

IN THE SUPREME COURT OF THE STATE OF DELAWARE

CALLISON INC.,
a Delaware corporation,
TIMOTHY MICHAELS, CLARE
LIEBERMAN, RHANEY PATRICKS,
JULIO LUIS-ROJAS, PATRICK
AUSTIN, MARSHA FRANKLIN, ARI
SINGH, and ALLEN ENTERPRISES
INC., a Delaware corporation

Defendants Below,
Appellants

v.

GALENA CAPITAL PARTNERS, LLC
a Delaware corporation

Plaintiff Below,
Appellee

No. 162, 2013

On Appeal from the
Court of Chancery of the
State of Delaware in and
for New Castle County

C.A. No. 7918-CN

APPELLEE'S ANSWERING BRIEF ON APPEAL

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NATURE OF PROCEEDINGS

The present action was commenced in the Court of Chancery on December 21, 2012 by Plaintiff Galena Capital Partners, LLC ("Galena") against defendants (1) Callison Inc. ("Callison"); (2) members of Callison's board of directors: Timothy Michaels, Clare Lieberman, Rhaney Patricks, Julio Luis-Rojas, Patrick Austin, Marsha Franklin, and Ari Singh (collectively "the Board"); and (3) Allen Enterprises Inc. ("Allen").

On December 21, Galena moved for a preliminary injunction preventing Callison from enforcing the Don't Ask, Don't Waive standstill provision ("DADW") and allowing Galena to proceed with its tender offer and subsequent cash-out merger. In a thoughtful opinion issued on January 14, 2013, Chancellor Aaron Nelson granted Galena's motion for a preliminary injunction. The Chancellor reasoned that the DADW violated the Callison Board's *Revlon* duty to maximize value. On January 15, an order enjoining Callison, Allen, and the Board from enforcing the DADW or preventing Galena's tender offer was entered.

Defendants appealed the interlocutory order on January 23 pursuant to Supreme Court Rule 42, and appeal was granted by Justices Ridgely, Jacobs, and Vice Chancellor Noble on January 25.

This is Appellee Galena's opening brief.

STATEMENT OF FACTS

Allen's interest in immediate liquidity. The events giving rise to this litigation began with Allen Enterprises, a 72% shareholder in Callison, Op. 2, whose executives comprise a majority of Callison's Board. Op. 3. In the summer of 2012, Allen's management began

contemplating the acquisition of a major restaurant chain. Op. 3-4. It recognized that to do so, it would need to liquidate its 72% stake in Callison. *Id.* By October 2012, Allen had set its sights on Ca' Foscari Italian Grill ("Ca' Foscari") and authorized its investment bankers to approach Callison to discuss liquidating its shares. Op. 4.

The Callison Board, led by a four-person majority constituting Allen executives Timothy Michaels (Allen VP-Finance), Clare Lieberman (Allan VP-Operations), Rhaneey Patricks (Allen Chief Information Officer), and Julio Luis-Rojas (Allen Assistant VP), Op. 3, considered this development on October 12. Op. 4. At that meeting, the Board unanimously agreed to create a Special Committee of the three independent directors (Patrick Austin; Marsha Franklin; and Ari Singh. Op. 3) and to delegate to it full authority and negotiating power to undertake a potential sale of the company. Op. 5. Although the Special Committee could act independently in some respects, the ultimate determination of a merger was to be approved by the full Board. Op. 6.

With the Special Committee in place, Allen turned its attention to acquiring Ca' Foscari. See Op. 5-6. By November 28, Allen had entered a merger agreement with FVP Restaurants, Ca' Foscari's owner. *Id.* The terms of that agreement ("Ca' Foscari Agreement") are as follows: (1) Allen would acquire Ca' Foscari in its entirety for \$2.4 billion in cash; (2) the deal closing must occur by March 31, 2012; and (3) either party that breaches the agreement must pay a break-up fee of \$60 million. Op. 6. The district court noted that Allen's contractual obligations under the Ca' Foscari Agreement placed "greater urgency on Allen's ability to monetize its 72% stake" in

Callison. *Id.* The agreement contained no financing provision, and thus Allen would be liable for the \$60 million break-up fee unless it could raise \$2.4 billion in capital by March 2013. *Id.*

The sealed-bid auction. The Special Committee "recognized the practical reality that Allen could block any potential transaction" not in Allen's "best interest." Op. 6-7. The Committee therefore set out to create an auction process that Allen would not oppose. Op. 7. It also considered the potential impact of a "protracted auction" on the Callison company and its shareholders, particularly the possibility of "demoralizing key employees and jeopardizing future long term commitments with important Callison customers like Kohl's and Target." Op. 7.

At an October 20 meeting, the Special Committee decided to conduct a first-price, sealed-bid auction. *Id.* To accomplish this, the Committee instructed its investment bankers to canvas "a limited universe of at most 20 logical potential buyers." *Id.* Those that wished to bid would be compelled to sign a Don't Ask, Don't Waive standstill provision ("DADW") prior to receiving Callison's confidential information and conducting due diligence. *Id.*

Pursuant to the DADW, any bidder for Callison was permitted to make only a single bid. Op. 8. Bidders were thereafter contractually barred from making another bid, either publicly or privately, and from requesting that the Board waive the DADW. *Id.* In theory, this would encourage the DADW bidders to put forth their "only, best and final offer." *Id.* (Whether that is true is the subject of this litigation).

