

IN THE SUPREME COURT OF THE STATE OF DELAWARE

BTRta Forest Products, Inc., a Delaware :  
Corporation, MATTHEW SUNSTEIN, :  
VIKRAM SARAVHAI, MICHAEL F. ALLEN, : No. 142,2012  
MILES D. LIU, KATHLEEN L. TODMAN, :  
HERBERT McCUSKER, PAULA ABAZIAN, :  
JANICE L. STERN, WILLIAM D. HEMPHILL, :  
RAVERT WARD L.P., AND BTR ACQUISITION : Court Below:  
CORP., : Court of Chancery  
Appellants, : State of Delaware  
v. : Civil Action No.: 6943-CJ  
:  
CONSOLIDATED FOREST INDUSTRIES CO., :  
a Delaware corporation, :  
Appallee. :

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APPELLEE'S OPENING BRIEF

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Appellee/Plaintiff below  
Consolidated Forest  
Industires Co.

Dated: February 10, 2012

TABLE OF CONTENTS

TABLE OF CITATIONS..... iii

NATURE OF PROCEEDINGS..... 1

SUMMARY OF ARGUMENT..... 2

STATEMENT OF FACTS..... 3

ARGUMENT..... 5

I. THIS COURT SHOULD RULE THAT THE LOWER COURT WAS CORRECT AS A MATTER OF LAW BECAUSE BTRta'S ART. II AUTHORIZES ITS DIRECTORS TO VIOLATE THEIR FIDUCIARY DUTIES TO THEIR SHAREHOLDERS AS PROSCRIBED BY SEC. §102(b) (7) AND REVLON ..... 5

A. QUESTION PRESENTED..... 5

B. SCOPE OF REVIEW..... 5

C. MERTS OF THE ARGUMENT..... 5

1. The "Revlon duty" applies to BTRta because it initiated a transaction that would result in a change or sale of control of the company. .... 7

2. BTRta's directors violated their Revlon duty by purposefully securing a transaction that did not offer the best value available for its shareholders. .... 8

3. BTRta's Art II is contrary to Delaware law because it authorizes its directors to violate the Revlon duty, thus limiting the director's duty of loyalty as proscribed by §102(b) (7). .... 11

II. THIS COURT SHOULD RULE THAT THE LOWER COURT WAS CORRECT AS A MATTER OF LAW BECAUSE THE DEFENSIVE DEVICES USED TO PROTECT THE MERGER AGREEMENT ARE CONTRARY TO DELAWARE LAW AND VIOLATE PUBLIC POLICE ..... 14

A. QUESTION PRESENTED..... 14

B. SCOPE OF REVIEW..... 14

C. MERTS OF THE ARGUMENT..... 14

1. The "Revlon duty" applies to BTRta because it initiated a transaction that would result in a change or sale of control of the company. .... 14

2. The defensive devices used in the BTRta merger are Per Se invalid because Omnicare properly held that such devices are invalid. .... 17

3. The defensive devices used in the BTRta merger are invalid because they are contrary to public policy in that they hurt the economic interests of the shareholders and overturning Omnicare would violate the doctrine of stare decisis. .... 22

CONCLUSION..... 25

**TABLE OF AUTHORITIES**

**Delaware Supreme Court Cases**

Account v. Hilton Hotels Corp.,  
780 A.2d 245 (Del. 2001)..... 24

Arnold v. Society for Savings Bancorp, Inc.,  
678 A.2d 533 (Del. 1996)..... 12

Box v. Box,  
697 A.2d 395 (Del. 1997)..... 5

Kaiser Aluminum Corp. v. Matheson,  
681 A.2d 392 (Del. 1996)..... 5, 14

Lyondell Chemical Co. v. Ryan,  
970 A.2d 235 (Del. 2009)..... 7

McMullin v. Beran,  
765 A.2d 910, 923 (Del. 2000)..... 9

Merrill v. Crothall-American, Inc.,  
606 A.2d 96 (Del. 1992)..... 14

Mills Acquisition Co. v. MacMillan, Inc.,  
559 A.2d 1261 (Del. 1989)..... 9

Omnicare Inc. v. NCS Healthcare, Inc.,  
818 A.2d 914 (Del. 2003)..... *passim*

Paramount Communications Inc. v. QVC Network Inc.,  
637 A.2d 34 (Del. 1994)..... 18

Paramount Communications, Inc. v. Time Inc.,  
571 A.2d 1140 (Del. 1989)..... 7, 8, 13, 18

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,  
506 A.2d 173 (Del. 1986)..... *passim*

Unocal Corp. v. Mesa Petroleum Co.,  
493 A. 2d 954..... 18, 19

Unitrin, Inc. v. Am. Gen. Corp.,  
651 A.2d 1361 (Del. 1995)..... 7, 20

**Delaware Chancery Court Cases**

Consolidated Forest Industries Co. v. BTRta Forest Products, Inc.,  
C.A. No. 6943-CJ (Del. Ct. January 26, 2012)..... *passim*

