3182

Plaintiffs' Co-Liaison Counsel

OF COUNSEL:

WOLF POPPER LLP
845 Third Avenue
New York, NY 10022
(212) 759-4600

FARUQI & FARUQI, LLP
369 Lexington Avenue, 10th Fl.
New York, NY 10017
(212) 983-9330

GARDY & NOTIS, LLP
560 Sylvan Avenue
Englewood Cliffs, NJ 07632
(201) 567-7377

Plaintiffs' Co-Lead Counsel

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PRELIMINARY STATEMENT

Defendants ask this Court to disregard binding Delaware Supreme Court precedent and apply business judgment as the standard of review in this action. In *Kahn v. Lynch*, 638 A.2d 1110 (Del. 1994), the Delaware Supreme Court 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 (citations omitted). Since that time, the Supreme Court has not wavered from or softened this rule. In fact, recently, in *Americas Mining Corp. v. Theriault*, No. 29, 2012, 2012 Del. LEXIS 459 (Del. Aug. 27, 2012), the Court, sitting *en banc,* reaffirmed, more than once, the continuing viability of *Kahn v. Lynch*'s holding. *See id.* at *63, 65, 70. Defendants ask this Court to follow, instead, *In re Cox Commc'ns S'holders Litig.,* 879 A.2d 604 (Del. Ch. 2005), where in *dictum* presented in connection with a settlement fee ruling, the Court suggested an alternative path whereby a controller freezeout, either by merger or a two-step process, could be reviewed under the more deferential business judgment standard rather than entire fairness. *Id.* at 643-44. The Court in *Cox* suggested that if such a transaction were both negotiated by a fully informed, fully empowered independent special committee and subject to a majority-of-the-minority approval condition, then the business judgment rule, rather than entire fairness, should apply. *Id.* While this suggested alternative path was seemingly followed in *In re CNX Gas Corp. S'holders Litig.,* 4 A.3d 397 (Del. Ch. 2010) (although still resulting in entire fairness review because the special committee was not fully empowered), the Court here should follow *Kahn v. Lynch* because, simply, it is still the law of Delaware and, as discussed below, the rule continues to be necessary to adequately protect the interests of minority shareholders. Here, it is clear that Perelman and M&F dominated and controlled MFW and because they stood on both sides of the transaction, under *Kahn v. Lynch*, entire fairness is the proper standard of review.

Even if the Court determines to follow a *Cox*-like path, Defendants' motion should still be denied. As discussed below, the record shows that the Special Committee here was neither independent nor fully empowered. Also, the efficacy of the majority-of-the-minority condition is questionable, but at a minimum, that inquiry is highly factual and, if necessary, will be the subject of expert testimony. Moreover, even if Defendants are entitled to a business judgment presumption, the record shows that the Board was not independent of Perelman and, therefore, the Buyout should be reviewed under the entire fairness standard.

<u>COUNTERSTATEMENT OF FACTS</u>[1]

I. <u>PERELMAN AND M&F DOMINATED AND CONTROLLED MFW.</u>

The record demonstrates that Perelman and M&F dominated and controlled MFW prior to, and up through, the consummation of the Buyout. Indeed, Defendants concede

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[1] The Verified Amended Consolidated Class Action Complaint ("Complaint") is cited herein as " Complaint ¶_____" and is attached to the Transmittal Affidavit of Christopher M. Foulds, dated June 18, 2012 ("Foulds Aff.") as Exhibit 1. All capitalized terms used herein shall have the same meaning as in the Complaint unless otherwise indicated. M&F Worldwide Corp.'s Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission ("SEC") on November 18, 2011 is attached as Exhibit 3 to the Foulds Aff. and cited herein as "Proxy at __." Deposition transcripts Redacted Redacted are cited as "[Deponent] Tr. at __" and are before the Court at Exs. 3 through 7 to Foulds Aff. Deposition transcripts Redacted are cited herein as "[Deponent] Tr. at____" and are attached to Plaintiffs' Notice of Lodging Depositions. Exhibits marked thereat are cited as "[Deponent] Ex. __."

that M&F very well "could have behaved like the proverbial 800-pound gorilla" that it is. M&F Defendants' Opening Brief in Support of Their Motion for Summary Judgment ("Defs. OB"). This, in fact, was the case, as Perelman effectively controlled the voting power, which in turn ensured that only individuals approved by Perelman and M&F served on the Board of Directors of MFW. Moreover, by virtue of entangling service agreements and unfettered access to confidential, non-public information regarding MFW's business, operations and current as well as projected financial information, Perelman and M&F exercised all the indicia of domination and control as well established by this Court's precedent.

A. <u>The Defendants</u>

Defendant Perelman served as director of MFW since 1995, including as Chairman of the Board of MFW from 1995 to 1997 and September 2007 to the present. Proxy Statement Pursuant to Section 14(a), Schedule 14A, dated April 22, 2011 ("Annual Proxy") at 3, Exhibit 1 to the McEvilly Dec. Perelman is also sole owner, Chairman of the Board and Chief Executive Officer ("CEO") of Defendant M&F, a Delaware holding company. *Id.* at 2-3. According to the MFW Form 10-Q filed with the SEC on November 3, 2011, Perelman, through M&F and its affiliates, owned 43.4% of the outstanding stock of MFW at the time of the Buyout. *See* November 3, 2011 Form 10-Q, Ex. 2 to McEvilly Dec. Two Perelman related entities, MX Holdings One, LLC and MX Holdings Two, Inc., are Delaware entities formed to facilitate the Buyout with M&F. Proxy at 2.

Perelman and M&F have a pattern of using control of enterprises to enrich themselves at the expense of minority stockholders. For example, in April 2001, Perelman caused MFW to purchase a stake in Panavision, Inc. ("Panavision"), a Perelman-owned entity, for a consideration of approximately $80 million in cash, 1.5 million shares of MFW common stock and 6.1 million shares of MFW preferred stock, at a price estimated at $17 per share, when Panavision was trading at $4 per share. This transaction resulted in Perelman increasing his stake in MFW from 35% to 53%, giving him control of the Company. After the court rejected a proposed settlement of litigation brought by minority shareholders of Panavision consisting of damages of approximately $12 million, Perelman ultimately unwound the transaction, taking back the Panavision shares and paying $10 million in damages. *See,* Ex. 3 to the McEvilly Dec., "Rage Against the Ronald," *Fortune,* Nov. 26, 2001 and Ex. 4 to McEvilly Dec., complaint filed in *The Renco Group, Inc. v. MacAndrews AMG Holdings, LLC, et al.*, C.A. No. 7668 (Del. Ch. June 29, 2012) ¶7 ("Renco complaint"). In 2009, Perelman and M&F attempted to acquire the remaining minority ownership of Revlon, Inc. ("Revlon"), which was the subject of litigation that resulted in a settlement consisting of improved economic terms for minority shareholders. Renco complaint ¶ 9.

Defendant Barry F. Schwartz ("Schwartz") was a director of MFW, President and Chief Executive Officer of MFW since January 2008 and has been Executive Vice Chairman and Chief Administrative Officer of M&F and various affiliates since October 2007. Annual Proxy at 6.

