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 HOPE PUBLISHING CO., and PRAISE NEW HOPE CORP.,	:	
Appellants, Defendants Below,	:	No.43, 2014
v.	:	Court Below: Court of Chancery of the State of Delaware C.A. No. 8974-CD
MERCER CHRISTIAN PUBLISHING CO. and SUSAN BEARD,	:	
Appellees, Plaintiffs Below,	:	

APPELLEES' OPENING BRIEF

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Counsel for Appellees
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TABLE OF CONTENTS

TABLE OF CONTENTS ii

TABLE OF CITATIONS iv

NATURE OF PROCEEDINGS 1

SUMMARY OF ARGUMENT 2

STATEMENT OF FACTS 3

ARGUMENT 7

I. THIS COURT SHOULD AFFIRM THE GRANT OF THE PRELIMINARY INJUNCTION BECAUSE THE BOARD'S PRE-MERGER CONDUCT WAS A BREACH OF ITS FIDUCIARY AND REVLON DUTIES. 7

Question Presented 7

Scope of Review 7

Merits of the Argument 7

A. The Board breached its fiduciary duties by failing to obtain the highest possible merger price. 8

B. The Board failed to balance the applicable interests and instead determined religious considerations were dispositive despite adverse consequences to the shareholders' pecuniary interests. 10

1) The difference in price between the New Hope and Mercer bids implicated the Praise shareholders' pecuniary interests. 11

2) The vast difference in price dwarfed the perceived religious differences between New Hope and Mercer. 12

3) The Board failed to demonstrate how accepting the New Hope bid was better for those materially affected by Praise's conduct. 13

4) By disregarding the Praise shareholders' pecuniary interests in selecting the New Hope bid, the Board failed to reasonably balance the applicable considerations. 14

C. The Board breached its fiduciary duties to the Praise shareholders by agreeing to the manifestly unreasonable Gaming Option terms. 15

1) The Gaming Option was adopted after the auction ended. **16**

2) The Gaming Option unreasonably and excessively undervalued Praise's crown jewel. **17**

II. THIS COURT SHOULD AFFIRM THE GRANT OF THE PRELIMINARY INJUNCTION BECAUSE, UNDER THE PRINCIPLES OF LAW OUTLINED IN *BLASIUS* AND ITS PROGENY, THE GAMING OPTION WAS INVALID BECAUSE ITS PRIMARY PURPOSE WAS TO INTERFERE WITH THE PRAISE SHAREHOLDERS' RIGHT TO A MEANINGFUL VOTE ON THE MERGER AND THE BOARD LACKED A SUFFICIENT AND COMPELLING JUSTIFICATION FOR ITS IMPLEMENTATION. **18**

Question Presented **18**

Scope of Review **18**

Merits of the Argument **18**

A. The Board's primary purpose behind its acceptance of the Gaming Option contained in New Hope's bid was to interfere with the effectiveness of the Praise shareholders' vote on the merger. **20**

B. The Board had no compelling justification for implementing the Gaming Option. **23**

CONCLUSION..... **25**

CERTIFICATE OF SERVICE..... ERROR! BOOKMARK NOT DEFINED.

TABLE OF CITATIONS

Air Prods. & Chems., Inc. v. Airgas, Inc.,
16 A.3d 48 (Del. Ch. 2011).....9, 14

Blasius Indus., Inc. v. Atlas Corp.,
564 A.2d 651 (Del. Ch. 1988).....passim

Buffalo Forge Co. v. Ogden Corp.,
555 F. Supp. 892 (W.D.N.Y. 1983).....16

Gilbert v. El Paso Co.,
575 A.2d 1131 (Del. 1990).....11, 19

Hanson Trust PLC v. ML SCM Acquisition, Inc.,
781 F.2d 264 (2d Cir. 1986).....17, 18, 22, 23

Hilton Hotels Corp. v. ITT Corp.,
978 F. Supp. 1342 (D. Nev. 1997).....21

In re Netsmart Tech. S'holders Litig.,
924 A.2d 171 (Del. Ch. 2007).....11

In re MONY Group, Inc., S'holders Litig.,
853 A.2d 661 (Del. Ch. 2004).....20, 22, 24, 25

Kaiser Aluminum Corp. v. Matheson,
681 A.2d 392 (Del. 1996).....7

Kidsco, Inc., v. Dinsmore,
670 A.2d 1338 (Del. 1995).....20, 25

Lawson v. Meconi,
897 A.2d 740 (Del. 2006).....19

Lyondell Chem. Co. v. Ryan,
970 A.2d 235 (Del. 2009).....11, 14, 15

Malpiede v. Townson,
780 A.2d 1075 (Del. 2001).....8

Mercier v. Inter-Tel, Inc.,
929 A.2d 786 (Del. Ch. 2007).....25-25

Mills Acquisition Co. v. Macmillan, Inc.,
559 A.2d 1261 (Del. 1989).....16, 17

MM Cos., Inc. v. Liquid Audio, Inc.,
813 A.2d 1118 (Del. 2003).....21, 24, 25

Omnicare, Inc. v. NCS Healthcare, Inc.,
818 A.2d 914 (Del. 2003).....22

Paramount Commc'ns, Inc. v. QVC Network, Inc.,
637 A.2d 34 (Del. 1994).....passim