In re Tyson Foods, Inc. Consol. S'holder Litig.,  
919 A.2d 563 (Del. Ch. 2007)..... 20

Orman v. Cullman,  
2004 WL 2348395, (Del. Ch.)..... 24, 25

Siegman v. Tri-Star Pictures, Inc.,  
1989 WL 48746 (Del. Ch.)..... 12

**Statutes and Regulations**

8 Del. C. § 102(b)(1)..... 11

8 Del. C. § 102(b)(7)..... 11

**Other Authorities**

Christina M. Sautter, *Rethinking Contractual Limits on Fiduciary Duties* 38 Fla. St. U. L. Rev. 55 (2010)..... 23

E. Norman Veasey, *The Defining Tension in corporate Governance in America* 52 Bus. Law. 393 (1997)..... 22

E. Norman Veasey, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments* 153 U. Pa. L. Rev. 1399 (2005)..... 23

Edward P. Welch et al., *Folk on the Delaware General Corporation Law* (5th ed. 2006)..... 21

### NATURE OF PROCEEDINGS

This is an interlocutory appeal from the order of Chancellor Meghan Jeuell of the Chancery Court of the State of Delaware entered on January 31, 2012 granting a preliminary injunction to Appellee Consolidated Forest Industries Co., ("CFI") plaintiffs bellow enjoining a merger between Appellants BTRta and Ravert Ward and requiring CFI post a \$1,000,000.00 bond by February 1, 2012.

The Chancery Court action, C.A. No. 6943-CJ, was filed on December 16, 2012 by CFI. Following an expedited discovery, CFI moved for the entry of a preliminary injunction on January 23, 2012. On January 26, 2012, Chancellor Jeuell issued a Memorandum Opinion ruling in favor of CFI on the grounds that Article II of BTRta's by-laws and the merger violated the Revlon duties and because the merger included defensive devices that are invalid under the rule in Omnicare.

This appeal is pursuant to Delaware Supreme Court Rule 42. The preliminary injunction was ordered on January 31, 2012. On February 2, 2012, Appellents applied for certification of the interlocutory order. Appellee responded to this application on February 3, 2012 and Chancellor Jeuell, by letter, granted the application the same day.

After receiving certification from the Chancery Court, Appellants filed notice of interlocutory appeal on February 6, 2012. Because of the shareholder vote scheduled for March 23, 2012, the parties agreed to proceed with the appeal on an expiated basis. This Court granted the appellants' interlocutory appeal on February 10, 2012.

## SUMMARY OF THE ARGUMENT

I. This Court should uphold the lower court's decision to grant a temporary injunction preventing BTRta's merger with Ravert, because the merger decision was based on a provision that allowed BTRta's directors to impermissibly breach their fiduciary duties to the shareholder according to Revlon and §102(b)(7). Revlon applies to BTRta because it initiated a transaction that resulted in a sale of control of the company. BTRta's directors violated Revlon by purposefully securing a transaction that did not offer the best value available for its shareholders. Because BTRta's Art. II authorizes this violation, it limits the director's duty of loyalty as proscribed by §102(b)(7) and is thus contrary to Delaware law.

II. This court should affirm the Chancery Courts holding that the defensive devices used in the BTRta merger agreement were per se invalid. These devices were the exact same devices used in the Omnicare case where this Court held them to be contrary to Delaware law. That holding was a logical extension of precedent and should be upheld because it is based on sound reasoning and is supported by public policy.

## STATEMENT OF FACTS

The Parties: Appellee, Consolidated Forest Industries Co. ("CFI"), a Delaware corporation, is one of the world's largest producers of paper and wood products. Consolidated Forest Industries Co., v. BTRta Forest Production, Inc., No. 6943-CJ, slip op. at 3 (Del. Ch. Jan. 26, 2012). Appellant, BTRta Forest Production, Inc. ("BTRta"), a Delaware corporation, manufactures and sells forest products using sustainably. Id. at 4. Co-Appellants Mathew Sunstein ("Sunstein") and Vikram Sarabhai ("Sarabhai") are founders, directors and co-CEO's of BTRta. Id. Also co-Appellant, is Ravert Ward ("Ravert"), an acquisition firm specializing in acquisitions of small companies. Id.

BTRta's Corporate Governance: BTRta is a publically held company composed of class A and B shares in which Sunstein and Sarabhai constitute 50.4% of the voting power. Id. at 5. Article II of BTRta's certificate of incorporation permits its directors to "accept an offer with a lower price per share than a competing offer" based on "interest of the communities and society" served by BTRta. Id. at 6. Furthermore, it states that such an action will not be construed as a breach of the directors' fiduciary duties to the shareholders. Id.