Any deal emerging from the auction was subject to a fiduciary out: if the Callison Board determined in good faith, during a limited market check that a "superior proposal" was available, it could terminate the merger subject to a 3% break-up fee. Op. 8-9. The post-signing market check would consist of a 25-day Go Shop period, followed by a 15-day Window Shop period. Op. 9. At no point would a DADW bidder be permitted to submit a new offer. *Id.*

Through October and November, Callison's investment bankers contacted twenty potential acquirers. Op. 10. Seven expressed interest in bidding, and six agreed to sign the DADWs and proceed to auction. *Id.* The DADW bidders submitted their bids on December 14. *Id.* The Special Committee immediately reviewed those bids: Vicente Capital Inc.'s ("Vicente") bid of \$34 per share all-cash was highest, followed by Galena's bid of \$32.50. Op. 11. The investment bankers then delivered a favorable fairness opinion to the Special Committee (the Vicente offer represented a 26% premium over the unaffected trading price for Callison's common stock) and the Committee voted to recommend the Vicente offer to the full Board. *Id.* The Board accepted the offer that same evening, and Vicente launched its tender offer. Op. 11-12. The tender offer was worth \$2.9 billion. Op. 13. Allen would receive just north of \$2 billion for its shares, nearly enough to finance its acquisition of Ca' Foscari. *See id.*

The Board ignores Galena's topping bid. On December 19, Galena approached the Board and asked it to waive the DADW so that it could increase its offer to \$35.50 per share. Op. 15. That offer exceeded the Vicente agreement by \$1.50 per share, or a total \$128 million (a

4.4% premium over the Vicente agreement). *Id.* Galena explained its belief that the DADW was likely unenforceable under Delaware law. *Id.* Nevertheless, after receiving a legal opinion stating that the DADW “likely would be upheld,” the Board refused Galena’s waiver request. Op. 16. It also ordered Galena to “cease all further communication with Callison” and its advisors. *Id.* In the meantime, Callison’s investment bankers canvassed the market pursuant to the Go Shop period, but were unable to find an interested buyer. Op. 15.

On December 21, Galena filed this lawsuit and simultaneously launched an all-cash, all-shares tender offer for Callison shares at its proposed price of \$35.50 per share. Op. 16. Galena challenged the validity of the DADW both under *Revlon*’s enhanced scrutiny and *McMullin v. Beran*’s entire fairness standard. The Go Shop and Window Shop periods have now closed. Galena’s tender offer is the sole competing offer to the Vicente agreement.

SUMMARY OF ARGUMENT

I. The Board violated its duties of care and loyalty under *Revlon* by failing to accept Galena’s superior offer. The *Revlon* duty to seek the highest price was triggered the moment the Board decided to sell control of Callison to a third party. Galena contends that the DADW was a *per se* violation of *Revlon* for three reasons: (i) DADWs prevent a board from satisfying its duty to remain informed of relevant information; (ii) DADWs are inherently unlikely to maximize value because DADW bidders bid only a fraction of their true value; and (iii) DADWs render post-signing market checks and fiduciary outs meaningless.

Even if this Court is unwilling to declare DADWs *per se* invalid, the DADW was misapplied in these particular circumstances for two reasons: (i) these facts do not fall within a limited range of circumstances in which a DADW *might* be required to entice "tired bidders" to offer a final bid; and (ii) the Callison Board neither attempted to, nor *could*, mitigate the harmful effects of the DADW by disclosing its use to the shareholders. The DADW was therefore invalid under *Revlon* and affirmance is warranted.

II. Alternatively, the sale of Callison fails under the entire fairness standard in *McMullin v. Beran*. The entire fairness standard applies because Allen had a financial interest in the transaction and the Board had a conflict of interest because a majority of directors are controlled by Allen, which rebuts the business judgment rule. The DADW fails under this standard because there was no fair process given that the sale was a rushed sealed-bid auction calculated to generate the *earliest* offer, with continued involvement by a conflicted board.

Finally, this Court should not overrule *McMullin*. *McMullin's* entire fairness standard protects minority shareholders. As this case demonstrates, a majority shareholder's interests may not be aligned with the minority shareholder's interest in maximizing value, particularly in a liquidity crisis. The Callison board failed to protect its minority shareholders because a majority of directors were controlled by Allen. As such, without *McMullin's* entire fairness standard, Allen and the Board would be able to hide behind the business judgment rule, leaving the minority shareholders helpless.

ARGUMENT

I. The Callison Board's Use of the DADW Provisions Violated Its Fiduciary Duties Under Revlon's Enhanced Scrutiny.

A. First Question Presented

Whether the Callison Board violated its duties of care and loyalty under *Revlon* when it required bidders in its sealed-bid auction to sign Don't Ask, Don't Waive standstill agreements, either as a *per se* matter or due to these particular circumstances.