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

Schnell v. Chris-Craft Indus., Inc.,
285 A.2d 437 (Del. 1971).....20

Stroud v. Grace,
606 A.2d 75 (Del. 1992).....19, 21

STATUTES

8 *Del. C.* § 251.....10, 14

8 *Del. C.* § 361.....8, 10

8 *Del. C.* § 362.....passim

8 *Del. C.* § 363.....10, 13, 14, 19

8 *Del. C.* § 365.....13, 14

OTHER SOURCES

Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 Minn. L. Rev. 239 (1990).....23

NATURE OF PROCEEDINGS

Plaintiffs Mercer Christian Publishing Co. ("Mercer") and Susan Beard commenced this action against Praise Video, Inc. ("Praise"), the Praise Board of directors (the "Board"), and Praise New Hope Inc. ("New Hope") on January 9, 2013, challenging the sale of Praise to New Hope. *Mercer Christian Publishing Co. v. Praise Video, Inc.*, C.A. No. 8974-CD (Del. Ch. Jan. 14, 2014). On January 14, 2014, the Court of Chancery granted a preliminary injunction enjoining Praise, the Board, and New Hope from enforcing the Praise Video Gaming Option (the "Gaming Option") and consummating the merger with New Hope. *Id.* at 16. In an order dated January 15, 2014, the Court of Chancery enjoined the merger of Praise and New Hope. *Mercer Christian Publishing Co. v. Praise Video, Inc.*, C.A. No. 8974-CD (Del. Ch. Jan. 14, 2014) (order granting preliminary injunction).

On January 22, 2014, the defendants collectively filed an application pursuant to Supreme Court Rule 42 for an order certifying an appeal from the interlocutory order. *Mercer Christian Publishing Co. v. Praise Video, Inc.*, No. ____, 2014 (order accepting interlocutory appeal). Both parties agreed to an expedited appeal. *Id.* On January 23, 2014, this Court accepted the interlocutory appeal. *Mercer Christian Publishing Co. v. Praise Video, Inc.*, No. 43, 2014 (Del. Jan. 23, 2014) (order accepting interlocutory appeal).

SUMMARY OF ARGUMENT

Under *Revlon,* when a board of directors decides to auction a company, its primary fiduciary duty is to obtain the highest price for its shareholders. The Board breached its fiduciary duties to the Praise shareholders by considering how Praise would be operated post-merger. The Board should have focused on obtaining the highest possible price for Praise's shareholders because the shareholders would have no say in how the company would operate in the future.

In the alternative, the Board breached its fiduciary duties by failing to balance the religious and pecuniary interests. The vast price difference between the bids dwarfed any religious differences between the companies, yet the Board failed to even consider the shareholders' pecuniary interests. This failure to balance the considerations is a breach of the Board's fiduciary duties.

The Board also breached its fiduciary duties to the Praise shareholders by agreeing to the unreasonable terms in the Gaming Option. While lockup options are not *per se* illegal, both the timing the valuation of the Gaming Option make it unreasonable. Even if the Board believed that a merger with New Hope was appropriate, it had no reason to significantly devalue Praise's "crown jewel" at the significant expense of the Praise shareholders.

Under *Blasius* a Board breaches its fiduciary duties if it takes steps to purposely disrupt the shareholders' right to a meaningful and effective vote on a merger, unless the Board has a compelling justification for doing so. With this possibility looming that the shareholders may reject the merger with New Hope, the Board agreed to

significantly reduce the price of the Gaming Option in order to coerce the shareholders into voting in favor of the Merger. This significant and unreasonable devaluation of the Gaming Option disrupted the shareholder's right to a meaningful and effective vote on the merger.

However, the Board did not and cannot demonstrate any compelling justification for implementing the Gaming Option. It is irrelevant that the directors may have had a good faith belief that the action would promote a public benefit. If the Board truly believed that the New Hope bid was in the shareholders' and corporation's best interests, they had both the right and the opportunity to persuade the shareholders to vote for the merger with New Hope.

STATEMENT OF FACTS

Praise is a Delaware corporation that was reorganized as a public benefit corporation ("PBC") on September 2013, soon after the Delaware General Assembly adopted a PBC statute on August 1, 2013. Mem. Op. at 2-3. As a PBC, Praise was required to identify specific public benefits that the corporation would promote. Mem. Op. at 3. In accordance with this requirement, Praise's stated public benefit was "the promotion of the values articulated in the Confession of Faith in a Mennonite Perspective." Mem. Op. at 3. More specifically, Praise specialized in the production of "wholesome" digital and film entertainment, and since 2003 has experienced particular success in their production of video games. Mem. Op. at 4. This gaming division was responsible for 60% of the $4 million annual profit Praise has earned over the past several years. Mem. Op. at 4.

The instigator of the Praise auction was a decision by the Praise

CEO, Jacob Bissinger, to retire from his position. Mem. Op. at 4, 6. Mr. Bissinger was both the CEO of Praise since its inception, and its largest shareholder, owning 22% of the 1 million Praise shares. Mem. Op. at 4. In light of the decision to retire, Mr. Bissinger soon decided to liquidate his shares in Praise. Mem. Op. at 6. After sharing that decision with the Board, the Board retained financial advisor Norman Stoltzfus to explore the feasibility of all Praise shareholders liquidating their investment at this time. Mem. Op. at 6.