Defendants William C. Bevins ("Bevins"), Bruce Slovin ("Slovin"), Charles T. Dawson ("Dawson"), Stephen T. Taub ("Taub") and John M. Keane ("Keane") have long-standing business relationships with Perelman and M&F and serve(d) as members of M&F-affiliated companies. Annual Proxy at 4-7. In fact, Perelman likened his relationship with Slovin, who was a director of MFW since 1995 and an executive officer of M&F and various affiliates from 1980 to 2000, to that of a brother. *See* Marvin R. Shanken, *Ron Perelman*, CIGAR AFICIONADO, Spring 1995 (available at http://www.cigaraficionado.com/webfeatures/show/id/6132), Exhibit 5 to the McEvilly Dec.

Defendant Theo W. Folz ("Folz") was a director of MFW since 1996, and served as its Chairman of the Board from 1997 to 1999. Folz was formerly President and CEO of Consolidated Cigar Corporation, a company acquired by Perelman in 1993 and its successor company from 1984 through September 2009. Folz has also served as President and CEO of Mafco Worldwide, a subsidiary of MFW. Annual Proxy at 5.

Defendant Philip E. Beekman ("Beekman") was a director of MFW since 2003. *Id.* at 4. Defendants Martha L. Byorum ("Byorum"), Viet D. Dinh ("Dinh") and Carl B. Webb ("Webb") have served as directors since 2007, while Defendant Paul M. Meister ("Meister") has been a director of MFW since 1995. *Id.* at 4-5. Defendants Byorum, Dinh, Webb and Meister, as more fully discussed below, served as members of the Special Committee established to review the Buyout, and also are dominated and controlled by Perelman and M&F, as set forth in Point D below.

B. **MFW's Business and its Robust Cash Flows**

The Company conducted its operations through its indirect wholly owned subsidiaries, Harland Clarke Holdings and Mafco Worldwide, and organized its business and corporate structure into four diverse business segments: Harland Clarke, Harland Financial, Scantron and Licorice Products. Proxy at 1. The Harland Financial segment provides technology products and services to financial services clients worldwide, including lending and mortgage compliance and origination applications, risk management solutions, business intelligence solutions, Internet and mobile banking applications, branch automation solutions, self-service solutions, electronic payment solutions and core processing systems. Redacted The Scantron segment provides data management solutions and related services to educational, commercial, healthcare and governmental entities worldwide including testing and assessment solutions, patient information collection and tracking, and survey services. Redacted Finally, the Licorice Products segment, which is operated by Mafco Worldwide, produces a variety of licorice products from licorice root, intermediary licorice extracts produced by others and certain other ingredients. Redacted Mafco Worldwide also manufactures and sells natural products for use in the tobacco industry. Redac

The Harland Clarke segment, which offers checks and related products, is the largest segment by revenue and contributed approximately 67% of the Company's 2010 consolidated net revenues ($1,191 million out of $1,782 million).

Redacted

Although the Company saw a slight decline in its consolidated revenues since 2008, it grew its operating and net income and increased its earnings per share from $3.30 in 2008 to $6.26 in 2010. Annual Report on Form 10-K at F-4. Likewise, the Company's net cash from operations increased from $199 million in 2008 to $293 million in 2010. *Id.* at F-6. While the check printing industry is generally declining due to competition from alternative payment methods such as debit and credit cards, the Company made significant restructuring efforts to improve operating margins since 2007. Redacted These included Redacted improving operating efficiencies with greater technology investments, and streamlining the manufacturing process. Redacte As a result, the Harland Clarke segment increased its Adjusted EBITDA margin from 26.4% in 2008 to 30.0% in 2010 despite a decline in revenue. Redacted

C. The Businesses of M&F and MFW Were Significantly Entangled Due to the Management Services Agreement

The record evidences the significant entanglement between the businesses of MFW and M&F. Indeed, Perelman's domination over MFW led *Barron's* financial reporter Andrew Bary to conclude "Perelman runs M&F Worldwide like a private company, with no glossy annual report or shareholder letter, no investor get-togethers, minimal analyst coverage and no published earnings estimates." Cheap Stock… With One Big Catch, January 22, 2011, Ex. 6 to McEvilly Dec.

MFW and M&F shared company headquarters at 35 East 62nd Street in New York City. Proxy at 1. Furthermore, since 2005, MacAndrews & Forbes LLC, an affiliate of M&F, has provided the services of the Company's CEO and Chief Financial Officer ("CFO"), as well as other management, advisory, transactional, corporate finance, legal, risk management, tax and accounting services pursuant to the terms of a Management Services Agreement, which has been amended from time to time. Redacted Redacted Ex. 7 to the McEvilly Dec.; Redacted Under the terms of the Management Services Agreement, MFW pays MacAndrews & Forbes LLC $10 million per year for these services. Redacted

Schwartz, MFW's President and CEO, and Paul Savas ("Savas"), Executive Vice President and CFO of both MFW and M&F, provided their services to MFW pursuant to the Management Services Agreement. Proxy at 18. Redacted

Redacted

Redacted

Indeed, the entangled nature of the relationship between M&F and MFW created considerable confusion for even the directors of MFW. Redacted

Redacted

Redacted In fact, Savas also served as CFO of MFW. Proxy at 99. This illustrates that the lines were blurry even to an accomplished businessman like Webb.

As a result of the Management Services Agreement, M&F and Perelman had the ability to attempt to have MFW engage in transactions that M&F and Perelman viewed as potentially beneficial. Indeed, in the Spring of 2011, two such acquisitions were brought

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[2] Indeed, during the final state of negotiations regarding the Buyout, it was Schwartz, in spite of his leadership position as President and Chief Executive Officer of MFW, who presented to MFW the $25 per share offer that was ultimately accepted, adding that it "was our [M&F] best and final offer." Redacted

to the attention of the MFW Board. Redacted

Redacted

MFW also submitted a bid to acquire the recorded music division of Warner Music Group ("WMG") at the behest of Perelman. Redacted Redacted Perelman, through M&F ultimately bid $1.1 billion for the recorded music division Redacted

Redacted

Redacted

D. M&F and Perelman Had Unfettered Access to Confidential MFW Information

The instances of influence, including the overlap in directorship, permitted Perelman and M&F to have unfettered access to the Company. For example, on May 31, 2011, weeks before M&F transmitted the Buyout to the MFW Board, Moelis, financial advisor to M&F for the transaction, was provided with five year financial projections for

Redacted

4 Harland Clarke purchased Faneuil in March 2012 after the Buyout was consummated, Redacted

Harland Clarke Holdings Corp. and Mafco Worldwide Corporation. Proxy at 19. Prior to this, when Perelman first began considering the Buyout in May 2011, he went to Savas for information. Proxy at 18. Redacted

Redacted

Redacted Thus, the CEO of the Company was unable, most likely because of his relationship with Perelman and M&F, to form an opinion as to the fairness of the Buyout to MFW shareholders.

Savas similarly attended meetings with Evercore during the pendency of the Buyout in his capacity as both CFO of the seller and buyer. Redacted

Redacted

Redacted

As a result of the blurred lines between M&F and MFW, Perelman knew that the significant cash flow generated by MFW would easily permit M&F to recover its deal expenses of approximately $273 million by early 2012, and recoup the entire equity value of approximately $487 million by the end of 2012. Redacted

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Redacted

E. <u>The Special Committee Was Conflicted and Not Independent</u>

The Special Committee was originally comprised of purportedly independent directors: Defendants Slovin, Meister, Webb, Dinh and Byorum. Redacted Redacted At the outset of the first meeting, it was noted, however, that Slovin had agreed to serve on the Committee, but subsequently recused himself from serving because of certain close relationships with Perelman. Redacted

Nonetheless, the remaining four members of the purported Special Committee were conflicted and were not independent of the control exerted by Perelman and M&F. For example, Defendants Byorum, Dinh, and Webb had significant business and personal entanglements with Perelman and his related business entities.

