IN THE SUPREME COURT OF THE STATE OF DELAWARE

BTRTA FOREST PRODUCTS, INC., a Delaware corporation, MATTHEW SUNSTEIN, VIKRAM SARABHAI, MICHAEL F. ALLEN, MILES D. LIU, KATHLEEN L. TODMAN, HERBERT McCUSKER, PAULA ABAZIAN, JANICE L. STERN, WILLIAM D. HEMPHILL, RAVERT WARD L.P., and BTR ACQUISITION CORP., Defendants Below-Appellants, v. CONSOLIDATED FOREST INDUSTRIES CO., a Delaware corporation, Plaintiff Below-Appellee.	Court Below: Court of Chancery of the State of Delaware in and for New Castle County Civil Action No. 6943-CJ

Appellants' Opening Brief

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February 10, 2012

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NATURE OF PROCEEDINGS

This case comes before the Supreme Court as an appeal filed by the Defendants Below-Appellants, BTR̤ta Forest Products, Inc. ("BTR̤ta"), Matthew Sunstein, Vikram Sarabhai, Michael F. Allen, Miles D. Liu, Kathleen L. Todman, Herbert McCusker, Paula Abazian, Janice L. Stern, William D. Helphill, Ravert Ward L.P. ("Ravert Ward"), and BTR Acquisition Corp. ("the BTR̤ta Defendants"), from an interlocutory order of the Court of Chancery of the State of Delaware in and for New Castle County ("the Chancery Court") entered on January 31, 2012. The Chancery Court's ruling granted Plaintiff Below-Appellee Consolidated Forest Industries Co. ("CFI") a preliminary injunction against the consummation of a merger between BTR̤ta and BTR Acquisition Corp., a wholly-owned subsidiary of Ravert Ward.

This dispute arose from a decision made by the BTR̤ta directors to enter into a merger agreement with Defendant Ravert Ward, consequently rejecting a previous merger agreement made with CFI. CFI filed a lawsuit against the Defendants on December 16, 2011, to enjoin the consummation of the proposed Ravert Ward merger. Plaintiff CFI thereafter moved for an entry of a preliminary injunction.

The Chancery Court's decision on the Plaintiff's motion turned on the validity and effectiveness of a constituency provision found within Article II of BTR̤ta's certificate of incorporation ("charter"). Article II grants BTR̤ta's directors the ability to consider the Company's long-term interests along with the social, economic, and other effects on the Company. Acknowledging both the application of *Revlon* duties in a merger context and the consideration of *Omnicare* in

evaluating the deal-protection measures in the Ravert Ward merger proposal, the Court of Chancery found that 1) BTRta's directors breached their fiduciary duties by wrongfully relying on the Article II constituency provision and 2) *Omnicare*'s holding directly invalidates the deal-protection measures in the Ravert Ward merger.

Following the January 26, 2012, opinion submitted by the Honorable Meghan Jeuell, Chancellor, the Court of Chancery ordered a preliminary injunction on January 31, 2012, preventing the BTRta Defendants from effectuating the Ravert Ward Merger Agreement.

On February 2, 2012, the BTRta Defendants filed an application for certification of the interlocutory order to seek validation of the Ravert Ward merger agreement. Plaintiff CFI filed its response to the application in the trial court on February 3, 2012, which the trial court granted on the same day. The BTRta Defendants filed a notice of appeal from the Court of Chancery's interlocutory order on February 6, 2012 with Plaintiff CFI. The Supreme Court of the State of Delaware (the "Supreme Court") subsequently granted the application for an order certifying an appeal on February 10, 2012.

SUMMARY OF ARGUMENT

This Court should uphold the Ravert Ward merger agreement as a matter of Delaware law. First, Article II of BTRta's charter is valid under Delaware General Corporation Law ("DGCL") § 102(b)(1) and this Court's holding in *Revlon*. Second, to the extent the *Omnicare* holding would prohibit the deal-protection measures within the Ravert Ward merger agreement, the *Omnicare* holding should be overruled.

1. Article II of BTṚta's charter properly reflects § 102(b)(1)'s enabling language which allows corporate charters to set forth the boundaries of managerial power. This Court's jurisprudence dictates that charter provisions drafted within the bounds of § 102(b)(1)cannot be overruled by common law doctrine. The facts of *Revlon* can be distinguished from the case at hand, as BTṚta's board implemented its constituency provision long before discussions of a change in control ensued. Even outside of *Revlon*, such a provision aligns with the BTṚta directors' duties of loyalty and care.

