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.,	:	
Defendants Below, Appellants	:	
v.	:	No. 43, 2014
MERCER CHRISTIAN PUBLISHING CO., and SUSAN BEARD,	:	
Plaintiffs Below, Appellees	:	

On appeal from the Court of Chancery, New Castle County
C.A. No. 8974-CD
Date Decided: January 14, 2014

ANSWERING BRIEF OF APPELLEES

Team X,
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February 7, 2014

TABLE OF CONTENTS

NATURE OF PROCEEDINGS.. 1

SUMMARY OF ARGUMENT.. 1

STATEMENT OF FACTS.. 2

ARGUMENT.. 6

I. THE BOARD'S CONDUCT WAS INCONSISTENT WITH ITS FIDUCIARY OBLIGATIONS WHEN IT DID NOT PERFORM THE BALANCING REQUIRED BY DGCL §§ 362 (a) and 365 (a).. 6

A. Question Presented.. 6

B. Scope of Review.. 6

C. Merits of Argument.. 7

1. The Board failed to perform the balancing required by DGCL §§ 362 (a) and 365 (a) by failing to complete each part of the statute's tripartite mandate.. 7

i. The Statute requires the board of a PBC to balance the stockholders' financial interest with the public benefit identified in the certificate of incorporation.. 7

a. The text of the Statute is clear in requiring the pursuit of stockholders' financial interest within a tripartite balancing evaluation.. 8

b. All the interpretation elements available support this construction of the required balancing evaluation.. 9

ii. The Board failed to perform the statutory balancing evaluation, by ignoring value-maximization and by erroneously assessing New Hope's ability to protect the public benefit.. 11

a. The Board failed to engage in a value-maximizing effort as is required by *Revlon* and its progeny.. 11

b. The Board was unreasonable in its assessment that New Hope is better positioned to protect Praise Video's public benefit.. 13

c. The Board failed to perform the necessary comparative analysis as the final step of the mandatory balancing.. 14

II. THE CHANCELLOR CORRECTLY GRANTED THE PRELIMINARY INJUNCTION BECAUSE THE BOARD BREACHED ITS FIDUCIARY DUTIES UNDER *BLASIUS* AND *UNOCAL* BY AGREEING TO THE CROWN JEWEL OPTION.. 15

A. Question Presented.. 15

B. Scope of Review.. 15

C. Merits of Argument. 15
1. The Chancellor correctly held that the Board breached its fiduciary duties as they are articulated in *Blasius*. 15
i. This Court has not interpreted *Blasius* as applying only to the stockholder vote in elections of directors, and *Blasius*' reasoning applies with equal or greater force in a stockholder vote for the approval of a merger. 15
ii. *Blasius*' compelling justification scrutiny is applicable here because the Board's primary purpose in agreeing to the Crown Jewel Option was to impede the exercise of the stockholder franchise. 18
iii. The Board's actions fail scrutiny under *Blasius* because the Board does not articulate a compelling justification for implementing the Crown Jewel Option. 20
2. Even if *Blasius* were inapplicable, the Crown Jewel Option is subject to enhanced scrutiny under *Unocal*, and it fails this scrutiny because it is coercive and outside the range of reasonableness. 22
i. Because the Option is a defensive deal protection measure, *Blasius* should be applied within *Unocal* enhanced scrutiny. .. 22
ii. The Crown Jewel Option fails *Unocal* scrutiny because it is coercive and outside range of reasonableness. 23
CONCLUSION... 25

TABLE OF CITATIONS

Cases

Arnold v. Soc'y for Sav. Bancorp, Inc. 7
650 A.2d 1270 (Del. 1994)

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

Black v. Hollinger Int'l Inc. 16
872 A.2d 559 (Del. 2005)

CA, Inc. v. AFSCME Employees Pension Plan 17
953 A.2d 227 (Del. 2008)

Chesapeake Corp. v. Shore 20
771 A.2d 293 (Del. Ch. 2000)

City of Westland Police & Fire Ret. Sys. v.
Axcelis Technologies, Inc. 17
1 A.3d 281 (Del. 2010)

Coastal Barge Corp. v. Coastal Zone Indus. Control Bd. .. 10
492 A.2d 1242 (Del. 1985)

Crown EMAK Partners, LLC v. Kurz 17
992 A.2d 377 (Del. 2010)

eBay Domestic Holdings, Inc. v. Newmark 9
16 A.3d 1 (Del. Ch. 2010)

Gantler v. Stephens 17
965 A.2d 695 (Del. 2009)

Hollinger Int'l, Inc. v. Black 17, 21
844 A.2d 1022 (Del. Ch. 2004)

Johnston v. Pedersen 19
28 A.3d 1079 (Del. Ch. 2011)

Kaiser Aluminum Corp. v. Matheson 15
681 A.2d 392 (Del. 1996)

Malpiede v. Townson 12
780 A.2d 1075 (Del. 2001)

Mercier v. Inter-Tel (Delaware), Inc. 21
929 A.2d 786 (Del. Ch. 2007)

MM Companies, Inc. v. Liquid Audio, Inc. .... *passim*
813 A.2d 1118 (Del. 2003)

Paramount Commc'ns, Inc. v. QVC Network Inc..... 12, 19, 23
637 A.2d 34 (Del. 1994)