The CFI Merger Agreement: Sunstein and Sarabhai became disenchanted with their responsibilities in managing BTRta and decided to sell their interest in the company. Id. at 8. However, at the boards' direction, the board solicited bids to sell all outstanding stock. Id. After being identified as a potential bidder, CFI presented an offer of \$16 per share, 25% over market value. Id. at 8-9. Sunstein

and Sarabhai were resistant to the merger because CFI did not share their environmental sensibilities. Id. CFI raised its offer to \$17 per share and assured that post-merger Sunstein and Sarabhai would serve as consultants to CFI's environmental committee. Id. BTRta's board executed a merger agreement with CFI. Id. The merger agreement allowed BTRta to seek out and terminate the merger agreement for a Superior Proposal within a 60 day period. Id. at 10

The Ravert Merger Agreement: During the 60-day period BTRta solicited a bid from Ravert. Id. During negotiations, Ravert stated that it would be unable to finance a transaction above CFI's offer and that \$13 per share was the most it could offer. Id. at 11. Later, Ravert increased its offer \$15.50 per share and assured that BTRta's operations would be managed in accordance with its previous environmentally responsible practices. Id. In return for these concessions, Ravert demanded the following: Sunstein and Sarabhai must agree to vote all of their Class B Stock in favor of the merger; the board of directors must present the merger agreement to a vote of its stockholders regardless of whether they still recommended the merger; and BTRta could not shop for another bidder. Id. at 12.

On December 13, 2011, BTRta's board of directors concluded that a merger with Ravert was more likely to continue the founders mission of serving the environment and surrounding community and the board declared the Ravert merger agreement a Superior Proposal and approved it. Id. After BTRta informed CFI of the Ravert merger agreement, CFI commenced this litigation. Id. at 13.

## ARGUMENT

### I. THIS COURT SHOULD RULE THAT THE LOWER COURT WAS CORRECT AS A MATTER OF LAW BECAUSE BTRTA'S ART. II AUTHORIZES ITS DIRECTORS TO VIOLATE THEIR FIDUCIARY DUTIES TO THEIR SHAREHOLDERS AS PROSCRIBED BY SEC. §102(b)(7) AND REVLON

#### A. Question Presented

Whether this Court should uphold the lower court's decision to grant a temporary injunction preventing BTRta's merger with Ravert when the merger decision was based on a provision that allowed BTRta's directors to impermissibly breach their fiduciary duties to the shareholder according to 102(b)(7) and Revlon.

#### B. Scope of Review

The grant or denial of preliminary injunction by the trial court is reviewed by the Delaware Supreme Court for abuse of discretion. Box v. Box, 697 A.2d 395, 397 (Del. 1997). Nevertheless, this Court reviews the grant of a preliminary injunction without deference to the embedded legal conclusions of the trial court. Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392 (Del. 1996).

#### C. Merits of the Argument

Under Delaware law, for everyday decisions, a board has no duty to maximize short-term value and may consider the interests of non-shareholder constituencies as long as there is a rationally related benefit for shareholders. However, according to Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., and its progeny, the duties of corporate directors change considerably in three basic situations.

When a board is on the verge of selling, breaking up, or transferring control of the corporation, directors may not consider the interests of non-shareholders and have a narrow fiduciary duty to maximize shareholder value ("Revlon duty"). Revlon, 506 A.2d 173, 182. (Del. 1986); Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).

In such a context, that board's conduct cannot be judicially reviewed pursuant to the traditional business judgment rule, but instead will be scrutinized under a heightened standard for reasonableness in relation to this discrete obligation. Revlon, 506 A.2d at 180. Failure to maximize the shareholder value will result in a violation of the director's fiduciary duties to the shareholder. Id. at 182. Accordingly, Delaware General Corporation Law prohibits a corporation from "eliminating or limiting the liability of its director for any breach of their duty of loyalty to the stockholders" in its certificate of incorporation. Del. Code Ann. tit. 8 § 102(b)(7) (2010).

In light of the above, it can be rationally concluded that a corporation that includes in its certificate of incorporation a provision authorizing its directors to approve a sale of the company and forgo a merger that offers shareholders greater current value, based solely on the consideration of non-shareholder interests, violates Delaware law. Thus, because BTRta has done exactly that, its actions have violated Delaware Law and this Court should uphold the Court of Chancery's injunction.

**1. The "Revlon duty" applies to BTRta because it initiated a transaction that would result in a change or sale of control of the company.**

The Revlon duty, requiring a company's board to obtain the best price for stockholders at the sale of a company, arises at the time a company embarks on a transaction either by its own initiative or in response to an unsolicited offer that will result in a change or sale of control of the company. Lyondell Chemical Co. v. Ryan 970 A.2d 235, 242 (Del. 2009).

In Paramount Communications Inc. v. QVC Network Inc., this Court held that the Revlon duty applied to the Viacom-Paramount merger because, if consummated, it would shift control of Paramount from the public stockholders to a controlling stockholder (Viacom), thus causing a sale of corporate control. 637 A.2d 34, 48 (Del. 1994)

In Lyondell Chemical Co. v. Ryan, this Court held that the Revlon duty commenced when directors began negotiating the sale of the corporation. 970 A.2d at 238. This Court reasoned that despite Basell's multiple offers to buy Lyondell, the Revlon duty was not triggered until Lyondell's board of directors decided that it was interested in the Basell transaction and authorized negotiations for its sale. Id.