Mr. Stoltzfus identified several interested bidders, most notably Mercer, which had explicitly stated they would be interested in acquiring Praise at a price "north of $40 [per share]." Mem. Op. at 7). Mercer is a Florida-based corporation that specializes in religious themed media products, with an official mission statement to "spread inspiration by developing and distributing content that promotes biblical values and honors Jesus Christ." Mem. Op. at 5. Mercer is also an indirectly owned subsidiary of Mercer Media, a large multinational conglomerate headquartered in New York City. Mem. Op. at 5. Mercer also believed that significant synergies existed between their corporation and Praise's gaming division. Mem. Op. at 7. After receiving this information from Mercer, Mr. Stoltzfus reported his findings to the Board on June 24, 2013. Mem. Op. at 7.

Mr. Bissinger expressed consternation at the potential synergies Mercer touted, which was catalyzed by Mr. Stoltzfus' statement that violent video games were a growing industry that Mercer could theoretically employ Praise's gaming division in. Mem. Op. at 7. One of the directors, Mr. Holbrook, disagreed with Mr. Bissinger's

reservations and emphasized the need to focus on shareholder rights should Praise be sold. Mem. Op. at 8. The Board then inquired with their legal counsel as to their obligations in a merger, and they were told that their status as a PBC nullified most of the responsibilities that Mr. Bissinger noted. Mem. Op. at 8-9. The Board then renewed the search for bidders, requiring an emphasis on religious compatibility in addition to a fair price. Mem. Op. at 8.

One of the defendant directors, Mr. Pennock, proposed the creation of a new corporation, New Hope, for the sole purpose of acquiring Praise and operating in in a manner that would satisfy Mr. Bissinger and the other directors. Mem. Op. at 9. The Board approved of this decision, and Mr. Pennock partnered with Miller Price L.P. to create New Hope. Mem. Op. at 6, 9. Miller Price, a venture capital firm based in Delaware, was composed of two equal partners; one a Mennonite, and the other a non-Mennonite. Mem. Op. at 6.

Upon deciding to sell the corporation, the Board sought offers from potential bidders to acquire Praise, identifying five interested parties but only seriously considering Mercer and New Hope's respective bids. Mem. Op. at 7, 9. Mercer ultimately submitted a bid to the Board of $50 per share, while New Hope offered $41 per share. Mem. Op. at 9. Both bids contained 3% termination fees contingent on shareholder approval, but New Hope contained an aggressive lockup option (the "Gaming Option"). Mem. Op. at 9-10. The Gaming Option allowed New Hope to purchase the gaming division of Praise at a steep discount if the Praise shareholders did not approve of the sale to New Hope. Mem. Op. at 10. The Gaming Option locked up the Praise gaming

division at an $18 million price, 40% lower than the actual $30 million value of the division and equivalent to a discount of $12 per share. Mem. Op. at 10. New Hope demanded the Gaming Option because they wanted assurance that their bid would be accepted in spite of their significantly inferior price. Mem. Op. at 10. In furtherance of the Gaming Option, New Hope would retain Mr. Pennock as CEO after the proposed Praise merger. Mem. Op. at 10.

On December 9, 2013 the Board met and discussed the competing bids for a sufficient length of time and with adequate information to make an informed decision. Mem. Op. at 10. The Board expressed concerns with the purported religious differences between Mercer and New Hope, even though neither of them were PBCs and neither adopted any Mennonite beliefs in their respective charters. Mem. Op. at 10-11. The Board then voted 4-1 to approve the merger with New Hope and agreed to be bound by the Gaming Option, with Mr. Holbrook dissenting and Mr. Pennock absenting himself from the vote. Mem. Op. at 11. During that meeting, Mr. Bissinger bluntly stated that he would not vote for Mercer regardless of any price differences between the bids, implying price was not a consideration. Mem. Op. at 12. The Board acknowledged that the Gaming Option would likely change the vote of the Praise shareholders from Mercer to New Hope, yet the Board proceeded to submit the Merger proposal to the shareholders for a vote. Mem. Op. at 12. Plaintiff Susan Beard, the holder of approximately 3% of Praise's outstanding shares, alongside Mercer, a 2% shareholder, filed a preliminary injunction before the Board could hold a shareholder vote on the Merger. Mem. Op. at 12.

ARGUMENT

I. THIS COURT SHOULD AFFIRM THE GRANT OF THE PRELIMINARY INJUNCTION BECAUSE THE BOARD'S PRE-MERGER CONDUCT WAS A BREACH OF ITS FIDUCIARY AND REVLON DUTIES.

Question Presented

Whether the board of directors of a PBC violates its fiduciary duties to the shareholders when it prioritizes the post-merger operations of the corporation over the pecuniary interests of its shareholders in determining which of two bids to submit to the shareholders for a vote.

Scope of Review

Whether the Court of Chancery properly granted a preliminary injunction is reviewed for abuse of discretion. *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 (Del. 1996). However, this Court affords no deference to the Court of Chancery's legal conclusions. *Id.* Because the Court of Chancery did not rule on this issue, this Court reviews de novo whether the evidence presented justifies the grant of a preliminary injunction. *See id.*

Merits of the Argument

The Board breached its fiduciary duties to the Praise shareholders by failing to conduct the statutorily required balancing of considerations. The Delaware Code provides that "a public benefit corporation shall be managed in a manner that balances the stockholder's pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit . . . identified in its certificate of incorporation." 8 *Del. C.* § 362. The directors of a PBC satisfy their fiduciary duties when the directors' decision "is both informed and disinterested and not

such that no person of ordinary, sound judgment would approve." *Id.* PBCs are "subject in all respects to the provisions of this chapter, except to the extent this subchapter imposes additional or different requirements." 8 *Del. C.* § 361.