Paramount Commc'ns, Inc. v. Time Inc..................... 24
571 A.2d 1140 (Del. 1989)

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc......... 9
506 A.2d 173 (Del. 1986)

In re Santa Fe Pac. Corp. S'holder Litig................. 7
669 A.2d 59 (Del. 1995)

Stroud v. Grace 16, 20, 21, 23
606 A.2d 75 (Del. 1992)

Unitrin, Inc. v. Am. Gen. Corp....................... 24, 25
651 A.2d 1361 (Del. 1995)

Williams v. Geier 19, 25
671 A.2d 1368 (Del. 1996)

Statutes and Rules

6 Del. C. § 18-101 8
8 Del. C. § 114 8
8 Del. C. § 361 .... 8, 10
8 Del. C. § 362 .... *passim*
8 Del. C. § 365 .... *passim*
Del. Sup. Ct. Rule 42 1

Other Authorities

William T. Allen, *Our Schizophrenic Conception of the Business Corporation* 9
14 CARDOZO L. REV. 261, (1992)

Corporate Laws Committee, ABA Business Law Section, *Benefit Corporation White Paper* 10
68 BUS. LAW. 1083 (2013)

Hon. Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?* 9
75 S. CAL. L. REV. 1169, (2002)

S.B. 47, 147th General Assembly, Reg. Sess. (Del. 2013). 11

NATURE OF PROCEEDINGS

This action was commenced in the Court of Chancery on December 13, 2013, by plaintiffs Mercer Christian Publishing Company ("Mercer") and Susan Beard (collectively "Appellees"). The defendants, now "Appellants," are Praise Video Inc., a Delaware public benefit corporation ("Praise Video" or "the Company"); Jacob Bissinger, Francis Pennock, Mark Van Zandt, Howard Metcalf, and Peter Hornberger, directors of PV (collectively "the Board"); New Hope Publishing Company, and Praise New Hope Corporation, Delaware corporations (collectively "New Hope"). Appellees have continuously owned stock in Praise Video at all relevant times.

Plaintiffs moved to preliminarily enjoin the pending merger agreement between Praise Video and New Hope ("the Merger Agreement" or "the Merger"). Based on his finding that the Board breached its fiduciary duties with respect to the Merger Agreement, Chancellor Sean Develin granted the motion by an order dated January 15, 2014, and issued a Memorandum Opinion (hereinafter "Op."). This Court accepted Appellants' certified application for interlocutory review pursuant to Supreme Court Rule 42.

This is Appellees' opening brief.

SUMMARY OF ARGUMENT

Because the Board of Praise Video failed to perform the balancing required by Delaware General Corporation Law ("DGCL") §§ 362-365 and decided to accept a financially lower offer from New Hope, the Merger Agreement was not the result of an informed and reasonable decision. In order to comply with the public benefit corporation ("PBC") PBC

statute, when facing competing offers from New Hope and Mercer, the Board had to follow a balancing evaluation consisting of three steps: full exploration of the value maximization in compliance with *Revlon* duties, inquiry about how the two competing bidders were willing to protect the specific public benefit endorsed by the Company, and finally, comparative analysis of the two offers on both grounds.

The Board failed to perform these necessary steps and endorsed the New Hope bid without establishing a connection between the suboptimal financial condition and the alleged better alignment with the public benefit. Although the Chancellor did not decide this question, the Board's failure to satisfy the §§ 362-365 balancing should be a sufficient basis for enjoining the Merger.

The Chancellor was correct to grant preliminary injunctive relief, finding that the Board breached its fiduciary duties as articulated by *Blasius*. *Blasius* applies to this case because the Board's primary purpose in adopting the defensive Gaming Option was to interfere with the stockholders' vote on the Merger. Because the Board lacked a compelling justification for this interference, the Board's actions do not survive *Blasius* scrutiny and the injunction was proper.

Even if *Blasius* were inapplicable, the Gaming Option is a defensive deal protection measure subject to *Unocal* enhanced scrutiny. Because the Option functions to coerce the stockholders into voting for the Board's favored bidder, the Option fails *Unocal* scrutiny.

STATEMENT OF FACTS

Based in Lancaster, Pennsylvania, Praise Video is a privately held company that produces and distributes digital entertainment,

including video games. Op. 4. Since its incorporation in the 1970s, Praise Video's business model has been to market its products to consumers who identify with the Christian themes portrayed in Praise Video's content. Op. 3-4. The Company's directors and most of its 250 stockholders are affiliated with the Mennonite Church USA. Op. 4.

In early 2013, Appellant Jacob Bissinger, CEO of the Company since its inception, decided that he would retire by the end of the year. Op. 6. Bissinger owns a 22 percent stake of Praise Video and sought to liquidate it as part of his retirement planning. Op. 6. Upon hearing of Bissinger's decision, the Board retained financial advisor Norman Stoltzfus, and instructed him to explore a sale of the Company. Op. 6. Of the potential acquirors Stoltzfus identified, one was Mercer, a company which markets Christian faith-based content in print, audio, and digital media. Op. 5. Mercer, a subsidiary of a publicly-traded media conglomerate, suggested it would pay more than $40 per share for Praise Video. Op. 7.