B. Scope of Review

On appeal from a preliminary injunction, this Court reviews the lower court's order for abuse of discretion but does not defer to its legal conclusions. *SI Mgmt. L.P. v. Wininger*, 707 A.2d 37, 40 (Del. 1998).

C. Merits of Argument

The Chancery Court has recently called the validity of Don't Ask, Don't Waive standstill provisions ("DADW") into question. *See, e.g., In re RehabCare Grp., Inc. S'Holder Litig.*, C.A. No. 6197 VCL, Bench Ruling Tr. at 46 (Del. Ch. Sept. 8, 2011) (expressing doubt that DADWs are "ever going to hold up if it's actually litigated, particularly after *Topps*"); *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007) ("[S]tandstills are [] subject to abuse."). This case provides an opportunity for the Court to protect minority shareholders by invalidating DADWs. Galena makes three points supporting its *Revlon* theory: (1) this is a sale of corporate control, and thus is governed by *Revlon*; (2) DADWs such as the one in this case violate *Revlon* as a *per se* matter because they are unlikely to ever maximize value; and (3) in the alternative, this *particular* DADW provision is a *Revlon*

violation because it does not fall within a limited range of circumstances that arguably make a DADW permissible.

1. Revlon's enhanced scrutiny applies and required the Board to maximize value for the shareholders.

This case involves a sale of corporate control - cash for stock. As such, it is governed by this Court's seminal opinion in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); see *Paramount Commc'ns, Inc. v. QVC Network Inc.*, 637 A.2d 34, 44 (Del. 1994) (holding that *Revlon's* enhanced scrutiny standard applies when the board undertakes a transaction for change of corporate control). *Revlon* is a departure from the default business judgment rule, which states that "[u]nder normal circumstances, neither the courts nor the stockholders should interfere with the managerial decisions of the directors." *QVC*, 637 A.2d at 42. Instead, in a *Revlon* situation the board must seek to maximize value. That is, it must pursue the highest possible price per share. *Revlon*, 506 A.2d at 182.

2. DADW standstill agreements are per se invalid because they do not maximize value for shareholders.

A DADW standstill provision bars a bidder both from making a topping bid and from requesting a waiver to do so. This is a *per se* *Revlon* violation because: (i) DADWs violate the duty to be informed; (ii) they violate the duty to maximize value for shareholders; and (iii) they render post-signing fiduciary outs ineffective.

i. DADWs are always a breach of the duty of care to remain informed because they render the board willfully blind.

A board's duty of care requires that it remain informed of matters that bear on corporate and shareholder welfare. *Phelps Dodge*

Corp. v. Cyprus Amax Minerals Corp., C.A. No. 7398, 1999 WL 1054255, at *1 (Del. Ch. Sept. 27, 1999) (“Under our law, a board of directors must be informed of all material information reasonably available.”); see also *Stone v. Ritter*, 911 A.2d 362, 370 (Del.2006) (holding that directors may not “disabl[e] themselves from being informed of risks or problems requiring their attention”). The Chancery Court has held that “[e]ven the decision not to negotiate...must be an informed one” and that the board “should not have completely foreclosed the opportunity” to negotiate with a third party. *Phelps Dodge*, 1999 WL 1054255, at *1 (quoted by *Ace Ltd. v. Capital Re Corp.*, 747 A.2d 95, 108 n.46 (Del. Ch. 1999)).

But DADWs have the opposite effect: they *prevent* a board from staying informed about the highest price an acquirer is willing to pay. This case is a perfect example. When Galena made its topping bid of \$35.50, the Callison Board ignored it. The Board refused to consider the offer and instructed Galena to “cease all further communication with Callison and/or its advisors.” Op. 16. By severing negotiations with Galena—when it knew that Galena was offering a substantially better value to the shareholders (The \$35.50 offer was a 4.4%/\$128 million increase over the Vicente offer. *Id.*)—the Callison Board rendered itself willfully blind to a serious *Revlon* problem.

The Chancery Court has recognized as much. In *In re Topps*, the court enjoined the shareholder vote until the target board waived the DADW as to a potential acquirer. 926 A.2d at 92. And in *In re Complete Genomics, Inc. Shareholder Litigation*, the Vice Chancellor held that a DADW was impermissible because it had “the same disabling effect as

the no-talk clause, although on a bidder specific basis.” C.A. No. 7888-VCL, Bench Ruling Tr. at 18 (Del. Ch. Nov. 27, 2012). “By agreeing to [the] provision, the Genomics board impermissibly limited its ongoing statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information, and make a meaningful merger recommendation to its stockholders.” *Id.* As one scholar has concluded, “a Delaware court is unlikely to uphold such a provision, particularly when it would result in the target’s board being willfully blind to alternative bids that may maximize stockholder value.”¹ The informational vacuum created by the DADWs was a violation of the Board’s duty to remain informed. And without staying informed of Galena’s highest possible bid, the Board neglected its *Revlon* duty to maximize value. That alone renders DADWs invalid.

ii. DADWs are always a breach of the duty of loyalty because they are inherently unlikely to result in the best price per share.