In Paramount Communications Inc. v. Time Inc., this Court held that the application of Revlon does not extend to corporate transactions simply because the merger might be construed as putting a corporation either "in play" or "up for sale." 571 A.2d 1140, 1151 (Del. 1989). The Court reasoned that the Time-Warner agreement did not purport to change control of Time, but served to increase the scope of their position in the marketplace. Id. at 1150. Time would

still retain a stock percentage of ownership, current CEO, equal representation on the new board of directors, and a commitment to Time's journalistic integrity Id at 1144, 1146.

In this case, like the Viacom-Paramount merger, BTRta's merger with Ravert will vest Ravert with complete control of BTRta. This is evidenced by BTRta's board of director's decision to sell BTRta's "entire equity including both its class A and B shares." Additionally, like the board in Lyondell, once BTRta's board identified CFI and later Ravert as potential buyers, BTRta actively engaged in negotiation to sell to them. While BTRta's board did express a desire to sell to Ravert because it believed that Ravert would continue its environmentally responsible corporate practices, BTRta could not argue, as Time did, that its intention was not to sell but to expand its position in the market place. This is evidenced by the fact that BTRta did not secure in its merger agreement a stock percentage of ownership, equal representation on the board of directors or continued service of its co-CEOs as the Time-Warner merger did. Thus, because BTRta actively negotiated a sale of control with Ravert, the Revlon duty applies.

**2. BTRta's directors violated their Revlon duty by purposefully securing a transaction that did not offer the best value available for its shareholders.**

BTRta violated its Revlon duty to its shareholders when it accepted the lower of two cash merger offers based on impermissible non-shareholder considerations. "In the sale of control context, the directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the

stockholders—and they must exercise their fiduciary duties (of care and loyalty) to further that end.” Paramount, 637 A.2d at 44.; Revlon, 506 A.2d at 182.; Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1288 (Del. 1989). “The board may not allow any impermissible influence, inconsistent with the best interests of the shareholders, to alter the strict fulfillment of these duties.” Id. at 1285; McMullin v. Beran, 765 A.2d 910, 923 (Del. 2000). Accordingly, enhanced scrutiny applies and the directors have the burden of proving that they were adequately informed and acted reasonably in carrying out their specific fiduciary duties. Paramount, 637 A.2d at 45.

In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., this Court held that Revlon failed to obtain the best value for its shareholders when it entered into an agreement with Forstmann that destroyed the active bidding process in order to protect the note-holders interest over the shareholders interest. 506 A.2d at 182. The Court reasoned that this impermissible consideration violated the director’s fiduciary duty of loyalty and care, and was inappropriate when an auction among active bidders was in progress and the object was no longer to protect or maintain the corporate enterprise but to sell it to the highest bidder. Id.

In Paramount v. QVC Network Inc., this Court held that Paramount failed to obtain the best value reasonably available to the shareholders by entering into an agreement with Viacom that prevented it from critically evaluating the QVC tender offers, which exceeded the Viacom offer by over \$1 billion. 637 A.2d at 45. The Court reasoned that this significant disparity of value cannot be justified

on the basis of the directors' strategic vision for the company's future. Id. at 50. This is primarily because the change of control would supplant the authority of the current Paramount Board to continue to hold and implement their strategic vision in any meaningful way. Id. This belief paralyzed Paramount from taking reasonable action to negotiate on the shareholder's behalf and to fulfill their obligation to seek the best value available, thus violating Paramount's fiduciary duties. Id. at 51.

In this case, as in Revlon, where the Court found that the director impermissibly breached their fiduciary duties by considering non-stockholders' interest over its shareholders, BTRta's directors specifically accepted Ravert's \$15.50 per share over CFI's \$17 per share offer, believing that Ravert was more likely to continue the founders mission of serving the environment and surrounding community. By putting such focus on the corporate interest of maintaining "environmentally responsible practices" for the future, the BTRta's directors, like the Paramount directors, became paralyzed, intentionally locking themselves in a course of action that would not allow them to fulfill their obligation to seek the best value available for their shareholders.

Additionally, even if the directors' concern for environmental interest were not impermissible, the fact that BTRta was giving up complete control both in shareholder votes and director-seats, made it impossible for them to guarantee that Ravert would maintain BTRta's interest. Thus, BTRta sacrificed a higher price per share for little more than a promise by Ravert. Because BTRta accepted the lower of the

two cash merger offers based on impermissible considerations, BTRta violated its Revlon duty to its shareholders.