When the Board met on June 24, 2013 they were pleased with Stoltzfus' findings, especially because he had identified potential acquirors who appeared to share Praise Video's commitment to Christian values. Op. 7. Bissinger inquired about how the bidders, including Mercer, would achieve the synergies and revenue growth they sought, and Stoltzfus opined that growth potential existed in the combat-oriented video game market segment. Op. 7. Bissinger was distressed at the possibility of Praise Video expanding into this line of business, citing the Mennonite opposition to all forms of violence. Op. 7-8. The

Board instructed Stoltzfus to continue searching, keeping in mind the concerns expressed about the future operation of the Company. Op. 8.

The Board also consulted legal counsel about its fiduciary obligations in a sale of the company. Op. 8. Counsel reported that the Board's duty was to achieve the highest sale price, but also proposed a re-incorporation under Delaware's new public benefit corporation statute as a way the Board's legal obligation might be altered. Op. 8.

Based on this advice, the Board voted 5-1 to merge Praise Video into a newly-formed public benefit corporation ("the Reorganization"). Op. 8. The Board informed the Praise Video stockholders that it was exploring strategic alternatives, and asserted that the Reorganization would likely give the Board greater legal flexibility to take Mennonite values into consideration in any sale of the Company. Op. 8-9. The Reorganization became effective on September 30, 2013, pursuant to § 363(a). Praise Video's new certificate of incorporation specifies its public benefit, namely "the promotion of the values articulated in the Confession of Faith in a Mennonite Perspective." Op. 3.

At this point, Appellant Francis Pennock, a director of Praise Video, formed New Hope in order to join the bidding for Praise Video. Op. 9. Pennock owns 20 percent of Hope Hope, with the other 80 percent controlled by Miller Price, L.P., a Delaware limited partnership. Miller Price is owned equally by two partners, one of whom is a member of the Mennonite Church. Op. 6. Miller Price's partnership agreement states that in the event of a deadlock between its two principals, one principal must acquire the other's share of the partnership or its assets must be liquidated. Op.6.

When Pennock signaled his interest in submitting a bid, the Board directed Mercer, New Hope, and the three other bidders to make their best offer by December 5, 2013. Op. 9. Only Mercer and New Hope submitted bids, both fully-financed and in cash: Mercer for $50 per share, and New Hope for $41 per share. Op. 9. Neither bidder acquiesced to Praise Video's request that the surviving entity post-merger would be organized as a PBC or include the specific public benefit reflected in Praise Video's charter. Op. 9.

Recognizing that it would be unlikely to outbid Mercer, New Hope sought to enhance its chances of succeeding in the auction. Op. 10. Toward this end it conditioned its offer on Praise Video granting to New Hope an option to acquire Praise Video's gaming division for $18 million over five years (hereinafter "the Gaming Option," or "the Crown Jewel Option"). Op. 10. The gaming division, valued at $30 million, is Praise Video's most profitable asset, accounting for 60 percent of the Company's annual earnings. Op. 4. The Option becomes exercisable if the New Hope Merger is terminated due to failure to gain stockholder approval, and within a year Praise Video enters another merger agreement. Op. 10. Using M&A parlance, the Chancellor described the device as a "crown jewel option." Op. 2.

The Board met on December 9, 2013, to consider the bids. Op. 10. They agreed that no other potential bidders would be forthcoming in any reasonable time frame. Op. 11. The Board acknowledged the significant undervaluation of the Crown Jewel Option, and recognized that the effect of the Option would be to induce stockholders to vote in favor of the New Hope Merger, even if they may have preferred

Mercer’s higher bid. Op. 12. The Board believed that this would facilitate the consummation of the New Hope Merger. Op. 12.

Bissinger stated in the context of this discussion that because he believed Mercer might expand the gaming business into the combat-oriented game segment, he would not support a merger with Mercer regardless of price. Op. 12. The Board believed that since Pennock would be the CEO of the post-merger corporation, Praise Video’s public benefit would continue to be promoted. Op. 10-11. At no time did the Board attempt to make New Hope raise its offer price, nor did it attempt to obtain Mercer’s assurances from that it would operate the post-merger company in keeping with Mennonite teachings. Op. 9-12.

The Board voted 4-1, with Pennock absent, to approve the New Hope Merger at $41 per share, and granted the Crown Jewel Option as New Hope requested. Plaintiffs filed this action on December 13, 2013, seeking to enjoin the New Hope Merger prior to the stockholder vote.

ARGUMENT

I. THE BOARD’S CONDUCT WAS INCONSISTENT WITH ITS FIDUCIARY OBLIGATIONS WHEN IT DID NOT PERFORM THE BALANCING REQUIRED BY DGCL §§ 362 (a) and 365 (a).

A. Question Presented.

Do directors of a PBC breach their fiduciary duties when they fail to perform the necessary balancing between stockholders’ financial interest and protection of the corporate public benefit and, in a change of control transaction, endorse a lower offer without adequately informing their decision?

B. Scope of Review.

This issue was raised below and considered, but not decided, by the Chancellor. Op. 13-15. This Court may, however, decide issues not reached below in the interest of orderly procedure. *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 72 (Del. 1995). As a question of statutory interpretation, the review is *de novo*. *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1287 (Del. 1994).