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Redacted

Redacted In July 2012, Dinh joined the board of another Perelman-controlled entity, Revlon, Inc., Redacted Redacted Dinh was immediately selected to Revlon's nominating and corporate governance committee. Redacte

Redacted

Redacted Since January 2005, she has managed international business at Stephens Cori Capital Advisors ("Stephens Cori"), a division of Stephens, Inc. ("Stephens"). Redacted Proxy at 98.

Redacted

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5 Perelman, through M&F, owns over 35% of Scientific Games. Redacted Redacted

6 In 2002, Citigroup acquired Golden State Bancorp, Inc. ("Golden State"), an entity controlled by Perelman and his long time business partner and friend, Gerald C. Ford ("Ford"), in a deal valued at approximately $5 billion. *See* "The Return of Ron," *New York Magazine* September 8, 2002, Ex. 8 to McEvilly Dec. Redacted Redacted Webb was the President, COO and director of

Redacted

Redacted

Golden State from August 2005-2007, Redacted Redacted Redacted *See* Schedule 14A filed by Hilltop on April 30, 2012, Ex. 9 to McEvilly Dec; Redacted Just recently, Hilltop shareholders approved a merger with PlainsCapital Corporation. The financial advisor representing Hilltop in the merger was Stephens, Inc., the parent company of Byorum's current employer. *See* May 9, 2012 *Bloomberg* article, Ex. 10 to McEvilly Dec.

[7] At that time, the MFW Nominating and Corporate Governance Committee was comprised of Defendants Slovin, Folz and former director Durnan. *See,* Schedule 14A filed April 30, 2007, Ex. 11 to McEvilly Dec.

Redacted

Redacted Webb did not raise any potential issues surrounding his service on the committee. Redacted Redacted Webb simply assumed that other members of the Committee knew of his relationship with Perelman. Redacted However, it is unclear if counsel for the Special Committee knew of Webb's relationship with Perelman. Redacted

Webb's background includes significant business relations with Perelman. Redacted

Redacted

Redacted

Redacted

Redacted

Nonetheless, this extensive background was never discussed with members of the Board or other members of the Special Committee. Redacted

Redacted

Redacted

Redacted Thus, not only was Webb's relationship with the sole owner of MFW's would-be acquirer *not* discussed within the context of the composition of a purportedly independent committee, but the Special Committee was either uninformed and unaware of the relationship or was aware of the suspect relationship and simply chose to ignore it.

F. **The Special Committee Was Neither Fully Empowered Nor Fully Informed**

As discussed above, though the Special Committee was comprised of individuals who were not employees of M&F, its members were far from independent of Perelman, and allowed Perelman to run MFW like a private company.

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As noted in the Proxy, Perelman began to discuss a potential acquisition of MFW with "certain officers and employees of Holdings, including Mr. Schwartz and Mr. Savas," in "early May 2011." Proxy at 18. The Special Committee apparently did not question the timing of Mr. Dawson's change of heart; Redacted

Redacted

Similarly, in this instance, a weak and ineffective Special Committee did little in its three-month existence and achieved a paltry $1 for MFW shareholders, as window dressing. This result is not surprising given the Special Committee's conflicts, narrow mandate, failure to adequately consider other alternatives to the Buyout, and decision to handicap itself by instructing management to provide Evercore with a set of updated, but *lowered,* projections.

1. The Resolution Establishing the Special Committee Was Limited in Scope

Perelman made it clear from the outset that he would not be a seller, only a buyer and would not vote in favor of any alternative transaction. Redacted Redacted June 13, 2011 press release announcing Buyout, Ex. 12 to McEvilly Dec. On June 13, 2011, in conjunction with a letter informing the Board of Directors of the Buyout, the Board was provided with a draft resolution to form a special committee. Indeed, the resolution forming the Special Committee only granted the committee the power to consider and negotiate the Buyout, not consider other alternatives. Redacted Nevertheless, Keane, Folz, Beekman, Byorum, Dinh, Meister, Webb and Slovin adopted this resolution in its entirety without requesting a broader mandate for the Special Committee. Proxy at 21;

Redacted

2. The Special Committee Failed to Establish a Process For Third-Party Interest and Did Not Adequately Consider Alternatives to the Buyout

As a result of its narrow mandate, the Special Committee did not adequately investigate alternatives to the Buyout. Although it asked for Evercore's advice about the possible benefits of approaching other potential acquirers for either the entire Company or one of the individual segments, the Special Committee took no steps to contact any potential buyers of any segments of the Company Redacted and members of the Special Committee were not aware of any serious indications of interest for any segment of the Company. Redacted

Redacted

Redacted

Redacted

Redacted In fact, the Special Committee never even established a procedure for the

Company's management to alert the Special Committee or its advisors of any approaches or indications of interest.

3. The Special Committee Was Not Fully Informed and Had No Knowledge of Long Term Projections

In April 2011, when it sought to amend and extend its $1.7 billion credit facility, Harland Clarke updated its five-year projections in order to provide the most up to date projections to its lenders. Redacted

Redacted

Redacted These projections were created by management of each business segment and were ultimately reviewed by Savas in his capacity as MFW's CFO. Redacted However, these projections were not provided to the Special Committee until July 2011, though they had been provided to Moelis, M&F's financial advisor, in May of 2011. Redacted

Although management's projections were created within two months of negotiations with M&F and for the purpose of receiving lending, the Special Committee instructed Harland Clarke management to update their projections with the understanding that Harland Clarke's management would provide Evercore with lower projections than those created in April 2011. Redacted Members of the Special Committee apparently did not agree on the reliability of the April 2011 projections. Redacted

Redacted

Redacted the Special Committee did not take any steps to ensure that the financial information being relied upon by Evercore was independent of M&F. Moreover, on September 6, 2011, Evercore informed the Special Committee that it had received updated refinance assumptions from M&F and Moelis that further negatively impacted the projections. Redacted

Redacted

Redacted

Thus, in light of the foregoing, the Special Committee failed utterly to be fully informed regarding critical and material aspects of the Buyout.

4. Evercore Failed to Provide Material Information to the Special Committee

Redacted

At a meeting of the Special Committee on August 17, 2011, the Special Committee determined to counter M&F's $24 offer with $30 per share. Redacted

Redacted

Redacted In sum, the Special Committee members, and its financial expert who spent 24 years in M&A, did not appear to have received all of the material information from Evercore.

Redacted

5. The Special Committee Feared Liability for its Breaches

Redacted

II. PERELMAN AND M&F'S DOMINANCE OF MFW AND THE BUYOUT PROCESS RESULTED IN A BUYOUT AT AN UNFAIR PRICE

The ineffective Special Committee failed to protect MFW's public shareholders and allowed Perelman to acquire the Company at an unfair price.

[9] Plaintiffs have not had the opportunity to depose Perelman or Knee to probe whether the meeting occurred or what was discussed.