**3. BTRta's Art II is contrary to Delaware law because it authorizes its directors to violate the Revlon duty, thus limiting the director's duty of loyalty as proscribed by §102(b)(7).**

BTRta's Art II authorizes its directors to breach their Revlon duty to their shareholders thus limiting the director's duty of loyalty as proscribed by §102(b)(7). Under section §102(b)(1) of the Delaware General Corporation Law, the powers and duties of directors of a Delaware corporation can be expanded or restricted by provisions of the certificate of incorporation if such provisions are not contrary to Delaware law. Del. Code Ann. tit. 8 § 102(b)(1) (2010). While this language seems very broad, §102(b)(7) of the Delaware General Corporation Law, expressly prohibits a corporation from "eliminating or limiting the liability of its director for any breach of their duty of loyalty to its stockholders" in its certificate of incorporation. Id. As previously mentioned, in Revlon this Court held that non-shareholder considerations violated the director's fiduciary duty of loyalty. In this way, Revlon properly illustrates the protection that §102(b)(7) gives to shareholders by requiring directors to act loyally, putting the shareholder's interest above the corporation in a sale of corporate control.

In light of the importance of preserving the directors' duty of loyalty, the court in Siegman v. Tri-Star Pictures, Inc. held that a charter provision that could limit director liability for usurpation of a corporate opportunity would be inconsistent with Section §102(b)(7). 1989 WL 48746 (Del. Ch.). The court reasoned that to

"eliminate or limit the liability of directors for breach of their fiduciary duty of loyalty - - [is] a result proscribed by § 102(b)(7)." Id.

In the present case, BTRta's Article II limits the liability of its directors for a breach of their duty of loyalty by authorizing its directors to approve a sale of the company and forgo a merger that offers shareholder greater current value, based solely on the consideration of non-shareholder interests. Accordingly, because Art. II violates §102(b)(7), the directors of BTRta were not entitled to rely on it in approving the Ravert merger.

While this Court in Revlon also held the non-shareholder considerations violated the duty of care, § 102(b)(7) does authorize the certificate of incorporation to eliminate or limit the directors' liability for monetary damages for breach of the duty of care. However, as the court below stated, "102(b)(7) does not approve any alteration of the content of the duty of care, whether complete elimination of the underlying duty, or modifying it, even by charter provision, to permit directors to promote broader societal interests at the expense of the stockholder's interests." Consolidated Forest Industries Co., v. BTRta Forest Production, Inc., No. 6943-CJ, slip op. at 15 (Del. Ch. Jan. 26, 2012).

In light of this, 102(b)(7) is not a complete bar to relief, this Court in Arnold v. Society for Sav. Bancorp, Inc. held that while section 102(b)(7) leaves stockholders without a monetary remedy in some instances, they remain protected by the availability of injunctive relief. Stockholders are not discouraged from pursuing such

remedies when warranted. The Court of Chancery is responsive and this Court has demonstrated its willingness and ability to consider expedited appeals in appropriate injunction cases. 678 A.2d 533, 542 (Del. 1996). (See, e.g., Paramount Communications Inc. v. QVC Network, Inc., 637 A.2d 34, 37; Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1142). Thus, in this case, injunctive relief is available for both a breach of loyalty and care.

Based on the above analysis, this Court should uphold the lower court's decision to grant a temporary injunction preventing BTRta's merger with Ravert since the merger decision was based on a provision that allowed BTRta's directors to impermissibly breach their fiduciary duties to the shareholder according to 102(b)(7) and Revlon.

II. **THIS COURT SHOULD RULE THAT THE LOWER COURT WAS CORRECT AS A MATTER OF LAW BECAUSE THE DEFENSIVE DEVICES USED TO PROTECT THE MERGER AGREEMENT ARE CONTRARY TO DELAWARE LAW AND VIOLATE PUBLIC POLICY**

A. **Question Presented**

Whether this Court should uphold the lower court's decision to grant a temporary injunction preventing BTRta's merger with Ravert when the merger agreement includes defensive devices which are invalid according to this Court's precedent and public policy.

B. **Scope of Review**

The grant or denial of a preliminary injunction is review for abuse of discretion. Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 394 (Del. 1996). The Court of Chancery's legal conclusions however, are subject to *de novo* review. Merrill v. Crothall-American, Inc., 606 A.2d 96, 99 (Del. Super. Ct. 1992).

C. **Merits of Argument**

This Court should affirm the Chancery Court's holding that the defensive devices used in the BTRta merger agreement were per se invalid. These devices were the exact same devices used in the Omnicare case where this Court held them to be contrary to Delaware law. That holding was a logical extension of precedent and should be upheld because it is based on sound reasoning and is supported by public policy.

1. **The defensive devices used in the BTRta merger agreement are identical to those used in Omnicare v. NCS and are per se invalid under Delaware law.**

The BTRta board of directors' decision to use protective devices to ensure the merger would be consummated overstepped their ability to

protect the transaction. In Omnicare, this Court held that the board of directors' use of protective devices that made the merger a fait accompli<sup>1</sup>, and the failure to include an effective fiduciary out clause, completely locked up the transaction despite the continuing fiduciary duties owed to the minority shareholders, and was thus invalid. Omnicare Inc. v. NCS. Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003). The fait accompli was created by two key provisions in the agreement; a Section 251 (c) provision that required the board of directors to present the merger agreement to the shareholders' vote regardless of whether they continue to recommend the transaction, and a voting agreement with the two majority shareholders, also on the board, whom would vote for the transaction. Id.