When a board of directors decides to auction a company its primary fiduciary duty is to obtain the highest price for its shareholders. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986)); *see also Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001) (holding that the board must "perform its fiduciary duties in service of a specific objective: maximizing the sale price of the enterprise."); *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 47-48 (Del. 1994)(holding that *Revlon* applies only when the transaction in question will cause a change in corporate control). When *Revlon* is implicated, the court applies enhanced judicial scrutiny to determine the "adequacy of the decisionmaking process" and "reasonableness of the directors' action in light of other circumstances then existing." *Paramount*, 637 A.2d at 35. The directors bear the burden in establishing that their decision was reasonable. *Id.* at 45. This enhanced judicial scrutiny should therefore be applied to change-of-control transactions involving PBCs, given the unique circumstances with which the directors are faced.

A. The Board breached its fiduciary duties by failing to obtain the highest possible merger price.

The Board breached its fiduciary duties to the Praise shareholders by considering how Praise would operate post-merger. The directors of a PBC must consider the interests of those materially affected by the corporation when managing the corporation's affairs. 8

Del. C. § 362. However, this concern is significantly diminished when the directors decide to "liquidate their investment" and give up all managerial control. Mem. Op. at 6.

The directors of a PBC should have discretion to consider post-merger operations only when the shareholders will retain ownership in the new entity. *Revlon* applies only in situations that involve a "change of control" transaction. *Paramount*, 637 A.2d at 47-48. As Chancellor Develin noted, a blanket determination that any consideration of post-merger operations *in any context* were impermissible may "undermine" the purpose of establishing PBC. Mem. Op. at 14 (emphasis added). It is only in the context of "change of control" that such considerations should be prohibited. *See Paramount*, 637 A.2d at 35.

The Board should have focused on obtaining the highest possible price for Praise's shareholders because the shareholders would have no say in how the company would operate in the future. *See Air Products & Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48, 102 (Del. Ch. 2011) ("The reason the board's duty shifts . . . to maximizing shareholder value is simple: in such a setting, for the present shareholders, there is no long run."); Mem. Op. At 8-10. Holbrook recognized this when he expressed reservations to the other Board members about dictating how Praise would operate once it was no longer in their control. *See* Mem. Op. at 8. In rejecting Holbrook's concerns, the other Board members used their positions of power to determine how Praise would operate in the future at the expense of its shareholders. *See* Mem. Op. at 8.

If the Board truly wanted assurance that Praise would continue

to operate consistent with Mennonite doctrine, it should have required that both bidders adopt a post-merger agreement that contained the public benefit provision from Praise's charter. *See* Mem. Op. at 6. The board of directors of a PBC should have discretion to favor a merger with another PBC over a typical for-profit corporation. *See* 8 *Del. C.* § 363. This conclusion is supported by the creation of different merger requirements for PBCs. *Compare id.* (requiring two-thirds majority approval for merger with non-PBC), *with 8 Del. C.* § 251 (requiring only majority approval for mergers). Thus, the legislature intended to create stricter requirements for when a PBC merges with a non-PBC, but defers to the requirements of § 251 for mergers between two PBCs. *See* 8 *Del. C.* §§ 251, 361, 363. The Board breached its fiduciary duties to the shareholders by failing to obtain the maximum value for their shares. Mem. Op. at 2, 10-12.

B. The Board failed to balance the applicable interests and instead determined religious considerations were dispositive despite adverse consequences to the shareholders' pecuniary interests.

If this court finds that *Revlon* does not apply to PBCs in the strictest sense, then it must determine how to strike a proper balance between the balancing requirements of § 362 and this Court's jurisprudence regarding change-of-control transactions. This Court should hold that where a PBC decides to actively solicit bids, *Revlon* dictates that the board of directors should give price the greatest weight in its balancing of the applicable considerations. *See* 8 *Del. C.* § 363; *Revlon*, 506 A.2d at 182. Even if the directors of a PBC are permitted to consider other interests in change-of-control transactions, the balancing of interests should still be subject to

enhanced judicial scrutiny. *Paramount*, 637 A.2d at 35. Therefore, this Court must determine whether the Board's decision was reasonable under the circumstances. *Id.* Here, the Board relied exclusively on the religious implications for how the company would be managed post-merger, rather than focusing on providing the greatest value to the Praise shareholders. *See* Mem. Op. at 8, 10-12. Thus, the Board's actions should not withstand this Court's scrutiny.

1) The difference in price between the New Hope and Mercer bids implicated the Praise shareholders' pecuniary interests.

The Board violated its duty to seek the best possible deal for the Praise shareholders when balancing the interests implicated by Mercer and New Hope's competing bids. Directors must take reasonable steps to get the best deal in order to satisfy their *Revlon* duties. *In re Netsmart Tech. S'holders Litig.*, 924 A.2d 171, 192 (Del. Ch. 2007); *see also Gilbert v. El Paso Co.*, 575 A.2d 1131, 1146 (Del. 1990) (explaining that *Revlon* requires a board "to seek the best transaction and maximum value reasonably attainable under the circumstances"). Where the board of directors "utterly fail[s] to obtain the best sale price," the court may treat such action as an intentional violation of *Revlon*. *Lyondell Chem. Co. v. Ryan,* 970 A.2d 235, 243 (Del. 2009).

