IN THE SUPREME COURT OF THE STATE OF DELAWARE

PRAISE VIDEO,INC., a Delaware Corporation, JACOB BISSINGER, FRANCIS PENNOCK, MARK VAN ZANDT, HOWARD METCALF, PETER HORNBERGER, NEW HOPEPUBLISHING CO., and PRAISE NEW HOPE CORP.,	)	No. 43, 2014
Defendants Below, Appellants,	)	
v.	)	On Appeal from the Court of Chancery of the State of Delaware C.A. No. 8784-CD
MERCER CHRISTIAN PUBLISHING CO. and SUSAN BEARD	)	
Plaintiffs Below, Appellees.	)	

APPELLANTS' BRIEF

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February 7, 2014

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NATURE OF THE PROCEEDINGS

This case comes before the Court on Defendants' appeal from the Court of Chancery decision. Plaintiffs-Appellees, Mercer Christian Publishing Co. and Susan Beard, brought suit against the Defendants-Appellants, Praise Video, Inc. et al., asserting that Appellants' breached their fiduciary duty to the stockholders in connection with the Board's (1) approval of a merger agreement with New Hope Publishing Co. in 2013 and (2) decision to grant a "crown jewel" option that would encourage shareholders to approve the merger. On January 14, 2014, the Court of Chancery found in favor of Appellees and granted a preliminary injunction to prevent the consummation of the New Hope Merger. (Mem. Op. 3, 16). On January 15, 2014, the Court of Chancery filed the Preliminary Injunction Order. (Preliminary Inj. Order 1-2).

On January 16, 2014, Appellants timely filed a Notice of Appeal from Interlocutory Order. (Notice of Appeal). On January 23, 2014, the Supreme Court of the State of Delaware accepted the interlocutory appeal. (Order Accepting Appeal).

SUMMARY OF THE ARGUMENT

1. Public Benefit Corporations, added to Delaware law in 2013, are distinct corporate species, which ought not be treated in the same way as are traditional profit-driven corporations. Traditional corporations have as their only interest and goal the maximization of wealth for shareholders. *See*, *e.g.*, *Ford Motor Co. v. Dodge*, 204 Mich. 459, 507, 170 N.W. 668, 684 (1919) ("A business corporation is

organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors . . . does not extend to a change in the end itself, . . . or to the nondistribution of profits among stockholders in order to devote them to other purposes.”). Conversely, public benefit corporations like Praise Video have as primary obligations in addition to shareholder wealth advancing the best interests of those materially affected by their conduct (the stakeholders) and of the public benefit listed in their articles of incorporation. To hold public benefit corporations to the same level of scrutiny as other corporations would destroy the essence of the public benefit corporation, frustrate the express will of the legislature, and render the statute meaningless. Therefore, this court should apply the business judgment rule to the board’s decision to favor New Hope’s proposal over that of Mercer.

With limited discussion, the court below also cited to *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). Like *Ford*, *Revlon* mandates that directors in the context of a hostile takeover “determine the best interests of the corporation and its stockholders, and impose an enhanced duty to abjure any action that is motivated by considerations other than a good faith concern for such interests.” *Id.* at 181. Not only does the express language of the public benefit corporation operate in direct contradiction of that mandate, but even under a liberal reading of *Revlon*, the actions of Praise Video’s directors met the heightened level of scrutiny. This is so because the directors considered the unique shareholder role in

public benefit corporations as one of advocacy and not merely profit-driven investment.

2. The Court of Chancery erred in holding that the *Blasius* standard automatically applies to a corporate board's decision to enter into a "crown jewel" option, which may have some effect on a shareholder vote on a proposed merger. Under *Blasius*, where board action is designed to frustrate the result of a shareholder vote or interfere with the shareholder franchise, the ordinary business judgment rule does not apply and the board must demonstrate a "compelling justification" for its conduct. The Delaware courts have applied this limited standard to voting polices or board actions that either entrench the incumbent board or thwart a vote on a transaction. However, no Delaware court has applied this standard of enhanced scrutiny to board action that encourages shareholders to choose one option over another. Here, the Gaming Option simply encourages the shareholders to vote for the New Hope merger that furthers the corporation's public benefit. The Praise Video board's action neither entrenches itself nor frustrates the ability of shareholders to effectuate a successful vote for or against the proposed merger.