The critical facts of Omnicare are as follows: In 2001, because of a period of financial deterioration and a possible bankruptcy, the board of directors of NCS sought out a possible merger with Omnicare. Id. at 921. After two inadequate proposals and a slight financial improvement, NCS contacted Genesis to pursue a stalking horse strategy to increase the value of Omnicare's bid. Id. at 921-22. Rather than making a stalking horse bid, Genesis made a serious offer for the purchase of NCS. Id. Subsequently, Omnicare improved its bid contingent upon the completion of due diligence, a provision that carried with it too much risk so the NCS board declined. Id. at 924. Despite the NCS board's declining the offer from Omnicare, the offer was used as leverage to obtain a substantially improved offer from Genesis. Id. Genesis's improved offer was contingent upon NCS's

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<sup>1</sup> An accomplished fact.

acceptance within 24 hours and the inclusion of various deal protection devices, including the Section 251 (c) provision and the shareholder voting agreements, while excluding a fiduciary out clause. Id. at 924-26. The board agreed to Genesis's terms and voted to recommend the merger to the shareholders. Id. at 925. Between the execution of the merger agreement by the board and its being voted on by the shareholders, Omnicare made a superior offer that caused the board to withdraw their recommendation, however, due to the defensive devices, the merger was predetermined. Id. at 927.

The facts of the BTRta merger are nearly identical to the NCS merger. Here, BTRta-like NCS-initiated the transaction with the bidding companies. In Omnicare, the NCS board solicited bids because of the corporation's insolvency. In this case, the two founding owners of BTRta wanted to sell the company because they no longer desired to manage and control a public company. Consolidated Forest Products, Inc., C.A. No. 6947, 7. In this case, Ravert made an offer to BTRta conditioned upon the inclusion of several defensive devices, two of which were a Section 146 provision and a shareholder voting agreement that the two majority shareholders would vote all their shares of stock for the merger. Section 146 of Delaware General Corporate Law is the same provision as the earlier Section 251 (c) which was employed in Omnicare requiring the merger agreement to be put to a vote even if the board no longer recommended the transaction. Because the merger contained the Section 146 provision and the voting agreement, the BTRta merger, like the NCS agreement, was a fait accompli. The merger agreement also failed to include an effective fiduciary out clause.

Thus, in BTRta, the merger agreement contained the same three-prong defense as the merger in Omnicare. For this reason, a subsequent offer by the competing bid would be ineffective even if the board withdrew its recommendation of the merger with Ravert because the success of the merger was predetermined. Accordingly, here as was the case in Omnicare, the merger agreement is a breach of the fiduciary duties owed to the minority shareholders, and is invalid.

**2. The defensive devices used in the BTRta merger are Per Se invalid because Omnicare properly held that such devices are invalid.**

Generally, the board of directors is given broad discretion in its management of the affairs of a corporation under the business judgment rule. "The effect of a proper invocation of the business judgment rule as a standard of judicial review, is powerful because it operates deferentially. Unless the procedural presumption of the business judgment rule is rebutted, a court will not substitute its judgment for that of the board if the board's decision can be attributed to any rational purpose." Id. at 928 (quoting Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (citations omitted)).

There are situations, however, where a court will apply a heightened scrutiny "before the protections of the business judgment rule may be conferred." Id. (quoting Paramount Communications Inc. v. QVC Network Inc., 673 A.2d 34, 42 (Del. 1993)). This is "because of the omnipresent specter that the board may be acting primarily in its own interest, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial

examination at the threshold before the protections of the business judgment rule may be conferred.” Id. (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985)).

Situations where heightened scrutiny will be applied include, among others: “when a board adopts defensive measures in response to a hostile takeover proposal . . . where the board adopts a shareholder’s rights plan, even in the absence of an immediate threat” and those situations which give rise to the Revlon duty. Id. at 928.

In Omnicare, this Court assumed *arguendo* that the business judgment rule applied to the board’s decision to merge but applied a heightened scrutiny to the defensive devices which were in the merger agreement. Id. at 929-31. Heightened scrutiny was necessary because “[t]here are inherent conflicts between a board’s interest in protecting a merger transaction it has approved, the stockholders right to make the final decision to either approve or not approve a merger, and the board’s continuing responsibility to effectively exercise its fiduciary duties at all times after the merger is executed.” Id. at 931.