The basis for deferring to a corporate board (under the business judgment rule) is that each board is considered best suited to make decisions for the corporation because it best understands the circumstances and needs specific to that corporation. *Schoon v. Smith*, 953 A.2d 196, 207 (Del. 2008) (internal citations omitted). What works for Wal-Mart may not work for Microsoft. But what happens when a particular corporate strategy is unlikely to ever benefit a corporation’s shareholders, regardless of which corporation is at issue?

¹ Christina M. Sautter, *Promises Made to Be Broken? Standstill Agreements in Change of Control Transactions*, 38 DEL. J. CORP. L. 1, 41 (forthcoming 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2020828.

Galena submits that when a board implements such a strategy, it is never entitled to deference. Rather, it is always an exercise of poor business judgment and a violation of Revlon. DADWs are such a losing strategy. Game theory and sound economic analysis suggest that bidders in sealed-bid auctions—such as the one here—will *not* offer a bid reflecting the highest value they are willing to pay. This is for fear of “winner’s curse,” a phenomenon that occurs when a winning bidder realizes that it paid more than was necessary to acquire the target.² As a result, sophisticated bidders in a sealed-bid auction actually *underbid* what they are ultimately willing to pay, in order to avoid winner’s curse; as studies have shown, the optimal bidding strategy in a sealed-bid auction is to bid some “fraction” of the bidders true value.³

The winner’s curse is eliminated in open auctions,⁴ where each bidder can see all of the bids and can submit topping bids. A bidder only drops out of an auction when the amount required to win is greater than its value. Thus, in an open auction with a number of participants, the winner will pay some price higher than the value of

² Warren J. Hahn & Samuel L. Seaman, *The Winner’s Curse and Optimal Auction Bidding Strategies*, 12 GRAZIANO BUS. REV. (2009), available at <http://gbr.pepperdine.edu/2010/08/the-winners-curse-and-optimal-auction-bidding-strategies/>.

³ See *id.*

⁴ The effect of winner’s curse is also lessened in Vickrey Auctions. In a Vickrey Auction, participants submit a single, sealed bid. But the winner does not pay the value of its bid; rather, it pays the value of the second-highest bid. The result is that the winner is assured of paying less than its value, and therefore bids its value without fear of winner’s curse. Avinash K. Dixit & Barry J. Nalebuff, *The Art of Strategy: A Game Theorist’s Guide to Success in Business and Life*, 305-07 (W.W. Norton 2010). Yet the Board did not choose to use a Vickrey Auction, and instead chose a value-impeding process.

the second-highest bidder. Consistent with this principle, studies⁵ have shown that open auctions are likely to produce greater revenue than sealed-bid auctions, so long as the bidders are sophisticated (which these corporate bidders are).⁶

If, as Appellants claim, a DADW were properly designed to elicit the single highest price a bidder was willing to pay, we should expect that a DADW bidder would not later submit a topping bid. After all, a rational bidder will not bid more than its value. Yet case after case proves this expectation is false; bidders *repeatedly* attempt to make topping bids in spite of the DADWs they signed. This occurred in this case as well as in a plethora of Delaware cases in the past year alone. See, e.g., *In re Ancestry.com S'Holder Litig.*, C. A. No. 7988-CS, Bench Ruling (Del. Ch. Dec. 17, 2012); *Complete Genomics*, C.A. No. 7888-VCL; *In re Celera Corp. S'Holder Litig.*, C.A. No. 6304-VCP, 2012 WL 1020471 (Del. Ch. Mar. 23, 2012). DADWs therefore must not be functioning in the way Appellants suggest, and do not encourage value-bidding. Because they are not reasonably designed to fetch the best price, DADWs always fail *Revlon*.

iii. A market check cannot solve these problems because the DADW excludes prior bidders and skews the market.

In the past, boards have utilized post-signing market checks to cure potential *Revlon* problems. See, e.g., *In re MONY Grp. Inc.*

⁵ John H. Kagel & Dan Levin, *Common Value Auctions and the Winner's Curse: Lessons from the Economics Laboratory*, THE ECON. OF RISK, at 32 (2003), available at www.econ.ohio-state.edu/kagel/CVsurvey.short.PDF ("[Open] auctions raise more revenue than do sealed-bid auctions").

⁶ It is irrelevant that the Vicente bid was a 26% premium over Callison's unaffected trading price per share, Op. 11 n.7, or that the investment bankers offered a positive fairness opinion. Op. 7. *Revlon* required that the Board obtain the *highest* price per share, not merely a better price than what the shares were currently trading at.

S'Holder Litig., 852 A.2d 9, 22 (Del. Ch. 2004). The theory is that a market check ensures that the preceding auction actually resulted in an optimal price per share - if a potential acquirer in the open market is willing to pay a higher value, it can come forward during the market check. *Id.* (holding that five-month market check was "adequate time for a competing bidder to emerge and complete its due diligence"). But although the Board performed a post-signing market check in this case, the DADWs rendered that market check functionally meaningless.