C. Merits of Argument.

1. **The Board failed to perform the balancing required by DGCL §§ 362 (a) and 365 (a) by failing to complete each part of the statute's tripartite mandate.**

In change of control transactions, the stockholders' economic interest and the enhancement of the public benefit formally endorsed by a PBC can diverge. Cognizant of this potential conflict, the Legislature devised a mandatory balancing that a board of a PBC must perform to properly comply with its fiduciary duties. In order to satisfy the necessary balancing under DGCL § 365(b), the board of a PBC must establish a connection between the suboptimal financial condition and the alleged better alignment with the public benefit and disclose such relationship in order to justify a partial diversion from the general standard of firm's value maximization associated with for-profit corporations. In this case, the Board disregarded the statutorily required balancing, and did not make an informed, reasonable assessment of the advantages and disadvantages associated with the New Hope and Mercer bids. As a result, its decision to favor the New Hope Merger violated the requirements of §§ 361-365.

i. **The Statute requires the board of a PBC to balance the stockholders' financial interest with the public benefit identified in the certificate of incorporation.**

The recently enacted PBC statute requires the directors of a PBC to perform a balancing in the management of the business and affairs of the corporation. §§ 362(a), 365(a). With the statute, the Legislature afforded PBCs the opportunity to pursue other interests in conjunction with, and not in substitution of, the stockholders' value maximization. However, the newly introduced PBC is a for-profit corporation[1] and should not be immune from the common law of Delaware corporations.

a. The text of the Statute is clear in requiring the pursuit of stockholders' financial interest within a tripartite balancing evaluation.

With the enactment of §§ 361-365, the Legislature gave boards of PBCs a clear mandate: directors must pursue the public benefit *together* with the firm's value maximization, and must perform a tripartite evaluation:

> § 365(a): 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 specific public benefit or public benefits identified in its certificate of incorporation.

The Legislature intended this three-part balancing as the key feature of the PBC, as the reiteration of the same language in §§ 362 and 365 illustrates.

It is well established that directors' duty under Delaware law is to "generate stockholder wealth, and that the interests of other

[1] Delaware offers other forms of incorporation that allow the management of the firm to disregard stockholder value and the other constraints associated with for-profit corporations. *See* 6 Del. C. §§ 18-101 et seq. (Delaware Limited Liability Company Act); 8 Del. C. § 114 (defining nonstock and non-profit corporations).

constituencies are incidental and subordinate to that primary concern."[2] In reality, even before the recent PBC amendments, a board was permitted to take other constituencies into consideration if it could show that such interests were "rationally related [to] benefits accruing to the stockholders." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). Delaware courts have often reiterated that "[p]romoting, protecting, or pursuing non-stockholder considerations must lead at some point to value for stockholders," and held that directors who failed to establish how their actions would increase shareholder value "failed to prove [...] that they acted in the good faith pursuit of a proper *corporate* purpose." *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 33-34 (Del. Ch. 2010).

With the PBC statute, the legislature waives the necessity of proving this link between the consideration for other constituencies' interest and the benefit to stockholder, but it allows this only under specific conditions. These conditions are clearly set in the statute: first, the PBC's certificate of incorporation must identify a specific public benefit; second, in managing the affairs of the corporation, the directors must balance stockholder value maximization with the stated public benefit. §§ 362(a) and 365(a).

b. All the interpretation elements available support this construction of the required balancing evaluation.

[2] Hon. Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169, 1170 (2002); *see also* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264-65 (1992)(discussing the "property" model of corporate law).

This Court has not yet interpreted the PBC statute. Under Delaware law, the fundamental rule of statutory interpretation is that, "unreasonableness of the result produced by one among alternative possible interpretations of a statute is reason for rejecting that interpretation in favor of another which would produce a reasonable result." *Coastal Barge Corp. v. Coastal Zone Indus. Control Bd.*, 492 A.2d 1242, 1247 (Del. 1985). Sections 361-365, while requiring a tripartite standard of evaluation, establish that any failure by disinterested directors to otherwise meet the tripartite standard could be considered "an intentional infliction of harm on the corporation or the shareholders" unless the Certificate contains an opt-in exculpatory clause. In absence of an opt-in clause, failure to perform the mandatory test can be grounds for establishing breach of duty of care and duty of loyalty. This statutory structure underscores the importance of a meaningful performance of the balancing test as a bulwark against PBC directors using a proffered constituency's interest as an excuse for otherwise self-interested decisions.[3]

Furthermore, the legislative Synopsis appended to the PBC bill and authored by Sen. Sokola, first sponsor of the Bill, states that, "A public benefit corporation is a for-profit entity which is managed *not only* for the pecuniary interests of its stockholders *but also* for the benefit of other persons, entities, communities or interests."[4] (emphasis added). This language makes clear the intention of the legislature to impose upon the directors of a PBC the pursuit of the

[3] Corporate Laws Committee, ABA Business Law Section, *Benefit Corporation White Paper*, 68 Bus. Law. 1083, 1102 (2013)
[4] S.B. 47, 147th General Assembly, Reg. Sess. (Del. 2013), available at http://www.legis.delaware.gov/LIS/LIS147.NSF/vwLegislation/SB+47?Opendocument

firm's value maximization *as well as* the public benefit explicitly endorsed in the certificate.

ii. The Board failed to perform the statutory balancing evaluation, by ignoring value-maximization and by erroneously assessing New Hope's ability to protect the public benefit.