Even if the Court employ's *Unocal*'s enhanced scrutiny for defensive measures that coerce a shareholder vote, the Praise Video board demonstrates its action was reasonable in response to the perceived threat to Praise Video's corporate public benefit. In the face of a threat to corporate policy, *Unocal* requires directors to show reasonable grounds for believing that a danger to corporate policy existed and that the defensive measure taken was reasonable in

relation to the threat posed. Here, Appellees fail to demonstrate that the Gaming Option is either coercive or unreasonable in response to the perceived threat to Praise Video's public benefit.

STATEMENT OF FACTS

Praise Video, Inc. ("Praise Video") is a public benefit corporation organized under Delaware law. In accordance with 8 Del. C. §362(b), Praise Video's certificate of incorporation identifies as its chosen public benefit "the promotion of the values articulated in the Confession of Faith in a Mennonite Perspective." (Mem. Op. 3). Averaging approximately $4 million in earnings in recent years—a majority of which comes from its gaming division—Praise Video "has engaged in the production and distribution of filmed and digital entertainment, of what its web site describes as a wholesome nature and an alternative to violent or sexually offensive entertainment generally offered by secular media." (Mem. Op. 4).

Jacob Bissinger, Praise Video's CEO and director, decided in early 2013 that he would retire and sell his shares in the company. (Mem. Op. 6). Joseph Stoltzfus ("the financial adviser"), a financial advisor retained by Praise Video to identify transactions which would permit Bissinger and others to liquidate their investments, identified a number of potential bidders. (Mem. Op. 6-7). Among them were Mercer Christian Publishing Co. ("Mercer"), who suggested that a price above $40 per share was possible due to expected growth. (Mem. Op. 7). Although initially pleased with the high offer, the directors became concerned at a June 24, 2013, meeting when they learned "that considerable market growth might be anticipated in the area of combat-

oriented video games." (Mem. Op. 7). After significant debate—including references to Delaware's public benefit corporation statute—the directors requested that the financial adviser continue his search for potential bidders. (Mem. Op. 9).

In December 2013, only Mercer and New Hope Publishing Co. ("New Hope") submitted bids. (Mem. Op. 9). New Hope's majority stockholder "is engaged in venture capital investment focusing on portfolio companies that seek to balance financial gains with religious values." (Mem. Op. 6). Although New Hope's bid was $41 per share, as compared to Mercer's $51 per share, it "undertook [as part of its bid] that [Praise Video director] Pennock would be the CEO of Praise Video following an acquisition, and so long as he remained CEO he would operate Praise Video to the best of his ability in a manner consistent with the values of the Church." (Mem. Op. 10). Furthermore, New Hope conditioned its bid on Praise Video granting and option (the "Gaming Option") "to acquire Praise Video's gaming division for $18 million, payable in 5-year installment notes, if the New Hope merger failed to gain the necessary Praise Video stockholder approval." (Mem. Op. 10). The Gaming Option is exercisable if (A) the Merger agreement fails to garner majority shareholder approval, and at "at or prior to the time of such termination, a proposal to acquire Praise Video has been announced or made to Praise Video's board and not *bona fide* withdrawn," and (B) Praise Video is acquired or enters into an agreement to be acquired within twelve months of such termination. (Mem. Op. 10).

On December 9, 2013, at a board meeting lasting seven hours, the directors again "expressed misgivings about the potential impact of Mercer's status as a wholly-owned subsidiary . . . [of] a secular, multinational media conglomerate." (Mem. Op. 11). After careful deliberation, the board voted 4-1 to approve the New Hope Merger "because it appropriately balanced the stockholders' pecuniary interests, the best interests of those materially affected by Praise Video's conduct, and the public benefit identified in its certificate of incorporation." (Mem. Op. 11).

