EFiled: Mar 23 2015 01:42PM EDT
Filing ID 56958654
Case Number 702,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DELAWARE COUNTY EMPLOYEES RETIREMENT FUND, CITY OF ROSEVILLE EMPLOYEES' RETIREMENT SYSTEM and ROBERT FRIEDMAN, Derivatively and on Behalf of SANCHEZ ENERGY CORPORATION,	:	No. 702, 2014
Plaintiffs Below, Appellants	:	APPEAL FROM THE OPINION AND ORDER DATED NOVEMBER 25, 2014 OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN CONSOL. C.A. NO. 9132-VCG
v.	:	
A.R. SANCHEZ, JR., ANTONIO R. SANCHEZ, III, GILBERT A. GARCIA, GREG COLVIN, ALAN G. JACKSON, EDWUARDO SANCHEZ, ALTPOINT CAPITAL PARTNERS LLC, ALTPOINT SANCHEZ HOLDINGS, LLC, SANCHEZ RESOURCES, LLC, and SANCHEZ ENERGY CORPORATION	:	
Defendants Below, Appellees.	:	

APPELLANTS' REPLY BRIEF

DATED: March 23, 2015

CHIMICLES & TIKELLIS LLP
Pamela S. Tikellis (Del. No. 2172)
Scott M. Tucker (Del. No. 4925)
Tiffany J. Cramer (Del. No. 4998)
Vera G. Belger (Del. No. 5676)
222 Delaware Avenue, Suite 1100
Wilmington, DE 19899
(302) 656-2500

Additional counsel on signature page

GRANT & EISENHOFER P.A.
Stuart M. Grant (Del. No. 2526)
Michael J. Barry (Del. No. 4368)
Nathan A. Cook (Del. No. 4841)
123 Justison Street
Wilmington, DE 19801
(302) 622-7000

Co-Lead Counsel for Plaintiffs

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

ARGUMENT

I. THE COMPLAINT ADEQUATELY ALLEGES THAT A MAJORITY OF THE SANCHEZ ENERGY DIRECTORS WAS NOT INDEPENDENT OR DISINTERESTED

Presuit demand was excused under the first prong of *Aronson* because a majority of the five-member Board of Directors (the "Board") of Sanchez Energy Corp. ("Sanchez Energy") was not disinterested and independent with respect to the Transaction (as defined in Appellants' Opening Brief ("OB")). Defendants admit that A.R. Sanchez Jr. ("Sanchez Jr.") and Antonio R. Sanchez, III ("Sanchez III") lacked independence, but argue that Plaintiffs' Complaint failed to cast doubt on the independence of Alan G. Jackson ("Jackson") and Gilbert A. Garcia ("Garcia"). Defendants merely cite to cases where stockholders alleged far less detail than Plaintiffs did here, and then declare *ipse dixit* Plaintiffs' allegations to be insufficient without explaining why. But an examination of the actual allegations in Plaintiffs' Verified Consolidated Stockholder Derivative Complaint (the "Complaint") and the reasonable inferences drawn therefrom, make clear that Plaintiffs' allegations are markedly different from the bare-boned allegations of lack of independence that have resulted in dismissals in other cases.

The parties have never disputed that ordinary personal or professional relationships like those at issue in *Beam v. Stewart*, do not alone compromise independence. *See Beam v. Stewart*, 845 A.2d 1040, 1051 (Del. 2004); Answering

Brief of Defendants Below-Appellees ("DAB") at 22-23. But deep familial relationships, or relationships akin to that, can and do compromise independence. OB at 17-18, citing *In re China Agritech, Inc.*, 2013 WL 2181514, at *20 (Del. Ch. May 21, 2013) and *Texlon Corp. v. Meyerson*, 802 A.2d 257, 264 (Del. 2002). Likewise, longstanding and significant business relationships also can compromise independence. OB at 20, citing *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 889 (Del. Ch. 1999). Here, Plaintiffs have alleged such facts.