Here, the Board initially satisfied this standard by hiring Stoltzfus to locate potential bidders, specifically bidders with a religious mission. Mem. Op. at 6, 9-10. After conducting an auction between multiple bidders, the Board received bids of $50 and $41 per share from Mercer and New Hope, respectively. Mem. Op. at 9-10. Chancellor Develin correctly concluded that there "was no reasonable prospect that any bids superior" would be submitted, thus the Board

was correct in limiting its consideration to only New Hope and Mercer. Mem. Op. at 10-11. However, the Board's correct conduct ended at that determination. The difference in price between the two bids amounted to $9 per share, a 22% difference, aggregating to a $9 million dollar total price difference. Mem. Op. at 10.

Praise's status as a PBC in no way diminishes the vast price difference between the Mercer and New Hope bids, especially in the context of an open auction. *See* 8 *Del. C.* § 362; *Revlon*, 506 A.2d at 176; Mem. Op. 2, 9-10. The Board recognized the consequences of taking such action. However, the Board still decided to cause a $9 million economic loss to the Praise shareholders in order to pursue what the Board perceived was a more religious mission. *See* Mem. Op. at 8-11.

2) The vast difference in price dwarfed the perceived religious differences between New Hope and Mercer.

The religious differences between New Hope and Mercer were inconsequential compared to the impact on the Praise shareholders' pecuniary interests. Neither Mercer nor New Hope was specifically a Mennonite corporation like Praise, however, both companies adopted a similarly Christian corporate mission. Mercer's corporate mission is to "spread inspiration by developing and distributing content that promotes biblical values" and New Hope's controlling owner, Miller Price, is engaged in venture capital investments with a focus on "[balancing] financial gains with religious values." Mem. Op. at 5-6.

The Board unreasonably determined that Mercer's status as a wholly-owned indirect subsidiary of Mercer Media undermined its religious mission. *See* Mem. Op. at 11. However, there was no indication that Mercer's parent company ever tampered with Mercer's

religious mission. Furthermore, New Hope was managed under similar circumstances. *See* Mem. Op at 6. While Pennock was a member of the Church, he was only a 20% owner in New Hope. Mem. Op. at 6. The other 80% of New Hope was owned by two equal partners, only one of whom was Mennonite. Mem. Op. at 6. Miller Price's partnership agreement further states that if the partners disagree, one of their interests may be liquidated. Mem. Op. at 6. The religious differences between Mercer and New Hope were speculative at best and ultimately given far too much consideration by the Board.

3) The Board failed to demonstrate how accepting the New Hope bid was better for those materially affected by Praise's conduct.

In addition to considering the aforementioned interests, the directors must balance the interests of "those materially affected by the corporation's conduct." 8 *Del. C.* § 365. Neither Mercer nor New Hope agreed to include in its post-merger certificate the public benefit provision contained in Praise's charter. Mem. Op. at 9. Therefore, it is unlikely that either Mercer or New Hope would have a substantially different impact on those materially affected by Praise's previous status as a PBC.

Furthermore, New Hope was formed *only* for the purpose of acquiring Praise, whereas Mercer was already a well-established corporation in a similar industry as Praise. Mem. Op. at 6. New Hope could have easily formed as a PBC, strengthening the argument that New Hope more closely aligned with the religious beliefs of Praise. This would have provided a tangible incentive for the Board to select the New Hope bid, given the lessened voting requirements of § 363. Were the board faced with the decision of merging with either a PBC or a

regular corporation, a decision to merge with another PBC would be more likely to withstand judicial scrutiny. *See* 8 *Del. C.* §§ 251, 363.

4) *By disregarding the Praise shareholders' pecuniary interests in selecting the New Hope bid, the Board failed to reasonably balance the applicable considerations.*

The Board failed to balance the applicable interests in a reasonable manner and thus its actions should not withstand enhanced judicial scrutiny. As Chancellor Develin correctly noted, accepting the New Hope bid would be considered "unthinkable" under traditional corporate law. Mem. Op. at 2; *see also Lyondell Chem. Co.*, 970 A.2d at 243. To any extent the Board's status as a PBC weakens the *Revlon* analysis, the Board still failed to satisfy its fiduciary duties to the Praise shareholders. *See* Mem. Op. at 7-8, 10-12.

While the statute requires directors to balance all three considerations, the only meaningful consideration for the Praise shareholders was price because they had no "long run" as owners of Praise. *See Air Prods. & Chems.*, 16 A.3d at 102. Though the Board claimed to balance the 22% price difference against the public benefit and those materially affected, Bissinger nonetheless stated that he would not support a merger with Mercer "regardless of the difference between the Mercer and New Hope bid price." Mem. Op. at 11-12. This indicated Bissinger's intent to completely disregard his fiduciary duties and clearly indicated that there was no "balancing" of the competing interests whatsoever. *See* 8 *Del. C.* § 365. This statement could also be interpreted as a willful violation of *Revlon* duties because the Board "utterly failed" to obtain the best price. *See Lyondell Chem. Co.*, 970 A.2d at 243.

Even if the Board was concerned about Mercer expanding into combat-oriented video games, it is unclear how this would undermine the public benefit or harm those "materially affected" by Praise's operations. *See* 8 *Del. C.* § 362. An abundance of violent video games already exist; the public would certainly be served by having some of these games substituted with combat-oriented, yet Christian video games. Mercer never indicated that Praise's assets would be used to create combat-oriented video games. Thus, the Board had no reasonable basis to conclude that New Hope would have a substantially better impact on those materially affected by Praise than would Mercer. The Board failed to demonstrate that it conducted a reasonable balance of the applicable considerations in coming to its conclusion to submit the New Hope bid to the Praise shareholders.