ARGUMENT

I. EXISTING DELAWARE CASE LAW DOES NOT APPLY TO MERGERS INVOLVING PUBLIC BENEFIT CORPORATIONS.

A. Question Presented

Whether the decision of a corporate board of a public benefit corporation—as a distinct corporate entity with duties to stakeholder interests and the public benefit in addition to shareholder interests—is subject to the business judgment rule and not an enhanced level of scrutiny.

B. Scope of Review

This Court reviews the Court of Chancery's determinations *de novo* for errors in applying legal principles. *SI Mgmt. L.P. v. Wininger,* 707 A.2d 37, 40 (Del. 1998).

C. Merits

i. The statutory language of Delaware's public benefit corporation law mandates that directors consider non-shareholder interests.

Because Delaware law mandates that Praise Video consider interests beyond the limited shareholder interests made paramount in

existing Delaware law, the existing framework requiring directors to maximize shareholder wealth is anachronistic. Praise Video is incorporated as a public benefit corporation, "intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner." 8 Del. C. § 362(a). "To that end, a public benefit corporation shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation." *Id.*

A public benefit corporation cannot meet this express requirement—that it consider both stakeholder interests and the public benefit identified in its certificate of incorporation—if it is also required to maximize shareholder wealth. In *Revlon*, this court stated that when a company's breakup has become inevitable, "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company." *Revlon*, 506 A.2d at 182. Even if the facts of this case fit within the narrow context in which *Revlon* applies, the general application of the *Revlon* rule contradicts the statutory duties for directors of public benefit corporations to such an extent that the case cannot reasonably apply to these new and unique corporate forms. Directors acting as "auctioneers" on behalf of stockholders must do so to the detriment of other considerations. This the directors may not do under the clear edict set forth in § 362(a). Throughout the Merger process, Praise Video's directors had a

statutorily conferred fiduciary duty to consider stakeholder interests and the public benefit identified in its certificate of incorporation.

Importantly, the directors were required to balance these interests even through merger discussions, as their duty to defend the corporate bastion extends beyond the corporation's existence. Section 362(a) mandates that directors manage the corporation in such a way as "to produce a public benefit . . . and to operate in a responsible and sustainable manner." 8 Del. C. § 362(a). To operate in a sustainable manner, the directors must necessarily have the power to continue consideration of the public benefit and stakeholder interests even beyond the dissolution or sale of the corporate entity. To hold otherwise would run contrary to legislative intent.

Furthermore, shareholders of a public benefit corporation cannot be thought of in the same manner as the shareholders of strictly profit-oriented corporations. They have consciously invested in an entity tasked not only with recognizing profit but also charged with producing "a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests." 8 Del. C. § 362(b). To ignore the potential differences in public benefit corporation shareholders and traditional corporation shareholders would limit the freedom of shareholders to invest in these types of corporations, which balance other interests with pecuniary gain. Those shareholders who seek solely to maximize wealth are free to invest in corporations not statutorily required to consider other interests. To rob shareholders of this choice is to decimate a key aspect of the public benefit corporation.

Section 365(b)'s statutory language expressly endorses the business judgment rule ("BJR") as the proper level of scrutiny when assessing the decisions of directors of public benefit corporations. It states:

> [W]ith respect to a decision implicating the balance requirement in subsection (a) of this section, [a director of a public benefit corporation] will be deemed to satisfy such director's fiduciary duties to stockholders and the corporation if such director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.

8 Del. C. § 365(b). This language mirrors that which this court has used in applying the BJR. *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 74 (Del. 2006) (holding that to rebut the BJR with an argument of waste required a showing that the deal was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration."); *Brehm v. Eisner*, 746 A.2d 244, 262 (Del. 2000) (same); *Grobow v. Perot*, 539 A.2d 180, 189 (Del. 1988) ("[T]he issue becomes whether the complaints state a claim of waste of assets, i.e., whether 'what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid.'") (overruled on other grounds by *Brehm*). Faced with the choice of level of scrutiny and a wealth of precedent from which to choose, the legislature expressly adopted the BJR as the appropriate test when examining a board's balancing of shareholders' pecuniary interests, the stakeholders' interests, and the public

benefit, itself. To apply a more searching inquiry would frustrate the will of the legislature.