Like the Chancery Court's opinion below, Defendants gloss over Plaintiffs' particularized allegations by characterizing Jackson's relationship with Sanchez Jr. as a mere "alleged friendship" and Garcia's relationship with Sanchez Jr. as a simple "co-investment," as if doing so would make Plaintiffs' particularized allegations go away. DAB at 21-24. But the simple fact is that Plaintiffs' allegations go far beyond Defendants' characterizations. Plaintiffs have alleged a five-decade-long friendship between Jackson and Sanchez Jr. that started in childhood. A40. Plaintiffs have alleged the materiality of Jackson's employment at IBC Insurance Agency Ltd. ("IBC") where Sanchez Jr. has significant influence. A23-24, 41-42. Plaintiffs have alleged the long-term significant and multiple financial relationships between Garcia and Sanchez Jr. *Id*. These allegations go well beyond the kind of "same social circles" allegations at issue in *Beam* and its progeny. These allegations suffice for pleading purposes.

Further, the cases Defendants cite that reject allegations regarding fees and salaries as compromising independence hinge on the fact that, unlike Plaintiffs' allegations here, the plaintiffs in those cases made no particularized allegations regarding the materiality of those fees and salaries.[1] In *LC Capital Master Fund*, for example, plaintiffs alleged that a director was materially self-interested because he owned a large common stock stake and a hypothetical shift in the merger consideration to preferred stockholders would have cost him $500,000. The Court rejected this argument because the hypothetical $500,000 shift paled in comparison to the $5.6 million total value of his common stock stake, and the plaintiffs had not made any allegations regarding his personal economic circumstances that would indicate $500,000 would otherwise be material to him. 990 A.2d at 453. Here, Plaintiffs have alleged with particularity the materiality of Jackson's employment at IBC by alleging facts regarding his salary[2] and that his directors' fees comprise

[1] *See LC Capital Master Fund, Ltd. v. James*, 990 A.2d 435, 453 (Del. Ch. 2010); *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342, 359-60 (Del. Ch. 1998), *aff'd in part, rev'd in part by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *VGS, Inc. v. Castiel*, 2003 Del. Ch. LEXIS 16, at *46 (Mar. 10, 2003).

[2] Defendants criticize Plaintiffs for not alleging Jackson's actual salary. DAB at 18. To the contrary, based on publicly available information, the Complaint alleges that Jackson earned between $230,000-$310,000 in salary and bonus as an IBC executive in the year prior to the Transaction. A40-41. Defendants may contest this allegation factually, but for purposes of their

30-40% of his total annual compensation. A41-42.

In *Walt Disney*, the Court rejected plaintiffs' allegations that the director's salary as a principal of a school was low compared to her director's fees and stock options, causing her to lack independence. 731 A.2d at 359-60. The Court reasoned that finding a lack of independence would "discourage the membership on corporate boards of people of less-than-extraordinary means." *Id*. at 360. By contrast, Plaintiffs here have alleged not only the materiality of Jackson's employment at IBC with respect to his financial situation, but also that Sanchez Jr. has significant influence over IBC, where Jackson is employed.[3] A41-42.

The Court in *VGS*, in the context of a *summary judgment* motion, rejected plaintiffs' evidence that a director lacked independence based on his salary as an officer in a company controlled by an interested party. 2003 Del. Ch. LEXIS 16, at *46. The Court reasoned that while this was the director's sole employment, other evidence showed that this director had other substantial sources of income. *Id.* Here, the Complaint alleges that Jackson receives a salary as an officer of IBC, where Sanchez Jr. has significant influence, and receives compensation as a

---

motion to dismiss it must be accepted as true. *See, e.g.*, *Tvi Corp. v. Gallagher*, 2013 Del. Ch. LEXIS 260, *37 (Oct. 28, 2013).