That is because, following the sealed-bid auction and the imposition of the DADWs, the only probable acquirers were contractually barred from making a topping bid, either publicly or privately. Op. 8. The Callison Board had already approached the twenty likeliest purchasers prior to the sealed-bid auction. Op. 10. Those six that chose to bid were compelled to sign the DADW; otherwise they could not participate in the auction. *Id.* As a result, the six bidders most likely to maximize the price per share were forbidden to make a topping bid during the market check, a process that was supposedly *designed* to elicit value-maximizing topping bids. The DADWs therefore rendered the market check a pointless exercise.

Theoretically, there were potential acquirers in the open market that the Callison Board had not approached prior to the sealed-bid auction. While this is possible, it is unlikely that any could offer a topping bid that would defeat the margin created by the 3% break-up

fee.⁷ Even in the absence of a DADW, only 3 in 10 competing offers during pre-closing are successful. See Sautter, *supra*. That percentage is undoubtedly less when the previous bidders—who are the likeliest to want to bid again—are barred from making new offers.

A DADW combined with a break-up fee (even when the target is permitted to conduct a market check) is therefore similar to the combined DADW/no-talk provision that the Chancery Court thought would violate *Revlon* in *Celera Corp.*, 2012 WL 1020471, at *21, *rev'd in part on other grounds*, -- A.3d --, 2012 WL 6707736 (Del. Dec. 27, 2012) (noting that this combination of deal protection measures threatens to create "an informational vacuum," but not reaching the issue because the defendant-board waived the DADW). This Court should now hold that all DADWs are invalid.

3. Even if DADWs are not *per se* invalid, the DADW in this case was invalid given these particular circumstances.

Alternatively, if this Court were unwilling to declare DADWs *per se* invalid at this time, it should still invalidate their imposition under these particular circumstances.

i. The DADW was not used in the special category of circumstances that the Chancery Court has suggested may be permissible.

If ever a DADW could pass *Revlon*, it would be in a situation where it was necessary to elicit a *final* round of voting. Then-Vice Chancellor Strine left open this possibility in *In re Topps Co.*

⁷ There is actual evidence of this. During the Special Committee's preparation for the sealed-bid auction, it approached twenty potential acquirers. Op. 10. Seven initially expressed interest. *Id.* The seventh withdrew from bidding because it did not want to sign the DADW. *Id.* In theory, this seventh potential acquirer could have offered a bid during the market check. Yet it did not. This is likely due to the fact that if the seventh acquirer was not interested enough in bidding that it would sign the DADW, it lacked the capital to be a serious bidder in the first place. It was therefore unlikely to outbid the 3% break-up fee, which served as an added obstacle.

Shareholders Litigation, where he posited a "final round auction involving three credible, but now tired bidders, who emerged from a broad market canvas." 926 A.2d 58, 91 n.28 (Del. Ch. 2007). The court wrote that in such a circumstance, one could "imagine how a board striving in good faith to extract the last dollar they could for their stockholders might promise the three remaining bidders that at 8:00 p.m. on the next Friday they will get...a promise from the target not to waive the Standstill as to the lowers." *Id.*; accord *Ace Ltd.*, 747 A.2d 95, 107 n.36 (noting in dicta that a no-talk provision might be permissible in "limited circumstances," such as where "a board has actively canvassed the market, negotiated with various bidders in a *competitive environment*, and believes that the necessity to close a transaction requires that the sales contest end") (emphasis added).⁸

But that circumstance is not present here. There was never a protracted bidding war for Callison that required finality. Instead, the Board acted of its own self-interest (the same interest as Allen Enterprises)⁹ when it decided to adopt an auction process that would prioritize speed above best price. That is, the Board sought finality from the get-go, to the detriment of shareholders. This fails *Revlon* because *Revlon* does not elevate speed above value. It does the opposite.

⁸ Galena remains doubtful that even this hypothetical situation would justify use of a DADW. A target board could simply give the three "tired bidders" other assurances that the auction was coming to a close, without binding itself and jeopardizing shareholders. But to the extent this limited hypothetical justifies a DADW, it also lessens the informational concerns identified above. *Supra* § I.C.1.i. When a board has already engaged in prolonged negotiations with a number of bidders, it is better positioned to assess the best available value it might receive.

⁹ The Callison Board's conflict of interest presents a separate issue: whether the DADW fails entire fairness scrutiny. Galena argues below that the DADW, even if it survives *Revlon*, fails this strict scrutiny approach. *Infra* § II.

The Callison Board also reasoned that a "protracted auction" could "harm the Company and its stockholders by...demoralizing key employees and jeopardizing future long term commitments." Op. 7. This rationale was entirely improper. In *Revlon* itself, this Court held that once the sale of control process is underway, the board must stop pursuing the interests of various "corporate constituencies." 506 A.2d at 182. When an auction begins, the board's "object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder." *Id.* The Callison Board's focus was therefore misplaced when it sought to protect the company's long term interests, instead of maximizing shareholder value in the short term.¹⁰

ii. The harmful effects of a DADW are not mitigated by a disclosure to shareholders where, as here, there is a single controlling shareholder.