Omnicare was not the first case to apply enhanced scrutiny to protective devices. Id. at 931. In Paramount Communications, Inc. v. Time Inc., this Court held that “the business judgment rule applied to the Time board’s original decision to merge with Warner . . . however, [the] defensive devices adopted by the board to protect the original merger transaction must withstand enhanced judicial scrutiny under the Unocal standard of review, even when that merger does not result in the change of control.” Id. (citing Time, 571 A.2d 1140, 1151-55 (Del.

1989)). This Court held that decision to purchase Warner's stock and to reject Paramount's tender offer was valid under the business judgment rule. Time, 571 A.2d at 1154-55. This Court further held that the defensive devices met the requirements of Unocal because they were put in place to ensure the consummation of the merger were not preclusive because Paramount was not barred from attempting a hostile takeover of Time after Warner's stock had be purchased by Time. Id.

Heightened scrutiny uses a two-part test, which was first developed in Unocal, that requires the directors to "demonstrate 'that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed,'" id. at 935 (quoting Unoca, 493 A.2d at 955), and that their "defensive response was 'reasonable in relation to the threat posed.'" Id. In Unocal, this Court held that the board of directors' decision to engage in a selective stock exchange, which excluded the shareholder that was attempting a corporate takeover, was within the board's authority because the board was responding to what it reasonably believed was a threat based upon a good faith and reasonable investigation, and the action taken to protect the corporation was in proportion to the threat posed to the corporation. 493 A.2d at 958.

This Court did caution, however, that not all devices used to protect corporations will be deemed proportionate to the threat to the corporation. This court in Unical, stated that although the "directors have a fiduciary duty to act in the best interests of the corporation's stockholders . . . such powers are not absolute. A

corporation does not have unbridled discretion to defeat any perceived threat by any draconian means available." Id. at 955.

In Unitrin, this Court explained that whether the defensive device used is proportionate requires another two-step process. First the court must determine whether the device used is draconian and if not whether it is within the range of reasonableness. Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1387-88 (Del. 1995). "The court stated that defensive measures which are either preclusive or coercive are within the common law definition of draconian." Id. This Court held that enhanced scrutiny applied to Unitrin's use of defensive devices (the board adopted a poison pill and implemented a repurchase program) to deter American General's corporate takeover but, those devices were not preclusive or coercive because although they did make a takeover more difficult it was still possible. Id. at 1390, 1391.

In Omnicare, this Court appropriately applied the heightened Unocal scrutiny. The first clear use of heightened scrutiny in this context was Time. In Omnicare, this Court applied heightened scrutiny to defensive devices while applying the business judgment rule (at least for the sake of argument) to the decision to merge. This was consistent with Time. Where the two cases differ is the result of the application of the Unocal test. The merger agreement between NCS and Genesis was preclusive and coercive because it robbed the shareholders of the effectiveness of a choice between a merger with Genesis or Omnicare. In Time, however, the board's purchase of Warner stock despite Paramount's attempt to takeover Time was not preclusive or coercive because Paramount could have still taken over Time.

Accordingly, the use of heightened scrutiny was appropriate in Omnicare, but in that case the board did not overcome their burden.

The devices used failed the proportionality prong of the heightened scrutiny when compared with Unitrin. In Omnicare the sale of NCS to Omnicare became impossible when the board agreed to the defensive mechanisms and the merger with Genesis. Because the completion of the deal was predetermined, the devices were properly labeled preclusive and coercive because unlike Unitrin, where the deal could still have gone through but would have to be more costly, the merger with Genesis could not be stopped. The devices used made the merger a fait accompli and there was no ability to withdraw because the agreement lacked a fiduciary out clause.

After holding that the defensive devices were unenforceable because they were preclusive and coercive, this Court "alternatively found that the defensive measures were invalid because they prevented the NCS board from continuing to exercise its fiduciary duties to NCS stockholders." Edward P. Welch et al., *Folk on the Delaware General Corporation Law IV*, 102-03 (5<sup>th</sup> ed. 2006). A board's fiduciary duties to the corporation and its shareholders continue after the execution of a merger agreement. Omnicare, 818 A.2d at 938. As circumstances develop, the board must be able to execute their fiduciary obligations and insure that a particular course is in the best interest of the corporation and shareholders. Id. By putting in place protective devices that disabled the board's ability to cope with changing circumstances, the board breached its fiduciary duties. Id.

Here, the BTRta board also put in place protective devices that did not allow it to accept an offer that would be in the corporation's best interest. By precluding any adjustments to the agreement, the BTRta board, like the Omnicare board, breached their fiduciary duties.

**3. The defensive devices used in the BTRta merger are invalid because they are contrary to public policy in that they hurt the economic interests of the shareholders and overturning Omnicare would violate the doctrine of stare decisis.**

"The 'defining tension' in corporate governance today has been characterized as 'the tension between deference to directors' decision and the scope of judicial review.'" Omnicare, 818 A.2d at 927 (quoting E. Norman Veasey, *The Defining Tension in corporate Governance in America* 52 Bus. Law. 393, 403 (1997)). The time-tested business judgment rule is still alive and well in Delaware, but, as discussed above, there are certain factual circumstances where the board's decisions will be subject to a heightened scrutiny.