C. The Board breached its fiduciary duties to the Praise shareholders by agreeing to the manifestly unreasonable Gaming Option terms.

The Board should not have accepted New Hope's crown jewel lockup option. *Revlon* is implicated when the directors grant a lock-up option in the context of an open auction. *See* 506 A.2d at 182. The directors of a PBC must balance the applicable interests in managing the corporation. 8 *Del. C.* § 362. However, this Court should still apply enhanced scrutiny to determine whether the Board's actions were reasonable. *See Paramount*, 637 A.2d at 45; *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1268 (Del. 1989). The Board has the burden in this case to demonstrate why it was reasonable to grant the lock-up option. *See Paramount*, 637 A.2d at 45.

1) The Gaming Option was adopted after the auction ended.

It is well settled that lock-up options are not *per se* illegal under Delaware law. *See, e.g.*, *Revlon*, 506 A.2d at 176. However, the circumstances under which a board agrees to such a drastic provision may force a court to invalidate the agreement. *See id.* This is not an instance where the board of directors granted a lock-up option when it was only negotiating with one company. *C.f. Mills Acquisition Co.,* 559 A.2d at 1286 (holding that when the "intended effect [of a lock-up] is to end an active auction . . . the board must attempt to negotiate alternative bids before granting such a concession."). Nor is this a case where the board of directors granted a lock-up option to a "white knight" when faced with an unsolicited, hostile bid. *C.f. Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892 (W.D.N.Y. 1983). A PBC should certainly be afforded greater discretion in either of these contexts given the directors' balancing requirements.

In the instant case, the Board agreed to a lock-up option after receiving two bids simultaneously. Mem. Op. at 10-12. This was not a situation in which the Board had negotiated and come to a deal and was then trying to protect that deal from hostile bidders with a lock-up option. *See* Mem. Op. at 10-12. Because the Board received both bids at the same time, there was no reason to grant an auction-ending provision to one of the companies. *See Mills Acquisition Co.*, 559 A.2d at 1284 ("If the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts."). Here, the Board not only agreed to an unreasonable lock-up option, it did so to the substantial

detriment to the shareholders. *C.f.* id; *see* Mem. Op. at 12. This agreement is unreasonable under the circumstances.

2) The Gaming Option unreasonably and excessively undervalued Praise's crown jewel.

Even if the timing of the Gaming Option was appropriate, agreeing to the significant price devaluation violated the Board's fiduciary duties to the Praise shareholders. In relying on this Court's jurisprudence regarding change-of-control transactions, the Second Circuit held that "[w]hen engaging in defensive maneuvers, such as a lock-up option, a director's primary obligation is to ensure the overall fairness, including fair price, to the shareholders." *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 279 (2d Cir. 1986). In reviewing an option price, the court need not determine the "precise value" of the assets subject to the option, rather courts focus instead on whether the price was reasonable. *Id.*

While the price of Praise's gaming division was disputed below, Chancellor Develin determined the value to be at least $30 million. Mem. Op. at 10. However, the Gaming Option valued the gaming division at a mere $18 million, a full $12 million (40%) below the appraised value. Mem. Op. at 10. The $12 million crown jewel discount amounted to a 24% discount on the value of the entire Praise merger, which coupled with a 3% termination fee, amounted to a 27% discount on the value of the deal. Mem. Op. at 10. The Second Circuit referred to a 14% discount as a "severe devaluation." *Hanson Trust PLC*, 781 F.2d at 279. Therefore, the 40% discount in the Gaming Option is grossly unreasonable in comparison.

The Board violated its fiduciary duties to the Praise

shareholders by agreeing to the terms in the Gaming Option. Even if the Board believed that a merger with New Hope was appropriate, it had no reason to significantly devalue Praise's "crown jewel" to the detriment of the Praise shareholders. Such action cannot survive enhanced scrutiny, therefore, this Court should find that the Board breached its fiduciary duties to the Praise shareholders.

II. THIS COURT SHOULD AFFIRM THE GRANT OF THE PRELIMINARY INJUNCTION BECAUSE, UNDER THE PRINCIPLES OF LAW OUTLINED IN *BLASIUS* AND ITS PROGENY, THE GAMING OPTION WAS INVALID BECAUSE ITS PRIMARY PURPOSE WAS TO INTERFERE WITH THE PRAISE SHAREHOLDERS' RIGHT TO A MEANINGFUL VOTE ON THE MERGER AND THE BOARD LACKED A SUFFICIENT AND COMPELLING JUSTIFICATION FOR ITS IMPLEMENTATION.

Question Presented

Whether a preliminary injunction is proper to enjoin a merger where the board of directors of a PBC implements a severely discounted crown jewel lock-up option, forcing the PBC's shareholders to vote in favor of a merger to avoid a significant devaluation of their shares.

Scope of Review

This court reviews the grant of a preliminary injunction under the abuse of discretion standard. *Lawson v. Meconi*, 897 A.2d 740, 743 (Del. 2006). However, in reviewing whether Chancellor Develin properly applied the principles from *Blasius Indus., Inc. v. Atlas Corp.*, to the instant case, is a question of law. 564 A.2d 651 (Del. Ch. 1988). This Court reviews such questions of law de novo. *Stroud v. Grace*, 606 A.2d 75, 91 (Del. 1992). Under de novo review, Chancellor Develin's reliance on *Blasius* will only be overturned if the Chancellor "erred in formulating or applying legal precepts." *Id.* (citation omitted).