Nor can Appellants argue that disclosure could minimize the *Revlon*-defying effects of the DADWs. In *Ancestry.com*, the Vice Chancellor hesitated to invalidate the DADW on a *per se* basis¹¹ but nevertheless enjoined a shareholder vote on the merger until the board disclosed its use of the DADW on its proxy statement. C. A. No. 7988-CS, Tr. at 27-28 ("[T]he electorate should know that with respect to the comfort they should take in the ability to make a superior proposal, they should understand that there is a segment of the market where that segment cannot take advantage of that"). The Chancery Court

¹⁰ The minority shareholders could not have cared less about Callison's long term interests, as they would be cashed out well before those long term interests would ever be realized.

¹¹ The Vice Chancellor emphasized that "I'm giving you a bench ruling. Bench rulings are time limited...and because they're time-pressured, they shouldn't make broad law." C.A. No. 7988-CS, Tr. at 20. He cautioned, however, that directors should be "darn careful about [using DADWs]." *Id.* at 22.

elsewhere explained that undisclosed standstill agreements "threaten[] the [] shareholders with making an important decision on an uninformed basis." *In re Topps*, 926 A.2d at 92.

Yet disclosure will not solve the problem here. Allen Enterprises is a 72% controlling shareholder in Callison, Op. 2; and Allen executives comprise a majority of the Callison Board. Op. 3. Disclosure of the DADW therefore does nothing to protect the *minority* shareholders from the DADW's value-minimizing properties. A disclosure would merely alert Allen to what it already well knows. And if the minority shareholders wished to reject the merger because it was tainted by the DADW, they would be powerless to do so - Allen's "yes" vote is inevitable and will control. See *In re Santa Fe Pac. Corp. S'Holder Litig.*, 669 A.2d 59, 68 (Del. 1995) ("Board action which coerces stockholders to accede to a transaction to which they otherwise would not agree is problematic.") (quoting *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1154 (Del. 1990)). Accordingly, the lower court correctly invalidated the DADW.

II. The Callison Board's Conflict of Interest Triggered McMullin's Entire Fairness Standard, Which Is Violated Because of the Absence of Fair Process.

A. Second Question Presented

Whether the Callison Board's use of the DADW during its rushed sealed-bid auction—designed to satisfy Allen's need for liquidity—violates the entire fairness standard under *McMullin*.

B. Scope of Review

On appeal from a preliminary injunction, this Court reviews the lower court's order for abuse of discretion but does not defer to its legal conclusions. *SE Mgmt. L.P. v. Winger*, 707 A.2d 37 (Del. 1998).

C. Merits of Argument

The sale of Callison is subject to strict scrutiny because Allen had a financial interest in the transaction and a majority of Callison's Board was dominated by Allen. See *N.J. Carpenters Pension Fund v. Infogroup, Inc.*, C.A. No. 5334-VCN, 2011 WL 4825888 (Del. Ch. Oct. 6, 2011). The strict scrutiny standard applies if a majority of a corporation's directors had a financial interest in the transaction or were dominated by a materially interested director. *McMullin v. Beran*, 765 A.2d 910, 923 (Del. 2000). Under Delaware law, a majority shareholder is also a fiduciary and owes minority shareholders a duty of loyalty. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). Fiduciaries have a conflicting interest if they derive a personal financial benefit to the exclusion of the minority shareholders. *In re Synthes, Inc. S'Holder Litig.*, 50 A.3d 1022, 1033 (Del. Ch. 2012). Additionally, a director is dominated if she is "likely to be affected" by the controlling person or entity. *McMullin*, 765 A.2d at 923 (Del. 2000).

1. Allen's need for immediate liquidity created a financial benefit from the sale of Callison, resulting in a conflict of interest for the Board.

The possibility of receiving over \$2 billion in liquidity necessary to avoid paying the \$60 million break-up fee gave Allen a personal financial benefit from the sale of Callison not shared by all

shareholders. Delaware courts have repeatedly held that a majority shareholder's immediate need for liquidity is a material financial interest that is not equally shared with minority shareholders. *McMullin*, 765 A.2d at 921 (holding that majority shareholder's need for cash to fund a \$3.3 billion acquisition of another business was a personal financial interest "at the expense of" minority shareholders); *N.J. Carpenters Pension Fund*, 2011 WL 4825888, at *2 (holding that receiving \$100 million in cash from the sale of the corporation by a majority shareholder to pay off over \$25 million in personal and legal debts was a personal financial interest in the transaction). *But cf. In re Synthes, Inc.*, 50 A.3d at 1036 (finding no disabling personal interest when the majority shareholder was wealthy and did not immediately need to liquidate his shares for cash).