Public benefit corporations are unique corporate entities, distinct from traditional corporations (among other reasons) because of a statutory obligation to serve more than shareholders' pecuniary interests. That interest must be balanced against those of the identified public benefit and its stakeholders. Because of this, the normal requirement that directors seek only to maximize shareholder wealth has no place in the public benefit corporation context. Therefore, the enhanced scrutiny normally triggered in such situations has no place and the BJR should apply. The decision was "rationally related" to the long-term best interests of the company, and so the court must defer to the directors' judgment. *Revlon*, 506 A.2d at182-83. Under that rule, the Praise Video directors clearly met their fiduciary burden, balancing all of their statutorily required interests and reaching a disinterested decision to sell Praise Video to a bidder who would better serve the corporation's policies, the public benefit, and its stakeholder's interests.

ii. Even under the *Revlon* framework, the directors met their fiduciary obligation.

Even if this court concludes that the actions of a public benefit corporation rightly fall within the *Revlon* framework, the board's decision was an adequate and sufficient balancing of interests and passes muster under enhanced scrutiny. Public benefit corporations, a distinct type of corporate entity concerned with multiple interests, cannot be cabined within the shareholder maximization framework

traditionally applied. This is so because a shareholder's interests may extend beyond merely maximizing profit, particularly a shareholder in a public benefit corporation. *Revlon*, when it applies, requires that the board consider the "best interests of the corporation and its stockholders." *Revlon*, 506 A.2d at 181. Traditionally, courts have identified the best interests of shareholders as profit maximization. *See*, *e.g.*, *Revlon*, 506 A.2d 173; *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).

But a more searching inquiry into shareholder preferences might yield a more nuanced view of shareholder preference. Steven J. Haymore, *Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma*, 64 VAND. L. REV. 1311, 1336 (2011) ("Generally speaking, the determination of what is in shareholders' best interests involves inquiry into what the bargaining parties would have wanted had they been able to freely negotiate without transaction costs."). This nuance is particularly pertinent when considering what may be the best interests of individuals who would invest in a public benefit corporation as opposed to a corporation intent solely upon maximizing profit. Such "[s]ocially conscious investors believe that they can make money and make a meaningful difference by consciously directing investment capital toward enterprises that contribute to a clean, healthy environment, treat people fairly, embrace equal opportunity, produce safe and useful products, and support efforts to promote world peace." Steven J. Schueth, *Socially Responsible Investing in the U.S.*, 43 J. BUS. ETHICS 189 (2003). Mandating that the board maximize shareholder

wealth ignores the variable nature of shareholders, particularly in the context of a corporation expressly committed to a social cause. Attempting to fit the square peg that is the public benefit corporation into the round hole that is the *Revlon* framework would unduly punish those shareholders who invested in the corporation for reasons other than mere return on investment. It would reduce the public benefit corporation to a traditional corporation and render the statute meaningless and redundant.

Additionally, the Board's balancing of its shareholders' interests and those of stakeholders and the public benefit took into account a long-term strategy it deemed most beneficial to the corporation and its shareholders. Although corporations usually have a duty to maximize shareholder wealth, they may also forego short-term gain and craft a long-term strategy aimed at protecting corporate and shareholder interests. In the canonical case of *Shlensky v. Wrigley*, 95 Ill.App.2d 173, 180, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968), the court stated:

> Furthermore, the long run interest of the corporation in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating. By these thoughts we do not mean to say that we have decided that the decision of the directors was a correct one. That is beyond our jurisdiction and ability. We are merely saying that the decision is one properly before directors and the motives alleged in the amended complaint showed no fraud, illegality or conflict of interest in their making of that decision.