[3] Notably, the plaintiffs in *Walt Disney* did not allege that any of the interested parties had any influence over the director's school.

director of Sanchez Energy, which is controlled by Sanchez Jr. and Sanchez III; no other sources of income are alleged.[4]

Finally, Defendants' criticism of Plaintiffs for not pursuing a books and records demand pursuant to 8 *Del. C.* § 220 ("Section 220") (DAB at 5, 10) is irrelevant. A Section 220 demand would not uncover any additional facts regarding the materiality of these directors' inter-relationships. A Section 220 demand only allows inspection of corporate documents. 8 *Del. C.* § 220. Thus, pursuit of a Section 220 demand would not have allowed Plaintiffs to inspect documents delving further into the many personal and financial entanglements between the Sanchezes and the Board members, let alone the personal net worth of Jackson and Garcia. The Complaint contained particularized allegations of the nature and extent of Jackson's and Garcia's personal and financial relationships with the Sanchezes based on publicly available facts, and which would not have been available from Sanchez Energy in connection with a Section 220 demand. For purposes of the motion to dismiss, Plaintiffs' allegations were more than sufficient.

[4] Defendants improperly attempt to negate the materiality of Plaintiffs' allegations by pointing to Jackson's age and his prior co-ownership of a brokerage. *See* DAB at 18. However, this does not shed any light on Jackson's personal economic situation, and at this stage, all reasonable inferences must be drawn in favor of Plaintiffs. *See Cal. Pub. Emples. Ret. Sys. v. Coulter*, 2002 Del. Ch. LEXIS 144, *17-18 (Dec. 18, 2002).

II. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE TRANSACTION IS ENTITLED TO DEFERENCE UNDER THE BUSINESS JUDGMENT RULE

A. THE SANCHEZ FAMILY CONTROLLED SANCHEZ ENERGY AND THE TRANSACTION.

Defendants assert that "the Complaint fails to plead particularized facts creating a reasonable inference that the Sanchez family controlled [Sanchez Energy] or that they controlled the Audit Committee's decision with regard to the Transaction." DAB at 26. They are wrong. That is *precisely* what the Complaint alleges, with particularity.

1. Defendants Do Not Dispute That Sanchez III Negotiated The Transaction

Defendants do not dispute the particularized facts of the Complaint demonstrating that Sanchez Jr. and Sanchez III, who stood on both sides of the Transaction, initiated, structured and negotiated the Transaction. A23, 29-37, 39-42. In fact, Defendants acknowledge that Sanchez III negotiated the Transaction with Altpoint Capital Partners LLC ("Altpoint'). DAB at 30. In an attempt to minimize this admission, however, Defendants argue that Sanchez III's use of "we" and "us," when discussing the Transaction on the August 8, 2013 earnings call, refers to his capacity as CEO of Sanchez Energy, and "[t]hat Mr. Sanchez, SN's Chief Executive Officer, negotiated with Altpoint as part of structuring a

three-party deal with Altpoint and SR, is not in the least suspicious." DAB at 30. Defendants are wrong.

There was no legitimate reason for either Sanchez Energy or Sanchez III (in any capacity) to be negotiating with Altpoint *at all*, and Defendants ignore this point entirely. The *only reason* the Transaction was structured as a three-party deal in the first place was to provide Sanchez Resources (and thereby Sanchez Jr. and Sanchez III) with additional money via the newly-increased royalty payment that they deliberately hid from stockholders. OB at 13-14, 34-35. Specifically, Sanchez Energy could have simply made a direct investment in the joint venture with Sanchez Resources without looping the leases through Altpoint. But without a paper sale of the leases, they would not have been able to secretly increase the royalty obligation that ultimately would burden Sanchez Energy and benefit of the Sanchez family. In other words, the only reason the Transaction was structured as a three-party deal was to allow Sanchez Resources to pass the leases through Altpoint in order to increase the overriding royalty payment on the acreage, thereby creating a hidden payment stream from Sanchez Energy to Sanchez Resources. A34-36. *Even if* Defendants have some other explanation for the complex structure of the Transaction, at the pleading stage Plaintiffs were entitled to the reasonable inference that Defendants structured the deal for the reason Plaintiffs alleged -- to hide the royalty payment to Sanchez Resources. *See*

Coulter, 2002 Del. Ch. LEXIS 144 at *17-18 (reasonable inferences must be drawn in plaintiffs' favor on a motion to dismiss).