A. The Buyout Price Was Unfair to MFW Public Shareholders

1. The Buyout Consideration Was Not Within the Valuation Range Provided by an Appropriate Discounted Cash Flow Analysis

As part of the presentation given to the Special Committee on September 10, 2011 (the "September Presentation"), which formed a basis of the Special Committee's recommendation to shareholders, Evercore prepared a DCF which resulted in a valuation range for the Company's outstanding common stock of $21.39 to $38.22 per share. Evercore applied "a range of trailing terminal Adjusted EBITDA multiples of 5.0x to 5.5x to the Company's 2015E Adjusted EBITDA" (the "Terminal Multiple") and discounted the future cash flows "using a range of discount rates of 9.5% to 11.5%" (the "Discount Rate"). Proxy at 47.

However, this analysis undervalues the Company. For example, applying a more appropriate Terminal Multiple that is simply 0.5x higher—*i.e.*, 5.5x to 6.0x—to the same projections used by Evercore with the same Discount Rate results in a valuation range of $29.11 to $46.50 per share for the Company's outstanding common stock. Complaint ¶ 77.[10]

This higher range is appropriate in this circumstance because Evercore used inappropriate assumptions to derive the Terminal Multiple range of 5.5x to 6.0x. *See* Complaint ¶ 78. Redacted

[10] While Defendants argue that Plaintiffs' price claims do not rebut the presumptions of the business judgment rule, *see* Defs Mem. at 40-44, they do not argue that they have met their burden in an entire fairness review. Plaintiffs' price claims will be the subject of expert testimony at trial.

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Redacted

11 Redacted

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Redacted

Redacted By weighting the Terminal Multiple by the 2012 contribution amounts instead of the anticipated proportions of the Company's components in 2015, Evercore inappropriately overemphasized the Harland Clarke division and skewed the Terminal Multiple lower. A Terminal Multiple ranging from 5.5x to 6.0x better represents the appropriate multiple in 2015, and results in a valuation range of $29.11 to $46.50 per share. Complaint ¶ 79.

Redacted

These higher valuation ranges are confirmed by performing a DCF based on levered free cash flow, instead of unlevered free cash flow, which is appropriate for a company as highly leveraged as MFW. For example, using a terminal price to earnings multiple range of 7.0x to 9.0x and a discount range of 20.0% to 24.0% (which is derived from the equity component of the Capital Asset Pricing Model similar to that used by Evercore) results in a valuation range of $43 to $53 per share, significantly above the Buyout Consideration. *Id.* ¶ 81.

2. The Buyout Consideration Is Below the Values Illustrated by a Comparable Companies Analysis

Applying a change-in-control premium in a comparable companies analysis produces a reasonable valuation of the Company's common stock, which is substantially higher than the Buyout Consideration. *Id.* ¶ 82.

Redacted

3. The Buyout Consideration Is Below the Values Illustrated by Comparable Transactions

Similarly, determining appropriate multiples based on the last-four-quarter EBITDA multiples seen in precedent transactions results in a valuation range well above the $25 per share Buyout Consideration. *Id.* ¶ 84.

Redacted

Redacted

In contrast, applying reasonable multiples to each of the operating segments on a sum-of-the-parts basis results in a conservative valuation range of $51 to $75 per share. *Id.* ¶ 86.

4. MFW's Own Valuation Company, American Appraisal, Valued the Company In Excess of the Buyout

Redacted

12 Redacted

Redacted

Redacted

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Redacted Defendants cannot run away from these now.

B. <u>Delay of the Faneuil Transaction Until After the Buyout</u>

Redacted

Redacted

Redacted Harland Clarke Holdings filed a Form 8-K with the SEC, disclosing that, on March 19, 2012, it entered a stock purchase agreement to acquire Faneuil for $70 million in cash. Redacted On March 26, 2012, Harland Clarke Holdings filed another Form 8-K, disclosing a presentation made at the Barclays Capital High Yield Bond and Syndicated Loan Conference (the "March 2012 Presentation"). The March 2012 Presentation noted that Faneuil would contribute a projected $125 million in revenue (or 7% of revenue across Harland Clarke Holdings) and $11 million in Adjusted EBITDA in 2012. Redacted The acquisition would also provide estimated synergies of $4.5 million. The March 2012 Presentation also indicated that all of Harland Clarke Holdings was projected to have $498 million in Adjusted EBITDA in 2012. Even accounting for the $11 million contribution from Faneuil, this is considerably higher than the projected 2012 EBITDA of $427 million from the Updated Projections provided by management. Redacted

C. <u>The Special Committee Achieved a Nominal $1 or 4% Increase</u>

Ultimately, the Special Committee approved the Buyout at $25 per share, a price just 4% above the original $24 per share offered by Perelman in June 2011, Redacted

Redacted

III. THE TIMING OF THE BUYOUT WAS UNFAIR TO MFW SHAREHOLDERS

Perelman and others at M&F did well to take advantage of their intimate knowledge of MFW to launch the Buyout at a time when MFW was trading at a very low price as compared to its real value. This situation was observed by a number of financial analysts at the time. On June 13, 2011, Andrew Bary of *Barron's* published "Ron Perelman Makes Cheap Bid for M&F Worldwide." Specifically, Barry noted, "Perelman's offer values the company at just four times 2010 profits of $6.22 a share and at about five times 2010 pre-tax cash flow." Ex. 13 to the McEvilly Dec. He further observed, "M&F owns its licorice business separate from Harland Clarke and has about $100 million of net cash. The value of the licorice business and cash could be $300 million, or about $15 per share, meaning Perelman effectively is offering to pay little for the equity in the debt-heavy Harland Clarke." Barry concluded:

> It's true that the first-quarter results were weak with earnings falling to 66 cents a share from $1.73 in the year-earlier period and pre-tax cash flow down to $110 million from $132 million. The check business is eroding as more people pay bills electronically. Profits at the check division were down 15% in the first quarter.
>
> Still, M&F, which competes directly against Deluxe in the check business, is quite profitable with earnings exceeding interest payments by more than two to one.

Lisa Lee of Reuters Breakingviews echoed Barry's comments in her article entitled, "Ron Perelman's Lowball Offer Deserves Skepticism." Lee observed:

> Perelman's swoop, through his MacAndrews & Forbes investment vehicle, 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.

Ex. 14 to McEvilly Dec.

Perelman's timing was perfect. As stated above, Perelman began considering the Buyout in May 2011, at that time when he began having conversations with Schwartz and

Savas, who had dual officer roles in both companies. Not surprisingly, the announcement coincided with MFW's May 5, 2011 filing of its 10-Q with the SEC, which set forth the Company's first quarter earnings.[13] The Company's operating income had declined by $22.4 million. (10-Q at 2). However, this 22.5% decline was based mostly on the acquisitions of GlobalScholar by Scantron Corporation ("Scantron"), a wholly owned subsidiary of the Company, which closed on January 3, 2011, and Spectrum K12 School Solutions, Inc. ("Spectrum"), which closed on July 21, 2010. (Complaint ¶ 24; 10-Q at 6).

Redacted

However, importantly, there existed no indication that GlobalScholar and Spectrum would continue to languish, nor that the remainder of the Company was not profitable.

Redacted

[13] MFW's May 5, 2011 Form 10-Q is attached as Ex. 15 to the McEvilly Dec. and cited as "10-Q at__."