2. The Chancery Court erred in applying *Omnicare* to the Ravert Ward merger agreement. Because the "omnipresent specter" of board self-interest does not exist in the case at hand, the business judgment rule is the proper standard of review. Even if the *Unocal* test is applied, however, *Omnicare* should be overruled. The *Omnicare* majority misapplied the proportionality test of *Unocal* by failing to recognize the importance deal protection measures have in the context of change-in-control transactions. Such measures often serve the important purpose of ensuring a deal will go forward.

STATEMENT OF FACTS

Appellant BTṚta Forest Products, Inc. is a Delaware corporation in the business of manufacturing forest products using sustainably harvested trees. Mem. Op. 2, 4. Appellants Sunstein and Sarabhai, founders of BTṚta and current members of BTṚta's board, together own 9.2% of BTṚta's outstanding common stock and all of its Class B common stock. *Id.* at 5–6. Appellants Allen, Liu, Todman, Stern, McCusker, Abazian, and Hemphill, all independent members of BTṚta's board of

directors, own 581,142 shares of Class A common stock. *Id.* Appellee CFI, owner of 4,300 BTṚta shares, is a Delaware corporation which produces paper and wood products worldwide by means of acquiring small forest-product companies. *Id.* at 2–3. Appellant Ravert Ward, owner of BTR Acquisitions, is a boutique acquisition firm specializing in arranging private acquisitions of smaller public companies. *Id.* at 4.

The basis of the pending preliminary injunction arose from a merger agreement entered into by Ravert Ward and BTṚta's directors, in which Ravert Ward agreed to acquire 100% of BTṚta's outstanding stock. *Id.* at 8, 11. Ravert Ward's offer came several months after BTṚta's board decided in May 2011 to sell the company due to difficulty in maintaining "important aspects of the business." *Id.* at 7. BTṚta retained Eberhard Jefferson L.P. ("Eberhard") to elicit potential bids to acquire the corporation. *Id.* at 8.

After Eberhard searched for bidders unsuccessfully for several months, CFI expressed interest in acquiring BTṚta to complement its similar paper-producing operations. *Id.* CFI presented a proposal in September 2011 to acquire BTṚta for $16.50 per share. *Id.* at 8–9. Despite the attractiveness of CFI's offer, Sunstein and Sarabhai expressed significant concern that BTṚta's environmentally responsible operations would be threatened by CFI's large size and manner of logging practices. *Id.* at 9. Those concerns were temporarily mitigated by a revised merger agreement offering $17 per share and the opportunity for Sunstein and Sarabhai to serve as Environmental Committee consultants on CFI's board. *Id.*

The BTṚta board approved the CFI merger agreement on October 17, 2011. *Id.* The merger agreement required BTṚta to present the agreement to its shareholders for a vote and grant CFI a $15 million termination fee in the event of non-consummation. *Id.* at 10. BTṚta retained the ability to pursue Superior Proposals for sixty days following the merger agreement proposal and could elect to terminate the CFI merger agreement if a Superior Proposal was found. *Id.* Article II of BTṚta's charter defines "Superior Proposal" as "any merger proposal that BTṚta's board deemed in good faith would better serve the best interests of the Company . . . as defined under Article II . . . ." *Id.* Article II in part provides:

> [I]n determining what is in the best interests of the Company and its stockholders, a Director shall consider the long-term prospects and interests of the Company and its stockholders, and the social, economic, legal, or other effects of any action on the . . . communities and society in which the Company or its subsidiaries operate . . . together with the short-term, as well as long-term, interests of its stockholders and the effect of the Company's operations . . . on the environment and the economy of those communities and the larger world.

Id. at 6.

Due to Sunstein and Sarabhai's continued misgivings about the CFI merger and their continued desire "to promote the larger societal interests that BTṚta had been attending to," they discussed an alternative deal in late October with Ravert Ward, a company known for working with other socially responsible companies. *Id.* at 10. After initially offering $13 per share, Ravert Ward later increased its offer to $15.50 per share – a price above the pre-merger agreement price of BTṚta stock. *Id.* at

11. Ravert Ward also agreed to continue BTṚta's environmentally sound practices and promised a consulting role for Sunstein and Sarabhai after the merger. *Id.* The compensation for these positions is less than what they would have received with CFI. *Id.* at 2. In exchange, BTṚta agreed to: a mandatory shareholder vote regardless of board recommendation, an affirmative vote of Sunstein and Sarabhai's personal shares, a no-shop provision, and a $15 million termination fee. *Id.* at 11–12.