As such, the well pleaded allegations of the Complaint create a reasonable inference that Sanchez III either: (a) in his capacity as CEO of Sanchez Energy, negotiated the Transaction on behalf of and for the benefit of Sanchez Resources; or (b) negotiated and structured the Transaction in order to confer a secret benefit on the Sanchez family through the increased royalty payment that has never been disclosed to Sanchez Energy's stockholders. Either way, his direct involvement in the negotiations of the Transaction raises significant questions about the loyalty of his actions. *See Cede & Co. v. Technicolor*, 634 A.2d 345, 363 (Del. 1995) (a fiduciary breaches his duty of loyalty where he stands on both sides of a transaction or derives a personal benefit from it due to self-dealing).

2. The Sanchez Family's Complete Domination Of Sanchez Energy's Operations Constitutes Actual Control

Defendants' argument that Sanchez Jr. and Sanchez III cannot be deemed to control Sanchez Energy as a matter of law because they did not have sufficient voting power to *de facto* control the election of the Sanchez Energy Board is wrong. This Court has never imposed such a bright line rule, nor should it. The test for determining control (with attendant fiduciary duties) is a disjunctive, fact-intensive inquiry into whether the stockholder has (1) a "majority interest" *or* (2) "*exercises control* over the business affairs of the corporation." *Kahn v. Lynch*

Commc'ns Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994) (citations omitted). Plaintiffs ask the Court to apply that well-established test, which leads inexorably to the conclusion that the Sanchezes have effective and actual control over Sanchez Energy. Defendants, on the other hand, ask the Court to turn a blind eye to the striking facts that establish the Sanchez family's absolute control over Sanchez Energy and, at the pleading stage, adopt a sweeping legal principle divorced from those facts and based on inappropriate factual inferences.

"For a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct." *Citron v. Fairchild Camera and Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989). Plaintiffs alleged facts sufficient to demonstrate that the Sanchez family exercises actual, complete control over Sanchez Energy via Sanchez Energy's unusual corporate structure. A27-28. When the Sanchez family took Sanchez Energy public, they purposely structured Sanchez Energy as a shell company with *no employees* and *no operations* of its own in order to maintain direct control of its operations. *Id*. Due to that structure, Sanchez Energy has to rely completely on the Sanchez family, through Sanchez-controlled Sanchez Oil & Gas Corporation ("SOG") and its affiliates, to provide

Sanchez Energy with all of its employees and operations.[5] A27-28, A71, A91-92. The Complaint further alleges that Sanchez Energy's corporate structure allows Sanchez Jr. and Sanchez III to control not only Sanchez Energy's employees and operations, but also the flow and contents of the operational, strategic and financial information provided to the Board. A27, A29, A37, A71, A91-92. Thus, even if Sanchez Energy's Board were truly independent, which it is not, it would be unable to act independently because it must rely solely and completely on information provided by the very actors from whom the Board is supposed to exercise independence.

The Sanchez family chose to impose a contractual arrangement on the captive Sanchez Energy, assuring the Sanchezes of all the benefits of control but with minimal economic risk. Those decisions have consequences. Along with the substantial benefits the Sanchez family enjoys through this unusual and one-sided contractual arrangement comes some costs, including the need to justify to the

[5] Defendants half-heartedly assert that Plaintiffs for the first time on appeal raised claims challenging Sanchez Energy's inherent "'structural deficiency.'" AB at 7, 27-30. Even a cursory reading of the Complaint and Plaintiffs' opposition to the motion to dismiss clearly demonstrates that Plaintiffs have consistently alleged and argued that Sanchez Energy's structure prevented the Sanchez Energy Board from acting independently because it must rely upon the Sanchez family for the day-to-day operations of Sanchez Energy and all corporate information. *See* A19, A27-28, A37, A71, A91-92.