Redacted

Redacted

Redacted Perelman and M&F in particular were privy to this confidential information but sought to use this to their advantage by extending the Buyout at a time when MFW was trading at a temporarily low price.

Following the announcement of its first quarter earnings, MFW's stock price plummeted to a two-year low of $16.77 per share on June 10, 2011. Complaint ¶ 44. Prior to the Buyout, MFW had a 52-week high of $28.31 per share. Complaint ¶ 41.

Then, on August 8, 2011, the stock market took a steep decline after Standard & Poor's downgraded the nation's debt. This affected MFW's stock price, which went from a closing price of $23.41 on August 5, 2011, to close at $19.84 per share on August 8, 2011. Ex. 16 to McEvilly Dec., MFW closing stock prices and volume between June 13, 2011 and December 21, 2011. Redacted

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ARGUMENT

I. THE STANDARD OF REVIEW IN THIS ACTION IS ENTIRE FAIRNESS, NOT BUSINESS JUDGMENT

A. Entire Fairness Still Applies in Controller Freezeout Mergers

In 1994, following numerous cases that were divided over the proper standard of review in controlling shareholder transactions, the Delaware Supreme 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 explaining 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)) (bracketed word in original).

Prior to this year, the Delaware Supreme Court affirmed *Kahn v. Lynch*'s bright-line rule twice. *See Emerald Partners v. Berlin*, 726 A.2d 1215, 1221-22 (Del. 1999) (Applying 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, 428-29 (Del. 1997) (applying entire fairness review to the sale of a stake in a corporation by the corporation's controlling shareholder to a second corporation controlled by the same person, and finding that the existence of a special committee of independent directors did not alter the standard of review, but merely shifted the burden of proof to plaintiff).

After those decisions, in 2005, this Court, in *In re Cox Commc'ns S'holders Litig.,* 879 A.2d 604 (Del. Ch. 2005), in *dictum*, was critical of the rule and suggested an alternative path whereby a controller freezeout, either by merger or a two-step process, could be reviewed under the more deferential business judgment standard rather than entire fairness. *Id.* at 643-44. The Court in *Cox* suggested that if such a transaction were both negotiated by a fully informed, fully empowered independent special committee and subject to a majority-of-the-minority condition, then business judgment, rather than entire fairness, should apply. *Id.* Since *Cox,* many articles have been written, pro and con, concerning the Court's suggested "unified" standard,[14] and at least one decision of the Court of Chancery has famously adopted a version of that standard. *See In re CNX Gas Corp. S'holders Litig.,* 4 A.3d 397 (Del. Ch. 2010). However, after *Cox,* until this year, the Delaware Supreme Court was silent as to the continuing viability of *Kahn v. Lynch*'s rule and declined to accept the interlocutory appeal by the defendants in that case of the denial of their motion to dismiss. *In re CNX Gas Corp. S'holders Litig.,* 30 A.3d 782 (Del. 2010).

Then, in August of this year (after Defendants filed the present motion), the Delaware Supreme Court issued its opinion in *Americas Mining Corp. v. Theriault*, No. 29, 2012, 2012 Del. LEXIS 459 (Del. Aug. 27, 2012) (hereinafter, "*Southern Copper*"). In *Southern Copper*, the Court, sitting *en banc,* affirmed the decision of this Court in favor of the derivative plaintiffs, after trial. *See id.* at *4. In the context of reviewing the burden-shifting analysis in the Court of Chancery decision below, the Court reaffirmed the continuing viability of *Kahn v. Lynch*'s holding. *See id.* at *63 ("When a transaction

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[14] *See, e.g.,* Priya Gupta, Note, *Freezeouts in Delaware: an Exploration of the Appropriate Standard of Review*, 2012 Colum. Bus. L. Rev. 707 (2012) (arguing against adoption of unified standard proposed in *Cox*); Suneela Jain, Ethan Klingsberg & Neil Whoriskey, *Examining Data Points in Minority Buy-Outs: a Practitioners' Report*, 36 Del. J. Corp. L. 939 (2011) (in favor of unified standard that includes a business judgment rule safe harbor); Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 Bus. Law 775 (May 2007) (hereinafter, "Stevelman") (proposing a unified standard of entire fairness unless controller agrees to an auction and to sell if bid is topped); Clark W. Furlow, *Back to Basics: Harmonizing Delaware's Law Governing Going Private Transactions*, 40 Akron L. Rev. 85 (2007) (suggesting entire fairness review only if board did not delegate negotiations and decision-making to an independent special committee); Peter V. Letsou & Steven M. Haas, *The Dilemma That Should Never Have Been: Minority Freeze Outs in Delaware*, 61 Bus. Law. 25 (Nov. 2005) (suggesting unified standard similar to that proposed in *Cox* but adding consideration of any inequitable conduct).

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 *65, *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 more exacting standard of entire fairness as opposed to the more deferential business judgment standard.'"); *id.* at *70, *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.").

While in *Cox*, and elsewhere,[15] this Court has been openly critical of *Kahn v. Lynch*'s rule, the Court has also consistently recognized that the Chancery Court is constrained to follow decisions of the Delaware Supreme Court. *See, e.g., In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 30 A.3d 60, 93 (Del. Ch. 2011) ("But, I am constrained to adhere faithfully to *Tremont* as written . . . ."); *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC,* No. 5140-CS, 2012 Del. Ch. LEXIS 171, at *47 (Del. Ch. Aug. 7, 2012) ("In sum, I am constrained by the mandate of *Central Mortgage II* . . . ."); *see also Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 57 (Del. Ch. 2011) (Chandler, C.) ("Trial judges are not free to ignore or rewrite appellate court

[15] *See* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 Del. J. Corp. L. 859, 879-82 (2001) ("The better policy, we think, is to afford business judgment review treatment to self-interested mergers that are approved by either an effective independent director committee or by a majority of the minority stockholder vote. At a minimum, that treatment should be afforded to approval by an informed 'majority of the minority" of the shareholders.").

decisions. Thus, for reasons explained in detail below, I am constrained by Delaware Supreme Court precedent to conclude that defendants have met their burden under *Unocal* . . . ."). It is appropriate for the Court, here, to follow *Kahn v. Lynch* and recognize that entire fairness is the appropriate standard in this case, especially in light of the Delaware Supreme Court's recent discussion in *Southern Copper.*

B. Entire Fairness Should Continue to Apply in Controller Freezeout Mergers

Aside from the Court's obligation to follow *Kahn v. Lynch* because it is binding precedent, there are good reasons why entire fairness should continue to be the standard of review in all controller freezeout mergers, if not in all controller freezeout transactions, regardless of their form.

First and foremost, there is no reason to believe that the original rationale for requiring entire fairness review is less compelling today, eighteen years later, than it was in *Kahn v. Lynch.* Recently, the Court in *In re Atlas Energy Resources, LLC, Unitholder Litig.,* 10 Civ. 4126, 2010 Del. Ch. LEXIS 216 (Del. Ch. Oct. 28, 2010), explained why entire fairness review of controller freezeout mergers is necessary:

> The Delaware Supreme Court held, in *Kahn v. Lynch*, that a negotiated merger between a corporation and its controlling shareholder must be evaluated under entire fairness regardless of any safeguards the deal includes to protect the minority's interest. Although the standard of review that applies to tender offers involving a subsidiary and its parent remains subject to doubt, the 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 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."