In December 2011 BTṚta's board recommended and approved the Ravert Ward merger, believing that "BTṚta's environmentally responsible practices would continue" and the "interests of the communities and society served by BTṚta" would be upheld. *Id.* at 12. Shortly after BTṚta informed CFI of the Ravert Ward merger agreement, CFI brought the current action alleging that BTṚta's directors breached their fiduciary duties. *Id.* at 13. The validity and fairness of the Ravert Ward merger agreement and Article II of BTṚta's charter are now at issue before this Court.

ARGUMENT

I. THE COURT OF CHANCERY MUST BE REVERSED BECAUSE ARTICLE II OF THE COMPANY'S CHARTER IS VALID UNDER DELAWARE STATUTORY AND CASE LAW.

A. Question Presented

Whether a provision drafted into a company's certificate of incorporation fourteen years before change in control became a possibility is valid under the Delaware Corporate Code and *Revlon*.

B. Scope of Review

Provisions in a company's charter raise legal questions subject to *de novo* review. *Oberly v. Kirby*, 592 A.2d 445, 457 (Del. 1991).

C. Merits of the Argument

1. Article II is valid under DGCL § 102(b)(1) and this Court's holding in *Revlon*.

Article II of BTR̤ta's charter is valid under Delaware statute and common law. Section 102(b)(1) permits a company's charter to include any provision creating, defining, limiting, or regulating the powers of the corporation and its management. Del. Code Ann. tit. 8 § 102(b)(1). The provision at issue in this case, Article II of BTR̤ta's charter, was drafted consistently with § 102(b)(1) and has remained a pillar of the company's corporate governance during its fourteen-year existence. The fact that the company is for sale does not change Article II's validity; indeed, Article II was written specifically to enable management to satisfy their fiduciary duties under *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), while also weighing the interests of all affected parties. Because Article II conforms to Delaware statutory and common law, this Court should reverse.

i. Section 102(b)(1) authorizes provisions such as Article II that permit directors to consider the collective interests of shareholders and other constituencies when making corporate decisions.

Section 102(b)(1) expressly authorizes provisions creating, defining, limiting, or regulating the powers of a corporation and its management in the company's charter unless "contrary to the [statutory] laws" of Delaware. § 102(b)(1). Article II is a creature

of § 102(b)(1): it mandates that the company's directors consider the interests of all interested parties, including shareholders, and is not contrary to Delaware legislation. Hence, Article II is valid.

This Court has held that section 102(b)(1) "confers . . . the right to include in a [charter] any provision deemed appropriate for the conduct of the corporate affairs." *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 117 (Del. 1952). Furthermore, Section 102(b)(1) bars only provisions "contrary to the laws" of Delaware. § 102(b)(1). This Court has narrowly construed this statement so as not to invalidate charter provisions that vary rules of common law. *Sterling*, 93 A.2d at 117-19; *accord* Edward P. Welch & Robert S. Saunders, *Freedom and its Limits in the Delaware General Corporation Law*, 33 Del. J. Corp. L. 845, 849 (2008) (giving academic support to this theory). Thus, only charter provisions in direct conflict with a Delaware statute can be invalidated.

This broad expression of drafters' power recognizes that charters are contracts between the company and its shareholders. *See Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990); *Berlin v. Emerald Partners*, 552 A.2d 482, 488 (Del. 1988); *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 342-43 (1983). Section 102(b)(1) has allowed Delaware corporations to draft unique provisions such as those that grant directors exclusive ability to fill board vacancies and newly created directorships. *Siegman v. Tri-Star Pictures, Inc.*, 1989 Del. Ch. LEXIS 56, *20-22 (Del. Ch. May 5, 1989). Section 102(b)(1) has also allowed corporations to take away board powers,

such as the power to set a record date. *Jones Apparel Group, Inc. v. Maxwell Shoe Co., Inc.*, 883 A.2d 837, 843 (Del. Ch. May 27, 2004).

Here, section 102(b)(1) expressly validates Article II in BTR's charter. Pursuant to Article II, the company's directors must pool the interests of both the shareholders and other constituencies when making corporate decisions, including change-of-control transactions. The mandate that directors consider the interests of stakeholders and shareholders alike is a definition of management's power directly authorized by § 102(b)(1). This obligation is no different than the provision expanding a board's power in *Tri-Star* or limiting management's power in *Jones Apparel* - both approved by this Court. Thus, Article II is a proper expression of corporate governance authorized by Delaware law under § 102(b)(1).