So too have Delaware courts recognized the board's duty to maximize the long-term interests of shareholders. *See*, *e.g.*, *Katz v. Oak Indus., Inc.*, 508 A.2d 873, 879 (Del. Ch. 1989) ("It is the obligation

of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so 'at the expense' of others . . . does not for that reason constitute a breach of duty."). This is true even when corporate resources are used for charitable donations, so long as they benefit the corporation "in the long run." *Theodora Holding Corp. v. Henderson*, 257 A.2d 398, 405 (Del. Ch. 1969).

Here, the Board debated the propositions of merging Praise Video into one of two other entities. New Hope shared its vision and strategy of producing Christian-themed video games consistent with Praise Video's past practice. The other—though it offered a higher short-term profit to shareholders—offered a drastically different future. It is within the Board's province to choose the stability of New Hope over the revolution promised by Mercer when drastic market changes may harm long-term corporate and shareholder strength.

II. THE COURT OF CHANCERY ERRED IN CONCLUDING THAT THE *BLASIUS* STANDARD OF REVIEW WAS APPLICABLE TO THE PRAISE VIDEO BOARD'S APPROVAL OF THE GAMING OPTION.

A. Question Presented

Whether the decision of a corporate board to grant a "crown jewel" option that encourages stockholders to vote in favor of a merger that furthers the corporation's public benefit, is subject to the *Blasius* "compelling justification" heightened judicial review.

B. Scope of Review

This Court reviews the Court of Chancery's determinations *de novo* for errors in applying legal principles. *SI Mgmt. L.P. v. Wininger,*

707 A.2d 37, 40 (Del. 1998). This standard applies because although the Court of Chancery recited the *Blasius* "compelling justification" standard in its opinion, it incorrectly applied that standard to a "crown jewel" option, functionally expanding *Blasius*'s very limited holding.

C. Merits

i. The Business Judgment Rule is the proper standard to evaluate the Gaming Option because the Praise Video board's action did not trigger Blasius's narrow application for enhanced judicial review.

The Court of Chancery's application of the *Blasius* "compelling justification" test to the Gaming Option defies this Court's precedent and expands the very limited holding of *Blasius* far beyond its intended application. *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988), established that when a board acts for the "primary purpose of thwarting" the exercise of the shareholder franchise, it is no longer entitled to the protection of the BJR and is required to satisfy a more exacting standard that demands a compelling justification for such action. Such enhanced judicial scrutiny recognizes the importance of protecting shareholder franchise because it is "the ideological underpinning upon which the legitimacy of directorial power rests." *Id.* at 659. Therefore, when a board acts to interfere or frustrate a shareholder vote, the board "bears the heavy burden of demonstrating a compelling justification for such action." *Id.* at 661.

This exacting standard is not without limits. In *Blasius*, the Court of Chancery refused to adopt a "per se rule that would strike

down any board action taken for the primary purpose of interfering with the effectiveness of a corporate vote." *Blasius*, 564 A.2d 661. Rather, the Delaware courts have identified two broad categories of board action that trigger *Blasius* review: (1) board entrenchment or acts designed to thwart shareholders ability to replace the incumbent board, and (2) acts designed to thwart a vote on a business transaction or merger. See *Blasius*, 564 A.2d at 660-1; *Wisconsin Investment Board v. Peerless Systems Corp*, No. Civ. A. 17637, 2000 WL 1805376, at *12-13 (Del. Ch. Dec. 4, 2000). However, where the board demonstrates that its action does not trigger *Blasius*, the court shall apply the ordinary BJR. *Id.* Under that rule, the court will not substitute its judgment for that of the board. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). BJR is the fundamental principle that the board of directors manages the business affairs of a corporation without interference as long as "in making a business decision the directors of a corporation 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." *Id.* Because the Praise Video Board's use of a Gaming Option does not interfere or frustrate the shareholder franchise, this Court should evaluate the Board's conduct under the BJR. Furthermore, the Board's conduct satisfies its obligations under the BJR because it had a good faith belief and purpose for accepting the Gaming Option.

a. The Praise Video's primary purpose for entering into the Gaming Option was not to entrench the incumbent board.