2010 Del. Ch. LEXIS 216, at *32-33 (footnotes omitted; brackets in original; emphasis added).[16] Thus, the Court recognized that because of the inherent coercion in any controller freezeout merger, entire fairness had to remain the standard of review.[17]

Aside from the continuing vitality of the original rationale behind *Kahn*'s rule, some of the significant circumstances that led the Court in *Cox* to be critical of that rule have changed. And, there are compelling reasons to believe that special committees and majority-of-the-minority conditions do not necessarily provide sufficient protection such that eliminating entire fairness review would be justified.

[16] *See also* Stevelman, *supra* at p. 105 (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.")(citation omitted).

[17] Moreover, isn't it likely that a controller faced with the certainty that any freezeout transaction he proposes will be subject to entire fairness review will offer more than if the same transaction can be subject to the business judgment rule? *See* Subramanian, Guham, "Post-Siliconix Freeze-Outs: Theory, Evidence and Policy" (2004). *Harvard Law School John M. Olin Center fo Law, Economics and Business Discussion Paper Series.* Paper 472. http://lsr.nellco.org/harvard_olin/472 (showing, among other things, that post-*Siliconix* Delaware controller freezeout mergers provide greater premiums than tender offers).

1. The Circumstances that Concerned the Court in *Cox* Have Changed

While in the seven years since the *Cox* decision the Delaware Supreme Court has not altered *Kahn v. Lynch*'s rule, one important circumstance that led the Court in *Cox* to propose changes has, in fact, changed. According to the Court, the most important reason it proposed changing the *Kahn v. Lynch* rule was the regularly repeating dynamic where cases were filed prematurely based on a controller's going-private proposal and settled for the same consideration extracted by a special committee. As the Court stated, "The incentive system that *Lynch* created for plaintiffs' lawyers is its most problematic feature." *Cox,* 879 A.2d at 619.

Despite this incentive system, once the Court in *Cox* made it clear that plaintiffs' lawyers who presented a *Cox*-like settlement would be criticized by the Court and have their fees significantly reduced, *see, e.g., 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 those *Cox*-like settlements started to dwindle. And, it appears that those settlements came to a complete halt with the filing of V.C. Laster's opinion in *In re Revlon, Inc. S'holders Litig.,* 990 A.2d 940 (Del. Ch. 2010), where the Court not only was highly critical of lead counsel but also replaced them as lead counsel because of, among other things, what the Court believed was a settlement that followed the *Cox* pattern. *See id.* at 947. Presumably, the existing power of the Court to regulate fees and the leadership in the cases before it, together with plaintiffs' lawyers' concern for their reputation in the legal community were sufficient to address at least part of the problem with *Lynch* that the Court had identified.[18]

2. Special Committees and Majority-of-the-Minority Conditions Are Not Sufficient Protections to Abandon Entire Fairness_Protection for Minority Shareholders in Controller Freezeout Mergers

As this Court in *Cox* 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." *Cox,* 879 A.2d at 619 (ellipsis in original). The Court continued on this theme to 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 Minority Approval Condition seems hard to dispute." *Id.* at 619 (footnote omitted). Thus, in making its point, the Court made its skepticism of the special committee process clear. Despite the problems with that process, it certainly is hard to dispute that a special committee and majority-of-the-minority condition together are better than either alone or neither, in many instances. However, these protections are not sufficient to abandon entire fairness review of controller freezeout mergers.

[18] The discussion here is not intended to be an exhaustive response to the concerns raised in *Cox*. Also, the conclusions offered in this section are anecdotal and are based solely on the experience of Plaintiffs' counsel.

In addition to the problems with the special-committee process that the Court noted, with some exceptions, a majority-of-the-minority provision is often not the protection that litigants and courts have assumed. Upon the announcement of all transactions—controller freezeout or otherwise--a significant block of all public shares of the target company are sold to arbitrageurs who hope for a bump in the transaction price but bought the shares primarily for the almost certain pennies per share profit that they get when the transaction is consummated.[19] While this dynamic may be apparent in all transactions, because this group of new owners has no interest in whether or not the transaction price is fair, majority-of-minority conditions do not necessarily provide the protection to minority shareholders that has been universally acknowledged. Based on the arbitrageurs' strategy, this large block of new owners will not vote against the transaction because if the transaction fails, they will suffer losses when the stock price inevitably returns to pre-announcement levels. This Court has 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) ("Here, Air Products' tender offer would almost certainly result in a "change of control" transaction, as the offer would likely succeed in achieving greater

[19] *See* Malcolm Baker & Serkan Savasoglu, *Limited Arbitrage in Merger and Acquisitions,* 64 J. of Fin'l Economics 91, 92 (2002) ("After a merger or acquisition is announced, investors in the target firm face completion risk. Some shareholders may wish to insure this risk by selling their shares. In an efficient capital market, the price of the target and acquirer will fully and immediately reflect the terms of the merger. In reality, shareholders sell to a limited number of capital-constrained investors and financial institutions specializing in risk arbitrage. As a result of this selling pressure, the price of the target firm can fall below its efficient market price. This market inefficiency—what Shleifer and Vishny (1997) call the limits of arbitrage—leaves abnormal profits.").

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."); *see also Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc.)*, 651 A.2d 1361, 1386 (Del. 1995) ("This Court has stated that distinctions among types of shareholders are neither inappropriate nor irrelevant for a board of directors to make, e.g., distinctions between long-term shareholders and short-term profit-takers, such as arbitrageurs, and their stockholding objectives.").

While the amount and effect of arbitrageur holdings varies, in some cases, such a significant number of a target's shares comes to be held by arbitrageurs that a majority-of-the-minority provision would not reflect a belief on the part of a majority of the minority shareholders that the transaction at issue is fair. The variable nature of M&A arbitrageur acquisitions is reflected in two case studies described in an article in The Journal of Alternative Investments.[20] In the first case study, both companies were in a regulated industry and the acquirer initiated a proxy fight and a "bear hug." By obtaining data from "a leading proxy solicitation firm," the authors were able to establish that

[20] Keith M. Moore, Gene C. Lai & Henry R. Oppenheimer, *The Behavior of Risk Arbitrageurs in Mergers and Acquisitions,* J. of Alternative Investments, Summer 2006, at 20-21.

14.4% of the target company's shares were acquired by arbitrageurs. *Id.* at 20-21. In the second case study, the authors examined the period from the announcement of a hostile tender offer that ultimately became a friendly merger transaction. In the three days following the announcement of the hostile tender offer, arbitrageurs acquired 19.1% of the target's shares, but by the time the merger was consummated, arbitrageurs owned over 50% of the target's outstanding shares. *Id.* at 21.[21]

Outside shareholders face a difficult decision once the Company discloses, pursuant to SEC requirements, an initial offer by an interested party. The reality is that the share price will cluster around the announced price (as it did here) for months, with reduced responsiveness to market conditions or the performance of the Company, and with reduced or nonexistent analyst coverage. *See* Baker, *supra*, at 92 ("In an efficient capital market, the price of the target and acquirer will fully and immediately reflect the terms of the merger."). Shareholders can be stuck in this limbo for months or years as the deal is negotiated and a shareholder vote approaches. *See, e.g.*, Press Release, Venoco, Inc., Venoco, Inc. Announces Closing of Go-Private Transaction (Oct. 3, 2012) Ex. __ to McEvilly Dec. (announcing the eventual closing of a management buyout transaction initially announced on August 29, 2011, which was approved by shareholders on June 5, 2012).