Court the fairness of transactions in which the Sanchez family's interest conflict with those of Sanchez Energy's public stockholders. At the very least, at the pleading stage, allegations that the Sanchezes exercised actual 100% control over the conduct of Sanchez Energy through a unique management agreement that leaves Sanchez Energy without any actual operations of its own, and entirely dependent on employees and entities controlled by the Sanchez family, are enough to allege control. *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 913 (Del. Ch. 1999) ("[I]f in fact a plaintiff alleges facts from which one can reasonably infer that a stockholder controlled a corporation's conduct, I am to draw that inference despite the fact that the same facts also could support an inference less favorable to the plaintiff. Under both theories, the alleged facts supporting the reasonable inference overcome any failure by the plaintiff to plead expressly that the stockholder actually controlled the corporation's conduct.").

B. THE TRANSACTION MERITS ENHANCED SCRUTINY BECAUSE THE SANCHEZ FAMILY STANDS ON BOTH SIDES

Defendants argue that, even assuming the Court correctly determines that the Sanchez family controls Sanchez Energy, the Transaction between the controlled Sanchez Energy and the controlled Sanchez Resources is somehow entitled to the protections of the business judgment rule. Specifically, Defendants contend that "there is no basis in Delaware law for application of the entire fairness standard to a transaction between a corporation and its controlling stockholder where that

transaction (1) does not require stockholder approval, and (2) is approved by a committee of independent and disinterested directors." DAB at 31. That argument fails both as a matter of law and policy. Here, where the Sanchezes deliberately chose a corporate structure and contractual relationships that left Sanchez Energy entirely dependent on the Sanchez family and its controlled companies, the only way to ensure that the rights and interests of Sanchez Energy's public investors are adequately protected is to subject the Transaction to enhanced scrutiny.

1. Under Established Precedent, Entire Fairness Review Applies Because the Sanchez Family Controls Sanchez Energy and Stands on Both Sides of the Transaction

As Delaware courts have long recognized, enhanced judicial scrutiny in the form of entire fairness review applies when structural factors expose minority shareholders to abuse at the hands of interested directors. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."); *In re LNR Property Corp. S'holders Litig.*, 896 A.2d 169, 176 (Del. Ch. 2005) ("the court adheres to a more exacting entire fairness standard of judicial review to protect the minority shareholders, premised on the inapplicability of the business judgment rule where self-interest may have colored directors' actions") (quotation marks omitted); *Kahn v. Tremont Corp.*, 694 A.2d 422, 428-29 (Del. 1997)

(applying entire fairness review to interested transaction where controller caused company to purchase shares of other controlled company); *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 30 A.3d 60, 87 (Del. Ch. 2011) *aff'd* 52 A.3d 761 (Del. Ch. 2011) (applying entire fairness review to interested transaction where controller forced subsidiary to buy non-publicly traded company from controller). Although one example of such structural potential for abuse is when a shareholder or group of shareholders holds majority voting power in the company, entire fairness is appropriate in other factual scenarios as well.

There is no dispute that the Sanchezes, whom (as discussed above and in Plaintiffs' Opening Brief) Plaintiffs have pleaded controlled the Board of Sanchez Energy and its actions related to the Transaction, stand on both sides of the Transaction. And, through the Transaction, the Sanchez family forced Sanchez Energy's public investors to foot the bill for the buyout of Altpoint, for significant new drilling expenses, and for the undisclosed royalty kickback to Sanchez Resources, all while the Sanchez family reaps the benefit of that public investment. Such circumstances, characterized by asymmetrical bargaining power, are classic examples where the Delaware courts apply entire fairness review. *See, e.g.*, *Kahn v. Lynch*, 638 A.2d at 1115 ("A controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness."); *Weinberger*, 457 A.2d at 710; *LNR*, 896 A.2d at 176.

Moreover, even if Jackson and Garcia were independent (and they are not), approval by a committee of independent directors would still not lower the standard of review from entire fairness to business judgment. Although certain procedural protections such as a properly independent, empowered, and informed special committee "could" shift the *burden* of proving entire fairness, they would not lower the applicable standard. *See, e.g.*, *T. Rowe Price Recovery Fund v. Rubin*, 770 A.2d 536, 552 (Del. Ch. 2000) (entire fairness applied to transaction between controller and controlled company; "[a]t most … approval by a properly functioning committee of disinterested directors would shift the burden of proof on the issue of fairness to plaintiffs"); *Tremont*, 694 A.2d at 428 ("Regardless of where the burden lies, when a controlling shareholder stands on both sides of the transaction the conduct of the parties will be viewed under the more exacting standard of entire fairness"); *Orman v. Cullman*, 794 A.2d 5, 20 (Del. Ch. 2002) ("'[e]ntire fairness remains the proper focus of judicial analysis in examining an interested merger, irrespective of whether the burden of proof remains upon or is shifted away from the controlling or dominating shareholder'").