Furthermore, Article II is not "contrary to the laws" of Delaware because no Delaware statute expressly prohibits the provision's reach. It is true that Delaware has not followed other states in adopting statutes obligating directors to consider the interests of other constituencies. *See, e.g.*, Ohio Rev. Code Ann. § 1701.59(E) (West 2011); Va. Code Ann. § 13.1-788(A) (West 2011). But Delaware has not codified a section that expressly prohibits considering the interests of other constituencies, either. Instead, the Delaware code enables corporations to draft unique provisions suiting their particular needs, thereby further promoting freedom of contract in charters. *Centaur*, 582 A.2d at 928. Thus, Article II is a valid provision under the laws of this State and the injunction must be lifted.

ii. *Revlon*'s holding does not invalidate charter provisions drafted pursuant to DGCL § 102(b)(1).

Revlon does not invalidate Article II because its holding is common-law doctrine that does not affect provisions enabled by § 102(b)(1). This Court has held that § 102(b)(1)'s "contrary to the laws of this State" language does not preclude a charter from altering a common law rule. *Sterling*, 93 A.2d at 117–19. Because Delaware courts consistently add and subtract from a board's so-called *Revlon* duties, the Delaware legislature hesitates to codify and define them. In that sense, *Revlon* exists only in the common law and cannot invalidate properly enacted charter provisions such as Article II. Thus, Article II survives *Revlon* review and this Court should reverse.

The *Revlon* duty, simply stated, dictates that when a company is for sale the board should sell to the entity promising maximization of shareholder profit - i.e. the highest bidder. *Revlon*, 506 A.2d at 185; *see also Malpiede v. Townson*, 780 A.2d 1075, 1083-84 (Del. 2001); *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 44 (Del. 1994); *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 999 (Del. Ch. 2005). The Court in *Revlon* formed the initial version of this rule in response to specific facts: a hostile deal led the board to improperly favor one bidder over another, and the board used the interests of other constituencies as an excuse to include defensive measures. *Revlon*, 506 A.2d at 176-79. The Court found the Revlon board to be self-interested when choosing which bid to accept, and held the defensive measures enacted *at the time of the takeover threat* breached the board's fiduciary duties. *Id.* at 185.

Years of interpretation by lower courts and this Court have expanded *Revlon*'s breadth into areas not originally perceived or intended, resulting in a common-law duty that cannot invalidate otherwise-legal charter provisions. For example, *Revlon* stems from a hostile takeover of Revlon, Inc., but now affects decisions made by boards in a friendly deal context. *See, e.g.*, *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. Feb. 14, 2011). Also, a board enters the *Revlon*-zone only if the deal is a "change of control" transaction, i.e. stock-for-cash triggers the duty while stock-for-stock does not. *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 (Del. 1989). Amid these alterations, though, *Revlon*'s general purpose remains: it applies only to "actions of corporate directors responding" in the shadow of a deal. *Revlon*, 506 A.2d at 180.

Here, Article II was drafted fourteen years before BTR̤ta went "on sale" and therefore cannot be categorized as a decision made in the *Revlon* zone. BTR̤ta's charter adopted Article II in early 1997 and was a focal point in the "Risk Factors" section of the company's prospectus, Mem. Op. 6–7, which must be delivered to all shareholders under federal securities law. *See* Securities Act § 10, 15 U.S.C.A. §77j. The choice to adopt Article II comes from BTR̤ta's environmentally conscious mission, not from a takeover bid. Article II was drafted well before the scriveners were "tainted" to violate their fiduciary duties, and thus does not fall into the decisions *Revlon* and its progeny look to cleanse. *Revlon*, 506 A.2d at 176.

Furthermore, the individual nuances of a board's *Revlon* duties exist only in common law and their application to otherwise-valid

charter provisions will lead to absurd results. If the Court adopts the Appellee's view of the law, the disposition could change merely by changing the deal structure from a cash-for-stock deal to a stock-for-stock transaction; the former is a change of control, but the latter is not. *QVC*, 571 A.2d at 1150. And because there "are no legally prescribed steps" to satisfy *Revlon* duties, invalidating Article II could influence Delaware corporations into amending their charters in fear of being taken to court. *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009). This fear will discourage new companies from incorporating in Delaware and may give fodder to the scholars claiming that Delaware promotes a "race to the bottom." *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L.J. 663, 665 (1974). Thus, such a result would harm all Delaware corporations and this State as a whole.