In order to meaningfully perform the required tripartite balancing, the directors first need to explore the full potential of the two substantive components of the evaluation: the maximization of value, and the enhancement of the specifically identified public benefit. Fulfilling the first part of the evaluation involves the *Revlon*-type analysis aimed at obtaining the best price available. The second part involves the assessment of how the available bids are differently positioned towards the protection of the public interest. After establishing these two essential bases, the board can make its final comparison between the available offers and make its informed decision. In this case, however, the Board failed to examine thoroughly the two parts of the evaluation, and never performed a comparative assessment of the two offers. By merely adopting the New Hope offer, the Board failed to complete the required balancing under §§ 362 and 365.

a. The Board failed to engage in a value-maximizing effort as is required by *Revlon* and its progeny.

In the case of a change-of-control transaction involving a PBC, it is clear that the economic interests of shareholders and other constituencies or public interests can diverge. In this scenario, *Revlon* plays a double role: on one hand it is applicable to PBC directors as to all for-profit corporate decision-makers, and on the

other hand it is a prerequisite for the effective performance of the mandatory balancing test. In fact, there cannot be any meaningful balancing evaluation in absence of a preliminary exploration of the maximum potential financial gain.

If a business combination is deemed to constitute a "sale of the company" or a "sale of control," it is governed by the *Revlon* doctrine. *Revlon, Inc.*, 506 A.2d at 182; *see also Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 36 (Del. 1994)(involving sale of control). In this case, the Board committed to selling the Company by mid-November 2013, and its actions after that point should be subject to *Revlon* enhanced scrutiny. *Revlon* emphasizes that the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise. *See, e.g.*, *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001).

In this case, the Board rejected the fully-financed, all-cash $50 per share offer from Mercer, and signed the New Hope Merger agreement for $41 per share. The record shows no effort by the Board to persuade New Hope that they should increase their bid in light of the higher offer from another bidder. This deficiency is even more egregious in light of the Gaming Option, discussed in detail in Part II of this Argument. A reasonable negotiator in the Board's position would have reached out to New Hope and pressed its board to offer a better price, given that on financial grounds the New Hope bid was significantly inferior to Mercer's offer. The Praise Video Board failed even to attempt to maximize the price from its preferred bidder, and by accepting the lower offer in this way it entirely failed to pursue

value maximization part of the statutory balancing required by §§ 362 and 365.

b. The Board was unreasonable in its assessment that New Hope is better positioned to protect Praise Video's public benefit.

The Board failed to complete the second aspect of the balancing because it did not properly assess how the two bidders were positioned with regard to the public benefit element of the test. Both bidders refused to agree that the post-merger company's certificate would include the specific benefit endorsed by Praise Video. Op. 9. The surviving entity under both the New Hope and Mercer proposals will be a traditional for-profit corporation, concerned only with stockholder value maximization, in keeping with established Delaware law. With the New Hope Merger, Praise Video is being merged into a non-PBC, and the chosen buyer is not legally bound to balance value maximization with the specific public benefit in the future.

The reality is that New Hope has offered nothing more than Pennock's word that he will manage the post-merger company in accordance with Mennonite teachings. Op. 9-10. But Pennock holds only a 20 percent block of New Hope. Its 80 percent controller, Miller Price, is tenuously positioned: as a legal matter, should its two principals (only one of whom is Mennonite) come to a disagreement about the management of the company, they are required either to buy each other out or liquidate the assets. Op. 6. Thus, it is reasonably foreseeable that the 80 percent stake in New Hope will be sold, or its assets, including the Praise Video business, will be spun off. In the event that New Hope is sold, it will be sold as a non-PBC, subject

entirely to *Revlon*'s requirements of maximizing value. The public benefit will be disregarded. The Board failed to consider these possibilities in its hasty decision to sign the New Hope Merger. Thus, it lacked any reasonable basis to conclude that New Hope offers any more meaningful protection of the public benefit than would Mercer.

The Board's lack of bargaining on *Revlon* grounds has a mirror image in the lack of efforts displayed on the public benefit side of the deal. The Board should have leveraged on the inferior financial conditions of New Hope's bid and pursued real legal protection of the public benefit, rather than being satisfied with Pennock's role as the CEO of the surviving company. Op. 10. The Board simply gave up its effort to ensure that surviving company would be structured as a PBC in the way that Praise Video is structured. In the context of a sale of the company, such an aborted request should not qualify as fulfilling the requirements of the §§ 362 and 365 balancing.

c. The Board failed to perform the necessary comparative analysis as the final step of the mandatory balancing.

Finally, the board did not perform the necessary comparison between the negative financial outcome associated with the New Hope bid and the alleged positive effect on the public benefit to be secured by merging with New Hope. Not only did the Board fail to establish the two components of the required test (exploration of the economic value and pursuit of the public interest), it also failed to compare the available offers through the balancing method required by the statute. The critical assessment for the Board was to show why the inferior price was justified or balanced by the corresponding increase in protection of the public benefit. This necessary basis of an

informed and reasonable decision did not exist in the Board's actions. Jumping to a decision in absence of the necessary comparative analysis, the Board breached the standards imposed by §§ 362 and 365.

II. THE CHANCELLOR CORRECTLY GRANTED THE PRELIMINARY INJUNCTION BECAUSE THE BOARD BREACHED ITS FIDUCIARY DUTIES UNDER *BLASIUS* AND *UNOCAL* BY AGREEING TO THE CROWN JEWEL OPTION.