2. Delaware Law Does Not Mandate Business Judgment Review in the Absence of a Shareholder Vote

Beyond that established precedent, there are strong legal and policy reasons to subject transactions with controlling shareholders to entire fairness review, especially where there has been no majority-of-the-minority shareholder vote.

Defendants' brief, including its discussion of *Montgomery v. Erickson Air-Crane, Inc.*, suggests that although a transaction with a controller that is conditioned on a shareholder vote is subject to enhanced scrutiny, the more deferential business judgment standard applies where there has been no shareholder vote. DAB at 32-33 (citing *Montgomery*, No. 8784-VCL (Del. Ch. Apr. 15, 2014) (TRANSCRIPT)). In other words, in Defendants' view, a transaction with *less structural protection* for public shareholders should receive *less judicial scrutiny*. That makes no sense, and cannot be what the law requires.

Defendants contend that the business judgment rule applies if a transaction between a corporation and its fiduciary "receives *either* approval by a committee of independent … directors … *or* approval by the disinterested stockholders." DAB at 33 (citing *MFW*, 67 A.3d at 526-27). Defendants intentionally misrepresent the meaning, and plain language, of *MFW*. Even if the directors who approved the Transaction (Jackson and Garcia) were independent of the Sanchez family (as discussed above, they are not), *MFW* still requires *both* a majority-of-the-minority vote *and* approval by an independent committee as the "potent combination of procedural protections" that "best protects minority investors." *In re MFW Shareholder Litigiation*, 67 A.3d 496, 526 (Del. Ch. 2013). Because there has been no shareholder vote on the Transaction, business judgment deference cannot apply.

Moreover, given that minority shareholders were at all times entirely in the dark as to the royalties due to Sanchez Resources at shareholders' expense, enhanced scrutiny is necessary to provide shareholders with the benefits and protections they would have had in a fully informed, arm's-length transaction. The Sanchez family is on both sides of the Transaction and benefits greatly at the expense of Sanchez Energy's public investors. Those investors lacked material information about the Transaction, had no opportunity to vote on it or otherwise weigh in, and had no independent, unconflicted fiduciary to advocate on their behalf or enforce their interests. If Delaware law actually does allow Defendants to insulate the Transaction through business judgment review – when shareholders have been left in the dark and at the mercy of the Sanchezes – other controllers and conflicted fiduciaries will no doubt take note and follow suit, abusing their positions to meet self-serving ends. The so-called "benefits of control" will now extend to transferring significant wealth away from the minority.

C. THE COMPLAINT ALLEGES SUFFICIENT FACTS TO GIVE RISE TO A REASONABLE INFERENCE THAT THE TRANSACTION WAS NOT ENTIRELY FAIR

Defendants gloss over Plaintiffs' allegations that the Transaction was not fair to Sanchez Energy by arguing that they are "nothing more than a disagreement with the Audit Committee's business judgment." DAB at 33. They are wrong. The Complaint contained particularized allegations that the Transaction was

deliberately structured to hide a royalty payment to Sanchez Resources, and was effected at a price that, based on comparable transactions, did not appear to be entirely fair.