In sum, *Revlon* invalidates only corporate actions created and made apropos of a change-of-control transaction, not longstanding provisions of a company's charter. Because Article II was drafted and approved by shareholders well before a transaction materialized, it avoids *Revlon* review. Thus, this Court should reverse.

2. Even outside of *Revlon* review, Article II does not violate the general fiduciary duties of directors in this State.

Article II requires BTRta's directors to consider all of the company's stakeholders when making corporate decisions, which neither latently nor patently violates directors' fiduciary duties of care and loyalty. Article II is consistent with the duty of loyalty because it does not condone self-dealing by BTRta's directors or actions of bad

faith. Similarly, Article II encourages BTRta's directors to exercise a higher duty of care by considering the interests of all interested parties and not a single party. Thus, this Court must lift the preliminary injunction.

i. Article II does not violate the Duty of Loyalty because it does not condone self-dealing or bad faith.

Article II does not authorize self-dealing or bad-faith conduct because it compels directors to weigh all stakeholder interests without any detriment to the shareholders. Article II does not compel directors to favor one constituency's interests over another but instead pools the collective interests of all parties to make the best decision for the company as a whole. Hence, Article II does not violate the components of the duty of loyalty and is thereby valid under § 102(b)(7)(i). *See* § 102(b)(7).

Self-dealing, i.e., interested and non-independent behavior, and bad faith breach the duty of loyalty. Directors are "interested" if they receive a personal financial benefit not available to all shareholders. *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). Independent action means "a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984). Finally, bad faith is a "conscious disregard" of a director's duties or, simply stated, gross negligence or willful misconduct. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 64–68 (Del. 2006).

First, no part of Article II allows interested decision-making by BTṚta's management. As noted in the lower court's decision, nothing suggests self-dealing by any of the Appellants. Mem. Op. 2. As Class B common stockholders, Sunstein and Sarabhai will receive no financial benefit or bonus for choosing Ravert Ward over CFI: they receive the same price per share as the Class A shareholders. In this sense, any reduction in premium price would be felt by all shareholders equally; a small sacrifice that will improve the value of BTṚta in the long-term. Additionally, the directors' compensation as consultants to Ravert Ward, when compared to that promised by CFI, would also be significantly lower. *Id.* This salary reduction shows that Appellants are willing to take a personal profit decrease to guarantee the company's sustainability. Class A common shareholders will not feel this salary reduction; only Sunstein and Sarabhai will.

Second, Article II's language does not compel non-independent conduct by the company's directors. Article II authorizes the consideration of nine different constituencies; "interests of directors or management" is not listed. Unlike the provision in *Tri-Star* that allowed directors to usurp corporate opportunities from the company, Article II gives no temptation to directors to act in their own self-interest. *Tri-Star*, 1989 Del. Ch. LEXIS at *22–27. Thus, Article II may be followed during a change-of-control transaction without any chance of non-independent behavior.

Lastly, Article II compels BTṚta's directors to exercise good faith by expanding their liability under the charter. A board beholden to more interests is also beholden to more checks on its authority. If

the directors did not consider the welfare of one group of interested parties, they would be liable to that constituency pursuant to Article II. Thus, Article II invokes a higher standard of good faith and cannot violate the duty of loyalty.

Because Article II prescribed loyalty upon BTRta's directors by promoting disinterested, independent, and good faith behavior, this Court should reverse the Chancery Court's decision.

ii. Article II does not violate the Duty of Care because it mandates fair procedure and fair price.

Finally, Article II is written so that BTRta's managers may consider the interests of other constituencies while not violating their fiduciary duty of care to the company. The provision thus applies the duty of care and does not violate it.

The seminal case defining the duty of care, and one which is distinguishable from this case, is *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). There, the board members failed to adequately inform themselves of all material information prior to approving a merger agreement and opened themselves up to entire fairness review. *Id.* at 893. Because the *Van Gorkom* board did not avail itself of all possible information before making a decision, the Court found the board violated its duty of care to the company. *Id.*

Here, Article II promotes managers' search for information by obligating them to consider all parties' interests before making a final decision. The provision promotes an idea similar to the holding of *Van Gorkom*: the more information a board accrues, the more likely that decision reflects proper business judgment. By adding stakeholder

interests and shareholder interests together, the directors' final computation will be in the best interests of the company. But for Article II, the directors may have settled for the higher-priced, less environmentally sensitive CFI merger agreement and, ironically, could have opened themselves up to duty-of-care suits. Instead, Article II made the directors fully consider the material information and the interests they needed to serve; accordingly the directors satisfied their duty of care. This Court should reverse.