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[21] This is not to say that majority-of-the-minority conditions can never be effective to challenge an agreement reached between independent directors and a controlling shareholders. However, shareholders can face an imposing collective action obstacle when there are no significant holders who can threaten a hold out. *But see Alaska Elec. Pension Fund v. Brown*, 941 A.2d 1011, 1015 (Del. 2007) (describing a major shareholder's successful efforts to negotiate an increase in the tender offer price in order to meet a 90% minimum tender condition).

Because a controlling shareholder has control over not only the Company, itself, but also the progress and timing of the negotiations with independent directors, it is within his power to elongate the process, increasing the pressure for outside shareholders to liquidate their positions rather than wait for the opportunity to vote against a transaction. *See supra* note 18. The longer that the controlling shareholder waits, the greater the shareholder turnover and the higher the likelihood that the arbitrageurs, who, as a group, are increasing their holdings as the vote date gets closer, will support the transaction, even with a majority-of-the-minority condition. Moreover, experience shows us that once a transaction is announced, most often the deal ends up being consummated. Those who are considering selling are faced with that likely inevitability and do not necessarily choose to sell based on any particular notion that the price is fair. Thus, in many instances, a majority-of-the-minority condition no longer becomes the referendum on fairness that the Courts have envisioned.[22]

Given the coercion inherent in any controller freezeout transaction, and the potential flaws in both the special committee process and any majority-of-the-minority condition, the standard of review is appropriately entire fairness, not business judgment, for controller freezeout mergers, such as here.[23] Because Perelman and M&F controlled

[22] While arbitrageurs buy in contexts other than controller freezeouts, it is only in this context that a majority-of-the-minority condition is thought to provide a needed protection for minority shareholders.

[23] One of the criticisms that the Court in *Cox* leveled against the rule in *Kahn* is that "any amended complaint that the plaintiffs might file against an ultimate merger agreement could not be dismissed." *Cox,* 879 A.2d at 609. And one of the benefits the Court saw in its proposed new standard was the ability of a controller to structure a transaction where a complaint challenging it

MFW and because, by seeking to acquire MFW, they stood on both sides of the transaction, under *Kahn v. Lynch*, which is still the law of Delaware, Defendants bear the burden of proving the transaction's entire fairness. Defendants have not attempted to meet that burden and, therefore, their motion should be denied.

II. EVEN IF THE COURT FOLLOWS THE UNIFIED STANDARD OUTLINED IN *COX COMMUNICATIONS* AND *CNX*, PLAINTIFFS HAVE DEMONSTRATED THAT DEFENDANTS HAVE NOT MET THIS EXACTING STANDARD AND THE COURT SHOULD APPLY ENTIRE FAIRNESS TO THE BUYOUT

While both the *CNX* and *Cox Communications* Courts (in *dictum*) recognized the possibility of applying the unified standard to a transaction approved by a (1) fully empowered and independent special committee and (2) majority of the minority

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could be dismissed. *See id.* at 607. However, the independence and effectiveness of any given special committee and the effectiveness of any given majority-of-the-minority condition are intensely factual questions that are uniquely within the knowledge of the defendants. In the context of the burden in showing causation related to mootness fees, the Delaware Supreme Court stated:

> It is the defendant, and not the plaintiff, who is in a position to know the reasons, events and decisions leading up to the defendant's action . . . . To the extent fiduciary factors enter into consideration, it is useful to have at least the disclosure burden lie with the party in a position of trust. On the whole, it seems to us overly technical and unnecessarily expensive to attempt to superficially redress the balance by a shift in the burden of proof to a litigant who usually has no way to ascertain the facts except by asking his adversary.

Allied Artists Pictures Corp. v. Baron, 413 A.2d 876, 880 (Del. 1980). The same is true here. Given the "fiduciary factors" in a controller freezeout merger and that the relevant factual issues are not, for the most part, known by plaintiffs, plaintiffs should not be forced to shoulder the burden of pleading that any special committee is not independent or that a specific majority-of-the-minority condition is, or will be, ineffective.

Furthermore, the Court in *Southern Copper* acknowledged that there still will be an incentive for dealmakers to include special committees with independent directors and majority of the minority voting conditions because these best practices will help establish a fair process and fair price. *S. Copper*, 2012 Del. LEXIS 459, at *75-76.

shareholders, in practice the *CNX* Court applied the entire fairness standard upon a finding that CNX's controlling shareholder ran afoul of the first requirement. *See CNX*, 4 A.3d at 414; *see also Cox Commc'ns*, 879 A.2d at 606. At heart of the Courts' rationale is the notion that "the business judgment rule should apply to any freeze-out transaction that is structured to mirror *both* elements of an arms' length merger, *viz.* approval by disinterested directors *and* approval by disinterested stockholders." *Id.* at 412 (citing *Cox Commc'ns*, 879 A.2d at 606) (emphasis in original). According to the Court, "The two elements are complementary and not substitutes. The first element is important because the directors have the capability to act as effective and active bargaining agents, which disaggregated stockholders do not. But, because bargaining agents are not always effective or faithful, the second element is critical, because it gives the minority stockholders the opportunity to reject their agents' work." *Cox Commc'ns*, 879 A.2d at 606.

As to the first element, the *CNX* Court held that the unified standard would not apply where the special committee "was not provided with authority comparable to what a board would possess in a third-party transaction." *Id.* at 414. The CNX special committee had a narrow grant of authority and was permitted only to (1) review and evaluate the tender offer, (2) prepare a Schedule 14D-9, and (3) engage legal and financial advisors, but not to negotiate the terms of the tender offer or to consider alternatives. *Id.* at 404. Although the Court recognized that the CNX special committee would have been hampered by the controller's unwillingness to sell its shares, the Court held that, in order to come under the purview of the unified standard, the special committee must have broad authority and therefore "d[id] not pass muster" in that instance:

> The CNX Gas board majority grounded its decision on CONSOL's unwillingness to sell its CNX Gas shares. Given CONSOL's position as a controlling stockholder and the additional rights CONSOL possessed under its various agreements with CNX Gas, any effort to explore strategic alternatives likely would have been an exercise in futility. But that was a decision for [the Special Committee] and [its] advisors to make. Armed with an appropriate delegation of authority, [the Special Committee] and the creative minds at Skadden and Lazard might have devised ways to increase the Special Committee's leverage.

Id. at 414.

Similarly, the Special Committee here was neither fully empowered nor independent from Perelman and M&F. As a result, even if this Court accepts the unified standard as a framework for conducting freeze-out mergers, Plaintiffs have proffered sufficient facts showing that Perelman and M&F have not met this exacting standard and that entire fairness should govern this Buyout.

A. <u>The Special Committee Was Not Independent</u>

Foremost, at the heart of this Court's discussion in *Cox Communications* was the notion that the merger must be "negotiated and approved by a special committee of independent directors." 879 A.2d at 606. Here, Plaintiffs have shown sufficient facts supporting their assertion that the Special Committee was not independent of Perelman.