First, the Complaint details Defendants' deliberate concealment of the royalty kickback to Sanchez Resources. A35-36. At no point in time have Defendants ever disclosed that as part of the Transaction the parties increased the royalty that was set to be paid to Sanchez Resources. Contrary to Defendants' assertions, a passing mention on a single occasion two-thirds of the way through an earnings call "that the total royalty burden on the acreage is 25%"– a description that does not mention that Sanchez Resources will receive a royalty payment over and above what is paid to the land owners – does not disclose this additional income stream from Sanchez Energy to Sanchez Resources. *See* DAB at 15. Hiding that (1) the royalty payment is higher than that which is owed to the land owners and (2) the additional percentage will be paid to Sanchez Resources raises the inference that Defendants have acted with bad faith. *See In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 1000 (Del. Ch. 2007) (action taken by a board to conceal the nature of payments made to the company's CEO supported inference of bad faith); *Anglo American Sec. Fund, L.P. v. S.R. Global Int'l Fund, LP.*, 829 A.2d 143, 157 (Del. Ch. 2003) (failure to disclose withdrawal of funds by the general partner despite disclosure of withdrawals by limited partners may indicate

some degree of bad faith). Defendants offer *no response* to this unavoidable inference of bad faith, nor can they.

Second, the Complaint contains particularized allegations that the Transaction price was unfair as it was in excess of $1,000 more per acre paid for other land in the area. An entire fairness analysis requires the court to consider whether the price was fair, not whether the transaction constituted waste. *See Strassburger v. Earley*, 752 A.2d 557, 572 n. 35 (Del. Ch. 2000) (noting that even if a waste claim is negated, entire fairness is still an issue); *Harbor Finance Partners*, 751 A.2d at 892 ("The pleading burden on a plaintiff attacking a corporate transaction as wasteful is necessarily higher than that of a plaintiff challenging a transaction as 'unfair' as a result of the directors conflicted loyalties or lack of due care."). Here, regardless of Defendants' repeated assertion that the Transaction is not wasteful, Plaintiffs' allegations were more than sufficient to give rise to a reasonable inference that the price paid by Sanchez Energy was not entirely fair. *See* DAB at 12-13.

Plaintiffs specifically allege that the Transaction price was unfair. A32. The per-acre price paid by Sanchez Energy was roughly seventeen times more than both the initial price of $185/acre paid for the Tuscaloosa Marine Shale ("TMS") assets in 2010 and the $144/acre paid by Goodrich for a working interest in the area adjacent to and similarly situated to the Sanchez TMS acreage just months

before. A30, 32-33. Based on these allegations, there is more than sufficient basis to question the reasonableness of the $2,500 per acre price paid by Sanchez Energy. The Chancery Court, however, declined to draw that inference in Plaintiffs' favor, and instead made its own "assum[ption]" about the value of mineral rights leases, concluding that the Complaint "lacks sufficient information about the nature, quality, and duration of the Goodrich working interests to allow a meaningful comparison to those acquired by Sanchez Energy." OB at 34 Ex. A. at 28. The problem, of course, is that on a motion to dismiss the Chancery Court was required to draw all reasonable inferences in Plaintiffs' favor. *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009). That Defendants can try to articulate justifications for the wildly disparate price paid by Sanchez Energy as compared to the Goodrich leases (DAB at 14) does not make the inference that the $100 million price tag was too high unreasonable as a matter of law. *See O'Reilly*, 745 A.2d at 929 (accepting plaintiff's allegations of unfair price while acknowledging that defendants ultimately might have been able to prove that the price was fair).

Respectfully submitted,

Dated: March 23, 2015

Of Counsel:

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
Mark Lebovitch
Adam D. Hollander
1285 Avenue of the Americas, 38th Floor
New York, NY 10019
(212) 554-1400

Counsel for Co-Lead Plaintiffs Below-Appellants

GRANT & EISENHOFER P.A.

/s/ Michael J. Barry
Stuart M. Grant (#2526)
Michael Barry (#4368)
Nathan A. Cook (#4841)
123 Justison Street
Wilmington, DE 19801
(302) 622-7000

Counsel for Co-Lead Plaintiffs Below-Appellants

CHIMICLES & TIKELLIS LLP

/s/ Pamela S. Tikellis
Pamela S. Tikellis (#2172)
Scott M. Tucker (#4925)
Tiffany J. Cramer (#4998)
Vera G. Belger (#5676)
222 Delaware Avenue, Suite 1100
Wilmington, DE 19899
(302) 656-2500

Counsel for Co-Lead Plaintiffs Below-Appellants