A. Question Presented.

Did the Board breach its fiduciary duties under *Blasius* and *Unocal* when it granted the Crown Jewel Option in an attempt to interfere with the stockholders' vote on the New Hope Merger?

B. Scope of Review.

While the grant or denial of a preliminary injunction is reviewed for abuse of discretion, this Court reviews the decision below without deference to the embedded legal conclusions of the trial court. *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 (Del. 1996)

C. Merits of Argument.

1. The Chancellor correctly held that the Board breached its fiduciary duties as they are articulated in *Blasius*.

i. This Court has not interpreted *Blasius* as applying only to the stockholder vote in elections of directors, and *Blasius*' reasoning applies with equal or greater force in a stockholder vote for the approval of a merger.

A board's action is subject to the *Blasius* compelling justification standard of review if the primary purpose of the action is to "interfere with or impede exercise of the stockholder franchise." *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992); *see also Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 660 (Del. Ch. 1988). This Court re-affirmed *Blasius* and discussed it in great depth in *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del.

2003). In *Liquid Audio*, prior to a stockholder meeting at which a competing slate of directors was up for election, the Liquid Audio board of directors increased the size of the board from five to seven and immediately filled the board seats, in order to "diminis[h] the influence" of the dissident nominees, should they be elected. *Liquid Audio, Inc.*, 813 A.2d at 1123-26. This Court held that compelling justification scrutiny under *Blasius* was necessary because "the primary purpose of the Board's action was to interfere with or impede the effective exercise of the shareholder franchise in a contested election for directors." *Id.* at 1131.

Critically, however, the *Liquid Audio* Court did not hold that *Blasius* should apply only in the context of a stockholder vote for the election of directors.[5] To the contrary, the language and reasoning of the *Liquid Audio* decision logically extends to a stockholder vote for approving a merger agreement. *See Liquid Audio Inc.*, 813 A.2d at 1126-31. After a broad discussion situating *Blasius* in context of Delaware corporate governance law, this Court concluded that *Blasius*, like *Unocal*, responds to the conflicts that arise when a board acts to prevent the stockholders from "effectively exercising their right to vote *either contrary to the will of the incumbent board members*

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[5] No decision of this Court has held that *Blasius* applies only to stockholder votes respecting the election of directors. For this Court's citations to *Blasius* post-*Liquid Audio*, see *City of Westland Police & Fire Ret. Sys. v. Axcelis Technologies, Inc.*, 1 A.3d 281, 289 (Del. 2010)(declining to apply *Blasius* in a "proper purpose" inquiry under Section 220); *Black v. Hollinger Int'l Inc.*, 872 A.2d 559, 567 (Del. 2005)(affirming the Court of Chancery's finding in *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1089 (Del. Ch. 2004) that *Blasius* either did not apply or was satisfied by a compelling justification); *see also Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 395 (Del. 2010)(citing but not discussing *Blasius*), *Gantler v. Stephens*, 965 A.2d 695, 710 (Del. 2009)(same), *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 237 (Del. 2008)(same).

generally or to replace the incumbent board members in a contested election." *Id.* at 1129.

The "either/ or" formulation makes clear that the election of directors is *one* circumstance in which *Blasius* can be implicated, but not the *only* circumstance. This conclusion is buttressed by the *Liquid Audio* Court's discussion of *Blasius*. This Court affirmed Chancellor Allen's "cogent" explanation of why deference to the board of directors is inappropriate where the purpose of their action is to "interfer[e] with the effectiveness of a shareholder vote, especially in the specific context . . . of a contested election for directors." *Id*. at 1128. That *Blasius* applies *especially* but *not only* in director elections is further proven by *Liquid Audio*'s quotation of *Blasius*:

> [A] decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance. That, of course, is true in a very specific way in this case which deals with the question who should constitute the board of directors of the corporation, *but it will be true in every instance in which an incumbent board seeks to thwart a shareholder majority*.

Liquid Audio, Inc., 813 A.2d at 1128 (quoting *Blasius*, 564 A.2d at 659-60)(emphasis added).

Thus it is clear that the language of *Blasius*, and this Court's subsequent treatment of it, should be construed as applying to all stockholder votes insofar as they implicate the "allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation." *Liquid Audio, Inc.*, 813 A.2d at 1128 (quoting *Blasius*, 564 A.2d at 659-60). The stockholder franchise is implicated in precisely this manner in the context of a merger,

because the DGCL expressly provides for a balance of power between boards and stockholders with respect to merger transactions. *See Paramount Commc'ns Inc.*, 637 A.2d at 42. Thus the stockholder vote on a merger clearly touches upon the "issues of control" concerns underlying the *Liquid Audio* decision. *Liquid Audio, Inc.*, 813 A.2d at 1130; *see also, e.g.*, *Johnston v. Pedersen*, 28 A.3d 1079, 1090 (Del. Ch. 2011)("When the vote involves an election of directors *or touches on matters of corporate control*," *Blasius* applies)(emphasis added).