Members of the Special Committee had significant and longstanding ties with Perelman and were not sufficiently independent for the purposes of the unified standard for controller-led buyouts. Redacted

Redacted

Redacted

Redacted

At the very least, the materiality of these relationships and arrangements should not be decided on summary judgment. *See e.g., Kahn v. Dairy Mart Convenience Stores, Inc.*, 1996 WL 159628, at * 6 (Del. Ch. Mar. 29, 1996) (denying defendants' motion for summary judgment and finding that the question whether a consulting arrangement between an independent special committee member and controller could constitute a conflict of interest could be resolved only after trial); *see also Kahn v. Tremont Corp.*., 694 A.2d 422, 430 (Del. 1997) (finding that a director was conflicted by virtue of providing legal and advisory services to controlling shareholder).

Redacted

Redacted

B. The Special Committee Was Not Fully Empowered

Here, as in *CNX*, the Special Committee was not empowered to consider an alternative transaction or seek other buyers. Redacted

Redacted

Indeed, in his June 13, 2011 letter informing the Board of the $24 offer, Schwartz stated that "you should know that in our capacity as a stockholder we are interested only in acquiring the shares of the Company not already owned by us and that in such capacity we have no interest in selling any of the shares owned by us in the Company nor would we expect, in our capacity as a stockholder, to vote in favor of any alternative sales, merger or similar transaction involving the Company." Redacted

Schwartz provided the Board with a proposed resolution creating the Special Committee that did not provide the Special Committee with the power to explore alternative transactions. Redacted Nevertheless, the Board (with the exception of

Perelman, Schwartz, Dawson, Bevins and Taub, who recused themselves) adopted M&F's proposed resolution in its entirety without requesting a broader mandate for the Special Committee. Proxy at 21; Redacted

As a result of its narrow mandate, the Special Committee did not approach any other potential buyers. Redacted Likewise, the Special Committee was not aware of any interest in MFW or its segments. Redacted Redacted Indeed, the Special Committee did not even have a process for receiving and reviewing alternative proposals. Redacted Redacted

C. The Efficacy of the Majority-of-the-Minority Provision Here Is Highly Factual and, if Necessary, Will Be the Subject of Expert Testimony

The second element of the Unified Standard, an effective majority-of-the-minority condition, is also doubtful here, but at a minimum is highly factual and, if necessary, will be the subject of expert testimony. At the time of the transaction, there were approximately 10.9 million MFW shares outstanding not owned by Perelman or M&F. *See* Proxy; MFW Form 8-K, Ex. 99.1, Dec. 22, 2011. On Monday, June 13, 2011, before the market opened, M&F filed a Schedule 13D with the SEC announcing that it had sent a letter that day to the MFW's Board proposing to purchase the outstanding shares of MFW common stock that it did not control for $24.00 per share. In response to the announcement, on that day, over 1.2 million MFW shares were traded, with MFW's stock price closing at $24.06, and over the next four days, an additional 1.2 million MFW shares were traded, closing at the end of the week at $25.65. Over the next three months over 3.9 million MFW shares traded, on average over 67,000 shares per day. *See* Ex. 16 to the McEvilly Dec.

On September 12, 2011, before the market opened, M&F issued a press release announcing that MFW and M&F entered into the Merger Agreement pursuant to which M&F had agreed to acquire the common shares it did not own for $25 per share. On that date, over 2.3 million MFW shares were traded, with the stock closing at $24.25, and during the rest of that week over 1.4 million shares were traded, with the stock closing for the week at $24.57. *Id.* Between that time and the shareholder vote on December 21, 2011, over 4.6 million shares traded, with a daily average of over 105,000 shares changing hands. *Id.* While certainly some portion of the trades between June 13, 2011 and the shareholder vote on December 21, 2011 represented sales from one arbitrageur to another, it is clear that a significant portion of MFW's outstanding shares was acquired and held during this time by arbitrageurs who bought solely to profit from the spread between the stock's trading price and the merger price. As discussed above, these arbitrageurs had no interest in voting against the transaction and risking the return of the stock price to pre-announcement levels.[24] Because it is likely that by the time of the shareholder vote a significant number of MFW's public shares were held by arbitrageurs,

[24] On Friday, June 10, 2011, the last trading day before the announcement of M&F's offer, MFW's stock closed at $16.96 per share.

it is doubtful that the majority-of-the-minority condition here provided any protection to minority shareholders 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 be decided on summary judgment.

III. IN THE ALTERNATIVE, EVEN IF DEFENDANTS WERE ENTITLED TO A BUSINESS JUDGMENT PRESUMPTION, THE RECORD SHOWS THAT THE BOARD WAS NOT INDEPENDENT OF PERELMAN AND THE BUYOUT SHOULD THEREFORE BE REVIEWED UNDER THE ENTIRE FAIRNESS STANDARD

Even if Defendants were entitled to a business judgment presumption, the record shows that the MFW Board was not disinterested and/or independent of Perelman and M&F and the Court should review the Buyout under the entire fairness standard. *See Orman v. Cullman*, 794 A.2d 5, 22-24 (Del. Ch. 2002); *Gantler v. Stephens*, 965 A.2d 695, 707 (Del. 2009).

Here, the vast majority of the Board, including the majority of the members of the Special Committee, were not independent of Perelman and M&F. Indeed, Schwartz negotiated the Buyout on behalf of M&F Redacted Redacted Redacted Likewise, Dawson and Taub head MFW's business divisions, Harland Clarke and Mafco, respectively, and are not independent of M&F as well as M&F-controlled management. Redacted Redacted Redacted Similarly, Defendants Bevins, Slovin, Dawson, Taub, Folz and Keane have long standing business relationships with Perelman and Perelman-controlled entities, with Perelman once likening his relationship with Slovin as that of a brother. *See* Annual Proxy at 3-7; http://www.cigaraficionado.com/webfeatures/show/id/6132. Likewise, as provided in Point II, *supra*, members of the Special Committee were similarly not independent of Perelman and M&F, Redacted Redacted and Webb having had a long-standing business relationship with Perelman. Redacted Redacted Indeed of the nine directors that voted in favor of the Buyout (with Perelman, Schwartz, Bevins, Dawson and Taub recusing themselves), the majority was not independent of Perelman.

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This $1.1 billion proposal for Warner Music in April 2011—Redacted

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Redacted—contrasts with Defendants' arguments that the Special Committee was pressured into the transaction by the sizeable amount of debt due in 2014, Op. Br. at 16. This is particularly the case considering that the Company was able to extend a "significant" portion of this debt in the Spring of 2012, Redacted

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CONCLUSION

For foregoing reasons, Plaintiffs respectfully request that the Court deny Defendants' motion for Summary Judgment.

ROSENTHAL, MONHAIT & GODDESS, P.A.

By: /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

By: /s/ James P. McEvilly, III
James P. McEvilly, III (Del. Bar No. 4807)
20 Montchanin Road, Suite 145
Wilmington, DE 19807
(302) 482-3182

Plaintiffs' Co-Liaison Counsel

OF COUNSEL:

WOLF POPPER LLP
845 Third Avenue
New York, NY 10022
(212) 759-4600

FARUQI & FARUQI, LLP
369 Lexington Avenue, 10th Fl.
New York, NY 10017
(212) 983-9330

GARDY & NOTIS, LLP
560 Sylvan Avenue
Englewood Cliffs, NJ 07632
(201) 567-7377

Plaintiffs' Co-Lead Counsel