II. OMNICARE WAS WRONGLY DECIDED AND SHOULD BE OVERRULED

A. Question Presented

Whether this Court's decision in *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003), should be overruled for improperly using the enhanced scrutiny test from *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985), to evaluate deal-protection measures where no board conflict existed. Alternatively, if the *Omnicare* majority correctly chose the *Unocal* test to evaluate the board's decision, whether the *Omnicare* majority properly applied *Unocal* to the facts of the case.

B. Scope of Review

This Court departs from the doctrine of stare decisis where a prior decision has lost its legal vitality, *Travelers Indemnity Co. v. Lake*, 594 A.2d 38, 46 (Del. 1991), or "for urgent reasons and upon clear manifestation of error," *Seinfeld v. Verizon Communications, Inc.*, 909 A.12d 117 (Del. 2006) (citing *Oscar George, Inc. v. Potts*, 115 A.2d 479, 481 (Del. 1955)).

C. **Merits of the Argument**

Nearly a decade has passed since *Omnicare* was decided, giving Delaware's courts time to embrace it and other states' courts time to emulate it. Instead, *Omnicare* has been criticized from every corner. Although under normal circumstances this Court is dedicated to the principle of stare decisis, the *Omnicare* decision has outlived its legal vitality, was clearly in error, and should be overruled.

1. Other courts' criticism and outright rejection of *Omnicare* have undermined *Omnicare*'s legal vitality.

Delaware state courts, and courts in other jurisdictions across the country, have either taken a narrow view of *Omnicare*'s holding or rejected it outright. To the extent *Omnicare* had any legal vitality, the steady stream of criticism has eroded it.

Criticism of *Omnicare* in the Delaware state courts began in earnest with *Orman v. Cullman*, 2004 WL 2348395 (Del. Ch. Oct. 20, 2004). There, the Cullmans, shareholder-directors holding a voting majority in Class B stock, pledged to vote their shares in favor of a deal. The plaintiffs argued the agreement was coercive under the *Unocal* test and *Omnicare*, but the Chancery Court disagreed. The court distinguished *Orman* on the basis that the Cullmans made their voting agreement in their capacity as shareholders, which did not impair their ability later to disapprove of the deal in their capacity as directors. *Orman*, 2004 WL 2348395 at *5. The court upheld the deal, partly because it recognized the distinction between shareholder and director agreements that the *Omnicare* majority did not. *Id.* at *9.

The Chancery Court criticized *Omnicare* again with *In re Toys "R" Us, Inc. Shareholder Litigation*. 877 A.2d 975 at 1016 n.68. In *Toys "R" Us*, the toy retailer's board of directors agreed to deal-protection measures including a 3.75% termination fee, a no-shop provision, and a limited match-right in the event of a superior proposal. *Id.* at 980. A group of shareholders challenged the deal-protection measures, bringing an action against the Toys "R" Us board for breaching its fiduciary duties under *Revlon*. *Id.* at 981. Vice Chancellor Strine rejected the shareholders' argument and upheld the directors' actions and deal-protection measures. *Id.* at 1021, 1023. Vice Chancellor Strine criticized the *Omnicare* decision as "an aberrational departure from th[e] long-accepted principle" that a board needs only to be reasonable under the circumstances in agreeing to a bidder's demands for deal protection measures. *Id.* at 1016 n.68.

Other state courts have an advantage over Delaware courts because they can simply ignore *Omnicare*. In *Monty v. Leis*, 193 Cal. App. 4th 1367 (Cal. Ct. App. 2011), the court rejected *Omnicare* outright. Citing Vice Chancellor Strine's critique of *Omnicare* in *Toys "R" Us*, the *Monty* court reasoned that, because contracts are necessarily made without knowledge of the future, deal-protection provisions can be useful devices to clinch the best offer for shareholders. *Id.* at 1374.

2. The Court should correct *Omnicare* and apply the business judgment rule to deal-protection measures unless the "omnipresent specter" of board self-interest is present.

The Court created the *Unocal* test to police defensive actions taken by board members whose personal interests diverged from those of their shareholders. But where board members' and shareholders'

interests align, courts should not second-guess the informed, good-faith decisions made by those board members. The *Omnicare* majority erred by applying the *Unocal* test to board actions where, as here, the board did not have conflicting interests. This Court should take this case as an opportunity to correct the *Omnicare* majority's error by applying the business judgment rule to deal-protection provisions entered by a board without any conflicts of interest.

i. The business judgment rule generally applies to board decisions in change-of-control situations unless a threat of conflicted board loyalty triggers enhanced scrutiny.