Merits of the Argument

The Board's approval of the Gaming Option constituted a

deliberate and successful attempt to interfere with the Praise shareholders' statutory right to an effective vote on the merger. The shareholders of a PBC have an absolute right to vote on a merger, even if their shares are classified as nonvoting. 8 *Del. C.* § 363. The board of directors may recommend to the shareholders how they should cast their vote, so long as they do not deprive them of a "full and fair opportunity" to cast a meaningful vote. *Stroud*, 606 A.2d at 92.

Blasius and its progeny have provided the framework with which courts examine board action aimed at disrupting any shareholder vote. *Blasius*, 564 A.2d at 657-63. Courts have stated "[i]n any voting context, actions taken for the purpose of interfering with a full and fair exercise of the stockholder franchise will run afoul of basic equitable limitations found in our law." *In re MONY*, 8853 A.2d at 675, n. 51 (citing *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 437 (Del. 1971); *see also Kidsco, Inc. v. Dinsmore*, 670 A.2d 1338, 1338 (Del. 1995). Thus, where the board of directors takes action that has the "primary purpose of interfering with the effectiveness of a corporate vote," the board must demonstrate a "compelling justification for such action." Blasius, 564 A.2d at 661.

In *Blasius*, the directors of Atlas Corp. added two members to the staggered board in order to delay and hopefully defeat a takeover attempt by Blasius Industries. *Id.* at 657-58. The Atlas directors asserted, and the court acknowledged, that delaying the vote served both the corporation's and stockholders' best interests. *Id.* The directors attempted to invoke the protections of the business judgment rule, by establishing that their decision to delay the vote was both

in good faith and with due care. *Id.* at 659. The court denied the directors this protection, stating that this was not a question of business judgment; rather it was a question of power allocation between directors and shareholders over corporate governance. *Id.*

The court ultimately found that mere good faith and due care were not enough to protect the directors. *Id.* Instead directors could only interfere or impede a shareholders' right to vote if the directors could establish a compelling justification for doing so. *Id.* at 660-62. Therefore, under *Blasius*, if the directors' take action with the primary purpose of inhibiting the shareholders' meaningful right to vote, the directors will bear a "heavy burden" to demonstrate the reasonableness of its actions. *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1128 (Del. 2003) (quoting *Blasius*, 564 A.2d at 661). The *Blasius* decision has since been invoked to overturn a variety of measures taken for no other purpose than disrupting a shareholder vote. *See MM Cos.*, 813 A.2d at 1132-33 (invalidating expansion of board to prevent successful election of new directors by "hostile" shareholders); *Hilton Hotels Corp. v. ITT Corp.*, 978 F. Supp. 1342, 1347 (D. Nev. 1997) (invalidating drastic reorganization of corporation and creation of staggered board to prevent takeover). Chancellor Develin correctly applied *Blasius* to invalidate the Gaming Option in the instant case. *See* Mem. Op. 15-16.

A. The Board's primary purpose behind its acceptance of the Gaming Option contained in New Hope's bid was to interfere with the effectiveness of the Praise shareholders' vote on the merger.

A board's decision to implement a lockup option may violate the principles in *Blasius* if the lockup option interferes with the

shareholders' meaningful vote on the merger. *See* 564 A.2d at 661. This is in part because "[t]he stockholder's ability to effectively reject a merger agreement is likely to bear an inversely proportionate relationship to the structural and economic devices the board has approved to protect the transaction." *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 930 (Del. 2003). For this reason, "[a] board may not coerce the shareholder vote by agreeing to . . . structural devices that force stockholders to vote in favor of the transaction." *In re MONY*, 853 A.2d at 661, 676. An unreasonable lockup option with the effect of precluding a meaningful vote will not withstand enhanced judicial scrutiny under *Blasius*. *See id.* at 676.

The significant devaluation of the gaming division in the Gaming Option served the primary purpose of forcing the shareholders to vote in favor of the merger. When agreeing to an asset lockup option, the board of directors' primary obligation is to ensure the overall fairness." *Hanson Trust*, 781 F.2d at 278. While the court's scrutiny of a lockup option price is typically conducted via a *Revlon* analysis, a severe undervaluation should similarly be struck down under *Blasius* if the low option price was negotiated with the primary purpose of forcing shareholders to vote in favor of the merger in question. *See id.* at 278; *Blasius*, 564 A.2d at 661.

In the instant case, the Board had no reasonable basis to accept the valuation of the Gaming Option. As indicated above, the 40% devaluation on the Gaming Option amounted to a total value of 27% of the Merger. Mem. Op. at 10. Deal protection agreements that amount to a 27% discount are grossly excessive and thus unreasonable for their

purported purpose. *See, e.g.*, *Hanson Trust*, 781 F.2d at 279 (referring to a 14% discount on "crown jewel" assets as a "serious devaluation"); Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 Minn. L. Rev. 239, 324 (1990)(providing an overview of case law on the subject, while stating that some courts have held that a lockup worth 8% of a transaction price did not impede voting, but a 17% lockup did).