Allen's immediate need for liquidity gave it a "personal" financial benefit from the sale of Callison that was not equally shared with the minority shareholders. On November 28, 2012 Allen and FVP reached an agreement where Allen would buy Ca' Foscari for \$2.4 billion in cash by March 31, 2013; and, if it breached the merger agreement it would have to pay FVP a \$60 million break-up fee. Op. 6. Thus, by the time Allen reached this agreement with FVP it had less than three months to liquidate its shares. Op. 6. This three-month period is even less than the immediate need for cash within three years the court found sufficient to create a disabling personal interest in *New Jersey Carpenters Pension Fund*. 2011 WL 4825888, at *10. Allen could only receive cash for its shares if the entire company was sold. Op. 2-3. As a result, Allen prioritized liquidating

its shares before March 31 over getting the maximum value for Callison's shareholders. Because of Allen's immediate need for liquidity, the Allen executives on Callison's board had a personal financial interest in the sale that created a conflict of interest violating their duty of loyalty to minority shareholders.

2. Allen dominated a majority of Callison's Board.

Delaware courts have always held that directors who are nominated to the board and employed by the majority shareholder are not independent because their discretion is "sterilized." See *McMullin*, 765 A.2d at 923 (finding that a majority of Chemical's board was dominated by the majority shareholder because six of the twelve directors worked for and were nominated by the majority shareholder, and all were involved in the sale of the company). *But cf. In re CompuCom Sys., Inc. S'Holder Litig.*, C.A. No. 499-N, 2005 WL 2481325, at *8-9 (Del. Ch. Sept. 29, 2005) (finding a majority of the board was independent where none of the directors had any employment relationship with the majority shareholder at the time of the sale).

A majority of Callison's Board was dominated by Allen because four of the seven directors were not only nominated by it but are also executives at Allen. Op. 3. Furthermore, all four of these directors remained involved in the sale process: Although the board created a Special Committee comprised of the three independent directors to conduct negotiations, any sale had to be approved by the entire Callison board, including those directors who worked for Allen. Op. 5. Importantly, the Board also knew that Allen would veto any agreement not in its "best interest." Op. 6-7. As a result, while the Callison

Board could not realistically propose any alternative, it still had a duty to make a good faith independent judgment about whether the Vicente agreement maximized the value for minority shareholders. *McMullin*, 765 A.2d at 919. However, because a majority of the directors were dependent on Allen for both their position as director and employment as Allen management, their capacity to exercise that good faith judgment was compromised. The fact that there was minimal discussion of Galena's superior offer, and zero attempt to use that offer to elicit a higher price from Vicente, demonstrates that the Board made no good faith effort to maximize the price of Callison shares. Op. 10. Given that a majority of the Board was dependent on Allen for its employment and had ultimate approval of any sale, the Callison directors were dominated by Allen's desire to get its shares liquidated as soon as possible.

3. The Callison Board's imposition of the DADW and its abbreviated auction created an unfair process that fails the entire fairness standard.

The sale of Callison was not a fair process because Allen forced a fire sale that was calculated to generate the earliest offer, not the highest offer. Delaware courts have held that strict scrutiny, or entire fairness, has two parts. *McMullin*, 765 A.2d at 920. First, the court will examine whether the sale process was fair. *In re Synthes*, 50 A.3d at 1033-34. Second, the court will scrutinize whether the price paid to all shareholders was fair. *McMullin*, 765 A.2d at 920. In analyzing whether there was fair process, courts will look at a variety of factors including whether it was a patient, deliberative process; the independence of the board; and whether the process was

reasonably calculated to generate the highest offer. *In re Synthes*, 50 A.3d at 1033-34.

i. The use of the DADW during a rushed, sealed-bid auction was a fire sale.

Delaware courts have never found a patient, deliberative sales process where the sale was initiated by a majority shareholder with an urgent need for cash and the sales process lasted less than three months. When a majority shareholder initiates the sale process because of its urgent need for cash, courts scrutinize the length and quality of the board's deliberations. *Id.* at 1037 (finding there was no "fire sale" where the board initiated the sales process and negotiated with potential buyers for over a year); *see also In re CompuCom Sys.*, 2005 WL 2481325, at *7 (finding a patient, deliberative sales process where the board negotiated over two years and "exploited various strategic alternatives to maximize stockholder value"); *Van de Walle v. Unimation*, C.A. No. 7046, 1991 WL 29303, at *14 (Del. Ch. March 7, 1991) (holding no fire sale where directors led the eight-month market search and discussed the merger daily). *But see In re Answers Corp. S'holders Litig.*, C.A. No. 6170-VCN, 2012 WL 1253072, at *7-8 (Del. Ch. April 11, 2012) (finding a nine-month sales process unfair where the board rushed through the process to approve the majority shareholder's favored merger agreement before the company's stock market price rose above the offer price).