Delaware law entrusts primary responsibility for corporate decision-making to the board, acting on behalf of the corporation's and shareholders' interests. Delaware case law acknowledges the primacy of board decision-making through the business judgment rule, which is a "presumption that in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson*, 473 A.2d at 812. The business judgment rule places the burden on the plaintiff to rebut that presumption; if the plaintiff fails, "a court will not substitute its judgment for that of the board if the [board's] decision can be 'attributed to any rational business purpose.'" *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (citing *Unocal*, 493 A.2d at 954). Under the business judgment rule, a board's decision does not need to be perfect — it only needs to be reasonable under the circumstances. *See id.* at 1385–86 (quoting *QVC*, 637 A.2d at 45–46).

Courts presume the business judgment rule applies in change-of-control transactions unless a conflict of interest exists. *Unitrin*, 651 A.2d at 1372–73. Where the board's interests diverge from the shareholders' interests, enhanced scrutiny is appropriate – not here. *Id.* at 1373.

ii. The Court developed the *Unocal* enhanced-scrutiny standard for defensive measures aimed at hostile bidders.

When a board adopts defensive measures to thwart a hostile takeover bid, courts subject the board's actions to heightened judicial scrutiny because of the "omnipresent specter that a board may be acting primarily in its own interest, rather than those of the corporation and its shareholders . . . ." *Unocal*, 493 A.2d at 954. The *Unocal* test has two prongs: a reasonableness inquiry and a proportionality inquiry. The first prong requires a board to have reasonable grounds for believing a danger to corporate policy and effectiveness exists. *Id.* at 955 (citing *Cheff v. Mathes*, 199 A.2d 548, 554–55 (Del. 1964)). Even if the board satisfies the first prong, the second prong prohibits coercive or preclusive measures and requires that any defensive measure taken be within a "range of reasonableness" in light of the perceived threat. *Unitrin*, 651 A.2d at 1354–55 (citing *QVC*, 637 A.2d at 45–46).

This Court applied the *Unocal* test in *Omnicare* and concluded the deal-protection provisions there were invalid. *Omnicare* involved deal-protection measures adopted to prevent a disfavored takeover of a target corporation, NCS Healthcare. *Omnicare*, 818 A.2d at 917–27. These lock-up provisions made a merger between NCS and its preferred

suitor, Genesis Health Ventures, a foregone conclusion and prevented shareholders from accepting a last-minute offer from Omnicare. The *Omnicare* majority found the deal protection measures preclusive and coercive. *Omnicare*, 818 A.2d at 939.

iii. The *Unocal* test is inappropriate here because the "omnipresent specter" of board member self-interest is absent.

The BTṚta board was not conflicted when it adopted the deal-protection pact with Ravert Ward. Mem. Op. 2. Here, both CFI and Ravert Ward offered significant premiums on the shares' previous market price. Mem. Op. 11. BTṚta had an enviable choice, and it simply chose the deal securing the greatest possible stakeholder value. The deal-protection provisions were not meant to preclude a superior offer; instead, they added certainty — and its intrinsic value — by ending the active bidding process. Thus, the board's actions to close the Ravert Ward deal were far from "defensive measures" – the *Unocal* "omnipresent specter" was entirely absent.

Any argument that *Unocal* is appropriate because conflicts of interest are inherent in change-of-control transactions is simply wrong. The confluence of interests between BTṚta's board, Sunstein, Sarabhai, and the public shareholders belies the notion that deal-protection measures signal conflicted dealing. BTṚta's board and officers were shareholders, and the Class B stock held by Sunstein and Sarabhai constituted over 9.2% of outstanding stock. Mem. Op. 6. Their interests were aligned with those specified in BTṚta's charter. Thus, this Court should reverse the order for preliminary injunction and

overrule the *Omnicare* majority's application of the *Unocal* test to deal-protection measures where the board is not conflicted.

3. Even if the *Unocal* test were appropriate, this Court should overrule *Omnicare* because its majority misapplied *Unocal* to reasonable and proportionate deal-protection measures.

As argued above, without circumstances indicating a conflict of interest facing board members, courts should review corporate decisions according to the business judgment rule. In *Omnicare*, the board was not clearly conflicted: the board members were shareholders, and they were going to lose control over the corporation regardless of the deal they accepted. Applying the *Unocal* test to *Omnicare*'s facts was improper. But even if one assumes *Unocal* was the correct analytical framework, the *Omnicare* majority misapplied it.