The Gaming Option's primary purpose was not to entrench the incumbent board. Under Delaware General Corporate Law, Shareholders have the statutory right to elect directors and, as such, determine who may govern the corporation. 8 Del. C. § 211(b)-(c). Where a board decision frustrates that statutory right by allocating the effective power with respect to governance of the corporation from the shareholders to the board, *Blasius* rather than the ordinary BJR, is applied. *Id.* at 660. In *Blasius*, the board expanded the size of the staggered board and filled the new seats with directors who would not be up for election for two years. *Id.* at 655. The Court of Chancery rejected the board's action because the expansion's primary purpose was to prevent a hostile bidder from taking control of the corporation and that purpose frustrates a shareholder's statutory right to vote for or against a director's election to the board. *Id.* at 663.

Unlike *Blasius*, the Gaming Option did not effect the Praise Video shareholders' ability to vote for directors nor demonstrated any purpose on the part of the directors to protect their positions on or control of the Praise Video Board. Rather, the Gaming Options' primary purpose was to protect the deal that would promote the public benefit specified by Praise Video's certificate of incorporation. The Gaming Option's purpose was not to entrench the incumbent board because the Praise Video directors would no longer serve on the board regardless of which merger Praise Video entered into.

b. The Gaming Option's primary purpose was not to thwart a vote on the proposed merger.

The Gaming Option does not thwart a vote on the proposed merger, which requires shareholder approval as a matter of law. The allocation of power between board and shareholders extends beyond entrenchment cases because it is implicated "in every instance in which an incumbent board seeks to thwart a shareholder majority." *Blasius*, 564 A.2d at 660. Thus, when the board acts to thwart a vote on a matter on which the DGCL entitles shareholder approval, the principles underlying *Blasius* remain applicable. *Id.* Furthermore, the Court of Chancery in *Wisconsin Investment Board v. Peerless Systems Corp.*, recognized that *Blasius* encompasses board action designed to thwart a shareholder vote to approve a business decision. No. Civ. A. 17637, 2000 WL 1805376, at *12-13 (Del. Ch. Dec. 4, 2000). In *Peerless*, at the Annual Meeting the shareholders planned to vote on a board proposal that would increase the number of shares available for issuance through the company's stock option plan. *Id.* at *3. However, when the proposal appeared to lack the votes required for passage, the company's CEO suspended the meeting for thirty days without closing the polls. *Id.* The proposal passed by a small margin when the meeting reconvened. *Id.* at *3-4. The board argued that *Blasius* was inapplicable because, unlike the typical entrenchment case, the directors did not have an inherent interest in retaining jobs and were disinterested with respect to the vote. *Id.* at *11. Rejecting the board's argument, the Court of Chancery held that the board's primary purpose was to interfere with the shareholder's vote

to secure passage of the proposal and that such interference triggered *Blasius* review. *Id*.

Like *Peerless*, Praise Video's Board acknowledged the purpose of the Gaming Option was to effect a vote by encouraging stockholders to vote in favor of the Merger. As noted below, under DGCL Section 251(c) stockholders are entitled to an effective vote on a merger. (Mem. Op. 15); 8 Del. C. § 251(c) (Supp. 2008). Even in light of the statutory requirement for a vote on the Merger, the character of the Board's action here, which affects the Merger vote, is vastly different from the action in *Peerless*. Unlike *Peerless*, the Gaming Option does not stop a vote on the Merger in light of the possible threat of defeat. If the shareholders vote down the Merger, the Gaming Option becomes exercisable only if within twelve months of terminating the Merger agreement Praise Video is acquired or enters into a definitive agreement to be acquired. Thus, the shareholders may still vote down the merger and avoid triggering the Gaming Option. Therefore, the Gaming Option is not designed to thwart a vote on a transaction because it does not interfere with an ongoing vote, nor does it make the shareholders' ability to defeat the merger ineffective.

c. Alternatively, if this Court finds that the Gaming Option thwarts a shareholder vote, thus triggering *Blasius*, the Praise Video board can demonstrate a "compelling purpose."