By any measure, Callison's three month sales process was a fire sale. The board rushed through the sales process from October to December to meet Allen's looming liquidity deadline of March 31, 2013. Op. 6. In fact, the entire purpose of the sale was to allow Allen to

cash out its shares as soon as possible. See *id.* During those three months the Special Committee met only three times, the entire Board deliberated over Vicente's offer for only a few hours, and the merger agreement was negotiated in two days. Op. 11-12. This minimal deliberation over such a short period of time does not come close to a "patient deliberative process" because the Board's focus was on reaching an agreement as soon as possible rather than working to reach the best agreement possible for Callison's minority shareholders. *In re CompuCom Sys.*, 2005 WL 2481325, at *7. Furthermore, there was only minimal discussion over whether the DADW provision would be upheld by Delaware courts and no attempt to use Galena's superior offer of \$35.50 per share to increase Vicente's offer. Op. 11-12. This demonstrates that the Callison Board was more focused on getting the deal done by March 31 rather than getting fair price.

ii. The use of the DADW was reasonably calculated to generate the earliest offer, not the highest offer for Callison.

While a board of directors had broad discretion in determining the sales process, Delaware courts have never held there was fair process if that process was not reasonably calculated to generate the highest offer. Courts look at a variety of factors in making this determination including whether the sale process discriminated against a class of buyers, *In re Synthes*, 50 A.3d at 1037, and whether the sale process allowed the board to accept any superior offer. *In re Answers Corp.*, 2012 WL 1253072, at *4.

A process that prevents the most logical buyers from making a superior offer is not a fair process. *Cf. In re Synthes*, 50 A.3d at

1037 (finding the sale process fair where the board approached all logical buyers "with wallets large enough" and attempted to negotiate an even higher offer with a consortium of private equity firms, making a "post-signing jumping bid" viable); *N.J. Carpenters Pension Fund*, 2011 WL 4825888, at *6 (finding the sales process unfair where the majority shareholder favored certain buyers during the negotiation process).

As discussed in Part I, Callison's use of a DADW in this circumstance prevented the class of buyers most likely to make a superior offer from doing so. *Supra* § I.C.2.iii. The DADW was signed by the only six parties seriously interested in acquiring Callison, making the viability of a "post-signing jumping bid" low because those buyers could not make a "topping bid." *In re Synthes*, 50 A.3d at 1037. While the alleged purpose of the DADW was to get buyers to put forward their "best and final" offer, in this case it prevented an extremely motivated buyer, Galena, from making a superior offer, and the Board from *accepting* a superior offer. Op. 15-16. The DADWs therefore were not reasonably calculated to generate the highest offer.

4. This Court should not overrule *McMullin v. Beran* because it protects minority shareholders from majority shareholder's and directors' conflicts of interest.

Appellants urge this Court to overturn *McMullin*. But "[o]nce 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." *Account v. Hilton Hotels Corp.*, 780 A.2d 245, 248 (Del. 2001).

As the present case illustrates, overruling *McMullin's* strict scrutiny standard would jeopardize minority shareholders whose interest in price maximization is no longer aligned with the majority shareholder's and directors' interests. During most sale transactions, majority and minority shareholders are both motivated to seek the highest price possible for their shares. *In re Synthes*, 50 A.3d at 1035. But as the sale of Callison demonstrates, during a liquidity crisis a majority shareholder's interest diverges from the minority's. Allen's main interest was getting cash for its shares before March 31, see Op. 6; it would sooner accept only \$34 per share and immediate liquidity rather than negotiate for \$35.50 (or more) per share and possibly miss its liquidation deadline. *Id.* As a result, Callison's minority shareholders were deprived of the maximum value per share the market was willing to pay. Furthermore, Callison's directors failed to protect minority shareholders because they were beholden to Allen's interests as a majority shareholder. Without scrutinizing whether the process and price were fair in liquidity crisis cases,¹² Callison's directors and Allen would be permitted to hide behind the business judgment rule. Thus, the court should not overrule *McMullin v. Beran*.

CONCLUSION

For these reasons, this Court should affirm the lower court and uphold the preliminary injunction.

¹² Two further points demonstrate the necessity of *McMullin* to protect minority shareholders: First, if this Court reaches the entire fairness question, it will have already decided that *Revlon's* protections do not invalidate the DADW, see Op. 25, thus leaving the minority shareholders vulnerable; second, *McMullin* currently protects minority shareholders in cases where *Revlon* is generally inapplicable; for instance, when the board has a conflict of interest but is not engaged in a sale of control. Shareholders are thus dependent upon the cloak of protection that Delaware law, through the *McMullin* decision, affords them.

COMPENDIUM TABLE OF CONTENTS

Pursuant to Delaware Supreme Court Rule 14, Appellee Galena has included with the brief a single compendium containing unpublished bench rulings of the Chancery Court that are not reasonably available on the internet or in legal research databases. See Del. Sup. Ct. R. 14(b)(vi)(B)(2) ("If an opinion or order which is unreported or not yet reported is cited, a copy thereof shall be attached to the brief, except that if the number of decisions is too numerous to attach, then the decisions may be bound in a separate compendium."). Please find attached the following decisions:

<i>In re Ancestry.com S'Holder Litig.</i> , C.A. No. 7988-CS, Bench Ruling (Del. Ch. Dec. 17, 2012)	C1
<i>In re Complete Genomics, Inc. S'Holder Litig.</i> , C.A. No. 7888-VCL, Bench Ruling (Del. Ch. Nov. 27, 2012)	C2