Protection of the stockholder franchise is perhaps even more urgent in the context of the merger than of elections for the board of directors. Where, as in *Blasius* and *Liquid Audio*, the board acts to interfere with the stockholders' vote in a director election, the worst possible damage is the entrenchment of management. This is harmful, but may be undone in future elections. In this case, however, Praise Video's stockholders are presented with a "no tomorrow" scenario: an all-cash merger that will extinguish their ownership of Praise Video. For the same reasons that this Court has applied *Blasius* to protect the stockholder franchise in the director election context, it is consistent with the law and reason to apply it in this case as well.

ii. ***Blasius*' compelling justification scrutiny is applicable here because the Board's primary purpose in agreeing to the Crown Jewel Option was to impede the exercise of the stockholder franchise.**

The *Blasius* compelling justification standard is "quite onerous, and is therefore applied rarely." *Williams v. Geier*, 671 A.2d 1368, 1376 (Del. 1996). A board of director's action must satisfy compelling

justification enhanced scrutiny *only* where the primary purpose of the action is to interfere with or impede exercise of the stockholder franchise. *Stroud*, 606 A.2d at 92. In this case, the Chancellor found that the Praise Video Directors agreed to grant New Hope the Crown Jewel Option specifically because it "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." Op. 12. The Directors "viewed this likely effect positively, because it would favor and facilitate the consummation of the bid" that the Directors preferred. Op. 12.

In determining whether the primary purpose of disenfranchisement is present, "the most important evidence of what a board intended to do is often what effects its actions have." *Chesapeake Corp. v. Shore*, 771 A.2d 293, 320 (Del. Ch. 2000). The Praise Video Directors knew that the Crown Jewel Option dramatically undervalued the Company's most profitable asset, the gaming division. Op. 10, 12. They viewed the Option favorably precisely because of the effect that it would have on the stockholders' Merger vote: it would cause many stockholders to vote for the Merger even if they may not have absent the Option. The Board agreed to the Crown Jewel Option in order to diminish the likelihood that the stockholders would vote down the Merger. The Board's motivation here closely parallels that of the board in *Liquid Audio,* where the directors' action had the primary purpose of disenfranchisement because they acted to "diminish the influence" of the dissident directors who were up for election. *Liquid Audio, Inc.*, 813 A.2d at 1126. The Chancellor was correct to find that

by approving the Crown Jewel Option, the Praise Video Directors sought to "intentionally deprive the stockholders of their statutorily-mandated right to vote on a merger." Op. 16. The Board's actions should be subject to *Blasius* compelling justification scrutiny.

iii. The Board's actions fail scrutiny under *Blasius* because the Board does not articulate a compelling justification for implementing the Crown Jewel Option.

A board's decision to adopt a defensive measure touching "upon issues of control" that purposefully disenfranchises its shareholders cannot be sustained without a "compelling justification." *Stroud*, 606 A.2d at 92, n. 3. In decisions of this Court and the Court of Chancery applying *Blasius*, there are very few instances of a board whose disenfranchising action was found to satisfy compelling justification scrutiny. *See, e.g.*, *Mercier v. Inter-Tel (Delaware), Inc.*, 929 A.2d 786, 819 (Del. Ch. 2007)("When directors act for the purpose of preserving what the directors believe in good faith to be a value-maximizing offer, they act for a compelling reason in the corporate context."); *Hollinger Int'l, Inc.*, 844 A.2d at 1089 (finding that either *Blasius* did not apply, or alternatively, that a compelling justification existed under those "extraordinary circumstances," where the board had "knowledge of the misconduct of its agent," Black.)

The Praise Video Directors contend that a compelling justification for the Crown Jewel Option exists in protecting the Company's public benefit by ensuring that the New Hope Merger is consummated. Absent the Option, the Directors admit, the individual stockholders may be less likely to approve the Directors' preferred Merger. Op. 12. As discussed *supra* in Part I, the New Hope Merger does

not in reality offer any more assurance of protecting Praise Video's public benefit than an acquisition by Mercer. Even if, however, the New Hope Merger *did* offer more protection of the Company's public benefit, this should not be construed as a compelling justification to uphold the Crown Jewel Option.

In *Liquid Audio*, the board acted to diminish the effectiveness of the stockholder vote in the director election, primarily because the board was concerned that if the stockholders elected the dissident directors, their presence on the board "could jeopardize the pending merger, which the incumbent board favored." *Liquid Audio, Inc.*, 813 A.2d at 1126. The *Liquid Audio* board was motivated by the fear that the stockholders would vote against the board's wishes, and this Court invalidated the board's actions as lacking a compelling justification. *Id.* at 1132. Under very similar facts in *Blasius*, Chancellor Allen concluded that, "The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest." *Blasius*, 564 A.2d at 663. Noting that the Delaware law's delegation of power to the board "does not create Platonic masters," the Chancellor invalidated the action for lack a compelling justification. *Id.*

Just as was the case in *Liquid Audio* and *Blasius*, the gravamen of the Praise Video Director's reasoning is that they "know" the New Hope Merger is in the best interest of the Company, and they are willing to employ a coercive device in order to induce the stockholders to approve it. It may have been appropriate here for the Board to expend corporate funds to educate and persuade the stockholders as to the

purported superiority of the New Hope Merger. *See Blasius*, 564 A.2d at 663 (suggesting this as a reasonable measure). But here, as in *Blasius*, the Board's simple fear that a well-informed stockholder will vote against the Board's preference is not a sufficient justification for attempting to coerce a certain outcome in the vote. The Chancellor should be affirmed in his finding that the Praise Video Directors failed compelling justification scrutiny under *Blasius*.