The *Omnicare* majority diverged from precedent by extending the *Unocal* test beyond its logical and practical limits. The rare 3–2 split in *Omnicare* evinces its tenuous basis. Although the *Omnicare* majority claimed to apply existing doctrine, it functionally hindered boards' ability to secure deals and prevented majority shareholders from voting to facilitate profitable changes in corporate control.

i. The *Omnicare* majority misapplied the *Unocal* reasonableness test.

The *Unocal* test first considers the reasonableness of a board's decision to adopt defensive measures. The three-justice *Omnicare* majority — as the *Omnicare* dissenters pointed out — judged the NCS board's lock-up of the Genesis deal with the benefit of hindsight rather than with empathy for the board's understandable desire to

secure what, at the time, appeared to be their only attractive suitor. *See Omnicare*, 818 A.2d at 948 (Steele, J., dissenting).

The NCS board reasonably decided to take defensive action. *Unocal*'s first prong requires directors to act in good faith and have reasonable grounds to believe there is a threat to the corporate policy before adopting defensive measures. *Unitrin*, 651 A.2d at 1373. A proper application of this reasonableness requirement would have vindicated the NCS board. When the decision to lock-up a deal with Genesis was made, the only potential bidder for NCS was Omnicare, which "had refused to buy NCS except at a fire sale price through an asset sale in bankruptcy." *Omnicare*, 818 A.2d at 941 (Veasey, C.J., dissenting). Omnicare's highest offer would not have even paid off NCS's creditors, let alone its shareholders. *Id.*

The board managed to solicit a vastly superior bid from Genesis, one that would satisfy creditors and create value for shareholders. *Id.* But, for its trouble Genesis demanded assurance that it was not merely a "stalking horse" to elicit other bids. The board, reasonably, concluded that losing the Genesis deal — and being left with Omnicare's offer — would harm NCS's shareholders and creditors. *Id.*

ii. The *Omnicare* majority misapplied *Unocal*'s proportionality test.

The NCS board responded proportionately to the grave danger NCS's creditors and shareholders would face if the Genesis deal fell through. Genesis demanded, and the NCS board agreed to: a specifically enforceable provision requiring the two shareholder-directors holding a voting majority of NCS stock to vote in favor of the Genesis

acquisition; a mandatory DGCL § 251(c) shareholder vote; and no fiduciary-out clause. *Id.* These provisions made closure of the Genesis deal a virtual certainty, but that was precisely the point. As Chief Justice Veasey memorably put it: "If the NCS board would not have acceded to [Genesis's deal-protection demands] . . . there would have been no deal!" *Id.*

4. The deal-protection measures in this case were reasonable and proportionate responses to a threat to BTRta's environmental-sustainability mission.

When the BTRta board made its deal-protection agreements with Ravert Ward, it did so because it reasonably recognized BTRta's mission would be threatened if CFI acquired the company. Mem. Op. 9. Placement in the corporation's founding articles underscores the importance BTRta placed on environmental sustainability and other stakeholder interests. Mem. Op. 3. Given the gravity of these interests, the deal-protection measures taken by the board were proportionate to the serious threat from CFI.

Deal-making requires strong deal protections. Here, without the Ravert Ward deal, CFI would likely have decimated BTRta's entire corporate culture of sustainability and community-mindedness. When boards recognize such a serious threat, it is imperative they have the authority to secure more-promising deals.

This Court should overrule the *Omnicare* majority's misapplication of the *Unocal* test and reverse the Chancery Court's order for preliminary injunction.

CONCLUSION

For the foregoing reasons, Appellants respectfully request that this Court reverse the Court of Chancery and allow the Ravert Ward merger to proceed. Article II of BTRta's charter is valid because it was written within the bounds of DGCL § 102(b)(1), and this Court's holding in *Revlon* does not preclude constituency provisions formulated outside of a hostile bidder context. Contrary to the Chancery Court's finding, the deal-protection measures adopted in the Ravert Ward merger withstand the *Unocal* test despite the *Omnicare* majority's misapplication of that test in similar circumstances. Moreover, because the *Omnicare* opinion has received consistent criticism within Delaware and elsewhere, it is ripe for reconsideration and should be overruled. Accordingly, this Court should reverse.

Respectfully Submitted,

/s/ Team B

Team B, Counsel for Defendants – Below, Appellants

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