Even if the court find that the Gaming Option thwarts a shareholder vote, triggering *Blasius*, Appellants demonstrate a "compelling justification." When directors act for the primary purpose of thwarting the ability of shareholders to vote on a

transaction, they bear the heavy burden of producing a compelling justification to defend their actions. *Blasius*, 564 A.2d at 657, 661. Very few courts have illustrated what suffices for a "compelling purpose" under the second part of the *Blasius* standard. However, the Chancery court in *Mercier v. Inter-Tel, Inc.*, 929 A.2d 786, 819 (Del. Ch. 2007), found a compelling purpose when "independent directors believe that stockholders are about to reject a . . merger proposal that the independent directors believe is in their best interests . . . and if the stockholders vote no, the acquiror will walk away without making a higher bid and that the opportunity to receive the bid will be irretrievably lost." The Praise Video board faced a similar situation here. In order to further Praise Video's public benefit, the directors identified a deal with New Hope as the best opportunity to promote that goal. Like *Mercier*, the Gaming Option's purpose is to further a proposal that is in the stockholder's best interests and, without it, New Hope is likely to walk away. Additionally, when the "compelling justification" standard is applied to public benefit corporations, the special director duties of a public benefit corporation should be considered.

As the court below noted, directors of a public benefit corporation are subject to generally applicable Delaware corporate law unless "the specific public benefit statutory provisions require a different outcome." (Mem. Op. 15-16). DGCL public benefit law requires that "the board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that balances the pecuniary interests of the stockholders, the best

interests of those materially affected by the corporation's conduct, and the . . . public benefits identified in its certificate of incorporation." 8 Del. C. § 365. This public benefit provision suggests that this Court must consider Praise Video's public benefit when assessing whether the Appellants' use of the Gaming Option to protect that public benefit is a compelling purpose to effect a shareholder's vote on the proposed merger. *Id.* Therefore, the Gaming Option offers a "compelling purpose" because it incentivizes a merger with a company that is more likely to continue to further the company's public benefit.

ii. Alternatively, the Gaming Option remains valid under the *Unocal* enhanced scrutiny framework because the Praise Video Board satisfied its fiduciary obligations.

Even though Delaware law is unclear with respect to whether crown jewel options trigger *Blasius* review, this Court should not expand the limited *Blasius* application to deal protection devices similar to the Gaming Option. Rather, the Court should follow Chancellor Strine's opinion in *Mercier*, at 805-06, that the *Unocal* and *Blasius* standards "are not easily separable," and thus, where it is questionable whether disenfranchisement was the directors' primary purpose, the Court should conduct *Unocal* review in lieu of *Blasius* analysis.. Here, the Court should subject the Gaming Option to *Unocal* because the primary purpose is not clearly disenfranchisement of the shareholders.

Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-56 (Del. 1985), recognized that directors faced with a threat to the corporate policy are confronted with a conflict of interest and an objective

decision is difficult.. Therefore, when a board takes a defensive measure to protect the corporation from such threat, the court should apply enhanced judicial scrutiny rather than the ordinary BJR. *Id.* The *Unocal* enhanced scrutiny test requires the directors to show reasonable grounds for believing that a danger to corporate policy existed and that the defensive measure taken was reasonable in relation to the threat posed. *Id.* at 946. Once the board satisfies the *Unocal* standard, the board's action is afforded the protections of the BJR. The Gaming Option satisfies *Unocal*'s enhanced scrutiny test and warrants BJR protection because the directors were faced with a reasonable threat and their response was reasonable in relation.