2. Even if *Blasius* were inapplicable, the Crown Jewel Option is subject to enhanced scrutiny under *Unocal*, and it fails this scrutiny because it is coercive and outside the range of reasonableness.

i. Because the Option is a defensive deal protection measure, *Blasius* should be applied within *Unocal* enhanced scrutiny.

This Court has understood *Blasius* as representing a "specific expression" of the *Unocal* test. *Stroud*, 606 A.2d at 92 n. 3. If the board action in question would trigger *Unocal* in its own right, because it is a defensive measure taken in response to some threat to the corporation touching upon issues of control, then the compelling justification standard of *Blasius* must be applied within *Unocal*'s requirement that any defensive measure be proportionate and reasonable in relation to the threat posed. *Liquid Audio, Inc.*, 813 A.2d at 1131.

Under this Court's precedent, when a board implements defensive deal protection measures at the request of the acquiror in a sale of control situation, the board's actions are subject to enhanced scrutiny under *Unocal*, especially where the deal protection measures result in disparate treatment of competing bidders. *Paramount Commc'ns Inc.*, 637 A.2d at 49. The Crown Jewel Option is a classic deal protection device because, as the Praise Video Directors expressly

acknowledged, the undervaluation of the Option puts pressure on the rational stockholder to vote in favor of the New Hope Merger, lest the Merger fail and the Option become exercisable. Op. 10, 12. It is expressly the will of the Board that the Option function to make the New Hope bid more likely to succeed in spite of the higher offer from Mercer. Op. 12. Accordingly, *Unocal* enhanced scrutiny applies to the Option.

ii. The Crown Jewel Option fails *Unocal* scrutiny because it is coercive and outside range of reasonableness.

It is well established that Unocal scrutiny involves two inquiries: first, whether the board had reasonable grounds for believing that a danger to corporate policy and effectiveness existed, and second, whether the board's defensive response was reasonable in relation to the threat posed. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *see also Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995). As discussed in Part I of this Argument, New Hope is no better positioned than Mercer to protect Praise Video's public benefit in the future. For this reason, the Board was not reasonable in its assessment that Mercer posed a "threat." However, the Crown Jewel Option also clearly fails the second prong of *Unocal*, which inquires as to the proportionality of a board's response. To survive this test, a board's defensive response must not be preclusive or coercive, and then must be found within a "range of reasonableness." *Unitrin, Inc.*, 651 A.2d at 1388.

This Court has described board-initiated defensive actions as "coercive" where the action seeks to "force upon shareholders a management-sponsored alternative." *Paramount Commc'ns, Inc. v. Time*

Inc., 571 A.2d 1140, 1154 (Del. 1989); *accord Unitrin, Inc.*, 651 A.2d at 1387. Although the judicial determination as to coercion depends on the facts of each case, impermissible coercion may exist where the defensive action has "the effect of causing the stockholders to vote in favor of the proposed transaction for some reason other than the merits of that transaction." *Geier*, 671 A.2d at 1382-83.

In this case, the Crown Jewel Option has precisely this effect, by pressuring the stockholders to vote for the New Hope Merger even if they would not do so in absence of the Option. The Option undervalues the Company's most profitable asset, the gaming division, by at least fifty percent.[6] The Option becomes exercisable if the New Hope Merger is not approved by the stockholders and then Praise Video enters into another merger agreement within twelve months. Op. 10, n. 12. This places any value-maximizing stockholder in a bind: vote for the New Hope merger, or wait at least another year before a deal with Mercer or any other bidder is back on the table.

Praise Video's shares are not publicly traded and the company operates in the niche market of Christian-affiliated media. Further, there is pressure for a merger to be consummated in the near future, as Defendant Bissinger, CEO of Praise Video since its inception in the 1970s and holder of a 22 percent stake in the Company, decided in

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[6] The Chancellor found the gaming division to be worth $30 million. The exercise of the Gaming Option enables New Hope to acquire this asset for $18 million, so the Chancellor found the discount to be $12 million or 40 percent. But the $18 million is paid in installment notes over five years (Op. 12), so the face value neglects the time value of money. Even assuming a conservative discount rate (5 percent), the present value of the 5-year stream of payments is $15.5 million, closer to a 50 percent discount. At a reasonable 10 percent discount rate, the present value of the Option is $13.3 million, a 56 percent discount.

early 2013 that he would retire and liquidate his stake within the year. A rational stockholder would be hard pressed to take the risk that a deal as valuable as the $50/ share Mercer offer will be available in twelve months. But such a deal is available and fully-financed *now*, and many stockholders may prefer it to the $41/share New Hope bid. The Crown Jewel is coercive because it will have the effect of causing these stockholders to consider voting for the New Hope Merger not because it is the most meritorious deal, but because voting "no" carries significant and penalizing risk: there may not be *any* deal a year from now, much less a $50 all-cash bid. As such, the Option is designed to force upon the stockholders the Directors' sponsored alternative, and it should be invalidated as coercive under *Unocal* scrutiny.

CONCLUSION

For the foregoing reasons, the Chancellor's decision to grant the preliminary injunction should be AFFIRMED.

Respectfully Submitted,

Team X
Counsel for Appellees
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