The Omnicare rule is necessary to protect the interests of the shareholders because deal protection devices that completely lock up the transaction will reduce the value of the transaction. In Omnicare, Genesis had recently lost a bidding war to Omnicare and was faced with losing another acquisition so it required the implementation of deal protection devices to be inserted in the transaction and NCS only had 24 hours to accept. Omnicare, 818 A.2d at 923, 925-26. NCS was forced to accept the deal without allowing Omnicare to make a better offer. Thus, when they did make an improved offer, the deal was locked up and although the board no longer recommended the transaction, it could not be stopped. Id. at 927. Some scholars would argue that the deal

protection devices that result in lock-ups increase value because companies will increase their offer for security. See Christina M. Sautter, *Rethinking Contractual Limits on Fiduciary Duties* 38 Fla. St. U. L. Rev. 55, 97-98, n. 252 (2010). The logic behind this argument is flawed as is evident from the facts of Omnicare. The very point of the devices is to stop or avoid a bidding war which would increase the value to the shareholders.

Here, BTRta had an offer for CFI for \$17 per share but pulled out of that deal for an offer from Ravert. Initially, Ravert offered \$13 per share, but increased their bid to \$15.50 contingent on BTRta's acceptance of defensive devices which completely locked up the transaction. Because BTRta's board accepted these devices, they would be unable to accept later offers from CFI at an even higher price, or to attempt to get more value from Ravert. The security of the transaction did not have the effect of increasing the value to shareholders, but rather, halted the ability to receive more value for their shares.

The decision in Omnicare should not be overturned, but rather, limited to the particular circumstances which it covers. Former Chief Justice Veasey, one of the two dissenting justices in Omnicare, states that "when critiquing the case law and forming an opinion about whether our jurisprudence has set forth the ideal set of standards of review, or otherwise questioning whether a particular decision was the 'right' one, it is important to bear in mind the doctrine of stare decisis." E. Norman Veasey, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key*

*Developments* 153 U. Pa. L. Rev. 1399, 1409 (2005). In 1985 the Delaware Supreme Court expanded on the doctrine of stare decisis:

Once a point of law has been settled by decision of this Court, "it forms a precedent which is not afterwards to be departed from or lightly overruled or set aside...and [it] should be followed except for urgent reasons and upon clear manifestation of error.: The need for stability and continuity in the law and respect for court precedent are the principles upon which the doctrine of stare decisis is founded. In determining whether stare decisis applies, this Court should examine whether there is: "a judicial opinion by the [C]ourt, on a point of law, expressed in a final decision." The doctrine of stare decisis operates to fix a specific legal result to facts in a pending case based in a judicial precedent directed to identical or similar facts in a previous case in the same court or one higher in the judicial hierarchy. Id. at 1410 (quoting Account v. Hilton Hotels Corp., 780 A.2d 245, 248 (Del 2001)).

In the context of corporate law, stare decisis is important because of the "Delaware courts' role in defining corporation law and in preserving stability and predictability in corporate jurisprudence." Id. Cases which draw significant criticism, such as Omnicare, should not be freely overturned, but rather, their reach should be limited. Id.

It is possible to uphold Omnicare while limiting its reach to the deal protection combination used. In Orman v. Cullman, the Court of Chancery held that the deal protection devices were valid because they provided an effective and meaningful fiduciary out. They required the majority shareholders to vote for the merger and against any alternative proposal, but the deal included the requirement that the majority of the minority also approve the merger. 2004 WL 2348395, 8 (Del. Ch.). This gave the minority shareholders veto power over the merger. Because the minority shareholders could vote down the

agreement, it was not a mathematical certainty and did not violate the rule in Omnicare. Id.

Here, the facts are nearly identical to those of Omnicare. Both the BTRta merger and the NCS merger used the same deal protection devices. In both cases those devices resulted in negotiations being stalled because they were completely preclusive and coercive. Once the devices were in place, there was no possible way of avoiding the merger based on the continuing existence of fiduciary duties because of the total lack of a fiduciary out clause. Further, the BTRta transaction did not have a provision such as the one in Orman which allowed the minority of the shareholders to reject the transaction. The fact that the devices in this case were identical to those in Omnicare and lacking any effective fiduciary out clause such as the one in Orman made the agreement completely locked up.

The rule in Omnicare should be upheld on the basis of stare decisis because it presents a valid and workable precedent that can be limited rather than overturned. Omnicare creates a clear rule that says if the devices employed make the merger a certainty, there must be some fiduciary out clause. Orman shows that the Omnicare rule can be narrowly read to both allow merging companies to reduce the risk of a transaction but still provides corporate boards guidance against going too far. However, in this case, the BTRta merger was identical to Omnicare.

#### **CONCLUSION**

For the forgoing reasons, this Court should affirm the decision of the Chancery Court order because it was correct as a matter of law.