Directors satisfy the *Unocal* reasonable threat test by showing good faith and reasonable investigation for believing that a danger to corporate policy existed. *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1152 (Del. 1989) (citing *Unocal*, 493 A.2d 946). *Paramount* recognized board conduct that suffices for the *Unocal*'s reasonable threat test includes demonstrating a board's good faith belief that the corporate policy is threatened, reasonable investigation though a deliberative process of such threat, and its use of an independent special committee to asses the reasonableness of the threat. *Id.* at 1152-54

Like the board in *Paramount*, Appellants can clearly demonstrate a reasonable threat to corporate policy. During merger discussion with Mercer, the Praise Video Board was concerned that Mercer would expand Praise Video's gaming operations into the area of combat-oriented video games, which conflicts with the company's religious corporate

policy. The court below found that the directors acted with the utmost good faith in assessing the threat posed to the public benefit identified in Praise Video's certificate of incorporation. (Mem. Op. 16). Furthermore, Praise Video's directors considered this threat to corporate policy for over seven hours, as it deliberated between the two bids before it. Thus, the Mercer deal posed a reasonable threat to Praise Video's religious corporate policy.

Upon a showing of a reasonable threat, *Unocal* requires that the board demonstrate its response was reasonable in relation to the perceived threat. However, this Court in *Unitrin* expanded *Unocal*'s reasonable in relation test to require that the response is neither preclusive or coercive and within a range of reasonableness. With respect to the Gaming Option, the Court of Chancery rejected the Praise Video board action on the grounds that it coerced shareholders to vote on the New Hope transaction rather than the Mercer merger. However, this Court's precedent demonstrate that Praise Video's use of the Gaming Option is not coercive and satisfies *Unocal* enhanced scrutiny.

A coercive response is aimed at forcing upon stockholders a management-sponsored alternative to a hostile offer. *Unitrin, Inc. v. Am. Gen. Corp.,* 651 A.2d 1361, 1387 (Del.1995). In response to a hostile takeover attempt, the board in *Unitrin* initiated a defensive stock repurchase of its own shares on the market. *Id.* at 1361. The Court found the board's action not coercive because the measure did not discriminate between shareholders as all shareholders were able to voluntarily realize the same benefit in selling their shares. *Id.* at

1388. Furthermore, it did not force the shareholders to rush to participate in the repurchase for fear of missing the opportunity and being punished for not participating at the onset. *Id.* Like *Unitrin*, the Praise Video shareholders are not punished for voting against the proposed merger. The shareholders are able to vote the deal down without completely destroying the viability of a merger with another company.

With respect to lock-up options specifically, this Court in *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 934 (Del. 2003), found defensive devices that completely lock up a proposed merger to be coercive. In *Omnicare*, the target CEO and board chairman owned a large portion of the company's stock, which amounted to the effective voting control over the company. *Id.* at 926. The acquirer entered into voting agreements with the CEO and board chairman that required both to vote in favor of the proposal; however, if either individual breached the agreement the acquirer was entitled to a termination fee. *Id.* This Court held this deal protection was coercive because it forced the board's proposal down on the shareholders and "made it 'mathematically impossible' and 'realistically unattainable' for the Omnicare transaction or any other proposal to succeed, no matter how superior the proposal." *Id.* at 936.

Unlike *Omnicare*, the Gaming Option did not make any other transaction unattainable. The Praise Video Board did not enter into a voting agreement that guaranteed the proposed merger would pass. Furthermore, the directors' votes account for less than 25% of Praise Video's voting stock and thus were unable to guarantee the success of

the proposed merger. The Gaming Option encouraged the shareholders to consider factors beyond price. Praise Video's public benefit was an integral part of the companies footprint. In light of the threat to that corporate policy, the Praise Video board entered into the Gaming Option to promote the public benefit identified in its certificate of incorporation. The Board did not control a majority of the voting shares, force a rush to choose one option over the other, or discriminate between shareholders. Therefore, the Gaming Option satisfies enhanced *Unocal* scrutiny because it does not coerce a vote by encouraging shareholders to choose one merger over another.

CONCLUSION

For the foregoing reasons, Appellants respectfully request that the Court of Chancery's January 14, 2014 Memorandum Opinion and Order be REVERSED.

Respectfully submitted,

/s/ Team Attorneys
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