As the Chancellor noted in the court below,

> "[w]ith respect to the Gaming Option, the Praise Video directors recognized that the acknowledged undervaluation reflected in the exercise price would likely encourage many Praise Video stockholders to vote in favor of the Merger, even if they individually would have preferred Mercer's higher cash bid under the circumstances . . . the directors . . . viewed this likely effect positively, because it would favor and facilitate the consummation of the bid that achieved the balance previously approved by the majority of the directors."

Mem. Op. at 12. Thus, even if the Board believed that the Gaming Option was required in order to secure a deal with New Hope, the 40% devaluation of the Gaming Division was nonetheless "for the primary purpose" of deterring the shareholders from voting contrary to the will of the board. See Mem. Op. at 10, 16.

Had the Board negotiated the Gaming Option price to reflect the true value of the gaming division, there existed the possibility that the shareholders would nevertheless reject the Merger. *See* Mem. Op. at 10. Were the Gaming Option triggered at its appraised value, the shareholders would have instead received approximately $30 per share. *See* Mem. Op. at 10, 16. With this possibility looming, the Board agreed to significantly reduce the price in order to coerce the shareholders into voting in favor of the Merger. Mem. Op. at 16; *see*

In re MONY, 853 A.2d at 676. When faced with the prospect of losing an estimated value of $18 per share, the Praise shareholders had no rational choice but to vote in favor of the Merger. Mem. Op. at 10, 16. Because the Gaming Option removed the rational choice from the Praise shareholders by precluding all other options, this Court must apply the *Blasius* test. See 564 A.2d at 661; Mem. Op. at 10, 16.

B. The Board had no compelling justification for implementing the Gaming Option.

The Board lacked any compelling justification for agreeing to the Gaming Option terms. Once the court determines that the board of directors acted with the primary purpose of interfering with a shareholder vote, the inquiry then turns to whether the board had a "compelling justification" for doing so. *Blasius*, 564 A.2d at 662-63. Whether the board of directors' action was otherwise technically legal is irrelevant. *In re MONY*, 853 A.2d at 676 ("inequitable action does not become permissible simply because it is legally possible."). Delaware courts have continuously and unequivocally held that a good faith belief that the shareholders would benefit from the action is not a compelling justification for interfering with the shareholders' right to vote. Mem. Op. 16; *see also MM Cos.*, 813 A.2d at 1129-30.

Praise's status as a PBC does not alter their duty to provide its shareholders a meaningful vote. Mem. Op. at 16. The directors of a PBC must manage the business "in a manner that balances the pecuniary interests of the stockholders" with "the public benefit" the corporation seeks to further. 8 *Del. C.* § 362. However, nothing in the PBC statute suggests that promoting a public benefit would be a compelling justification for rendering the Praise shareholders' vote

on the Merger useless. As the Chancellor Develin correctly noted, it is irrelevant that the directors had a good faith belief that the action would promote a public benefit. *See In re MONY*, 853 A.2d at 676; Mem. Op. at 15-16.

If the Board truly believed that the New Hope bid was in the Praise shareholders' and corporation's best interests, they had both the right and the opportunity to persuade the shareholders to vote for the merger with New Hope: "There is a vast difference between expending corporate funds to inform the electorate and exercising power for the primary purpose of foreclosing effective shareholder action." *MM Cos.*, 813 A.2d at 1129 (quoting *Blasius*, 564 A.2d at 663). Instead of attempting to persuade the Praise shareholders, the Board agreed to a manifestly unreasonable Gaming Option at the significant expense of the shareholders. *See Kidsco*, 674 A.2d at 498; Mem. Op. 16.

In the twenty-six years since *Blasius* was decided, there exists only one case in which a court found a compelling justification for board action which interfered with a stockholder vote. *Mercier v. Inter-Tel, Inc.*, 929 A.2d 786, 809-13 (Del. Ch. 2007). In *Mercier*, the directors of Inter-Tel took action to postpone a stockholder vote on a merger. *Id.* at 798. At the time they acted, the directors had reason to believe that the company's valuation would be significantly impacted by the impending housing and debt crisis, information which had only been made available a short time before the vote was scheduled. *Id.* The court held that the directors established a compelling justification for their actions, in part because the acquirer "[would have] walk[ed] away without making a higher bid and

that the opportunity to receive the bid [would have been] irretrievably lost." *Id.* at 813, 819.

In the instant case, the Board not only took action to interfere with the shareholder vote, they did so with the knowledge that a significantly higher bid had been presented. *See* Mem. Op. at 10-12. This was unlike *Mercier*, where the directors took action out of a fear that the shareholders would lose immense value if the merger failed. Rather, the Board agreed to the Gaming Option to *ensure* that the Praise shareholders would lose significant value if they voted contrary to the Board's wishes. *See* Mem. Op. at 10-12, 15-16.

The Gaming Option in the instant case violated the principles of *Blasius* and its progeny. See Mem. Op. at 15-16. The Board acknowledged that it took action specifically to affect the Praise shareholders' vote. Mem. Op. at 16. However, the Board did not and cannot demonstrate any compelling justification for implementing the Gaming Option. *See* Mem. Op. at 10, 15-16. For the foregoing reasons this Court should affirm the lower court's decision.

CONCLUSION

For the foregoing reasons, this Court should affirm the Chancery Court's decision because Appellants breached their fiduciary duties as directors, and because the Appellants, by implementing the Gaming Option, deprived the Praise shareholders of a meaningful vote on the merger without a compelling justification for doing so.

Respectfully submitted,
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