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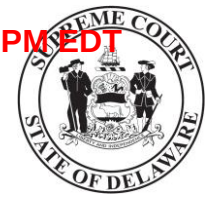

IN THE SUPREME COURT OF THE STATE OF DELAWARE

WALTER E. RYAN, JR., Plaintiff Below, Appellant, v. NAREN GURSAHANEY, THOMAS COLLIGAN, TIMOTHY DONAHUE, ROBERT DUTKOWSKY, BRUCE GORDON, BRIDGETTE HELLER, KATHLEEN HYLE, DINESH PALIWAL, KEITH MEISTER, and CORVEX MANAGEMENT LP, Defendants Below, Appellees, and THE ADT CORPORATION, a Delaware Corporation Nominal Defendant Below, Appellee.	No. 264, 2015 Court Below: Court of Chancery of the State of Delaware C.A. No. 9992-VCP

ANSWERING BRIEF OF DEFENDANTS BELOW, APPELLEES NAREN GURSAHANEY, THOMAS COLLIGAN, TIMOTHY DONAHUE, ROBERT DUTKOWSKY, BRUCE GORDON, BRIDGETTE HELLER, KATHLEEN HYLE, AND DINESH PALIWAL, AND NOMINAL DEFENDANT BELOW, APPELLEE THE ADT CORPORATION

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Dated: August 12, 2015

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NATURE OF THE PROCEEDINGS

This is the answering brief of The ADT Corporation ("ADT") and its directors in opposition to Plaintiff Walter E. Ryan's appeal from the Court of Chancery's order dismissing Ryan's derivative action under Court of Chancery Rule 23.1 for failure to bring a demand on ADT's Board of Directors or to allege adequately that demand is excused.

Ryan's amended complaint (the "Complaint") challenges several actions taken by the ADT Board, including: (i) adoption of a $2 billion share repurchase program in November 2012; (ii) an agreement in December 2012 to expand the eight-member Board by one seat to include Keith Meister, the managing director of Corvex Management LP ("Corvex"), a 5% stockholder of ADT; (iii) a one-year standstill agreement with Corvex in connection with Meister's appointment to the Board; and (iv) an agreement in November 2013 to buy back most of Corvex's shares at the market price – with no premium at all – in connection with Meister's resignation from the Board and Corvex's agreement to extend the prior standstill for another six years.

At the time Ryan filed this action, ADT's eight-member Board consisted of its CEO and seven independent directors, none of whom is alleged to have had a conflicting financial interest in any of the challenged transactions.

Nonetheless, Ryan did not make a demand on the Board to bring the claims he is asserting and instead argues that demand was futile.

Ryan's sole theory of demand futility is entrenchment. He argues that ADT's directors approved the challenged transaction because they feared Corvex would mount a proxy contest to remove them from office if they did not approve them, even though Corvex owned only 5% of ADT's shares and never took any steps to commence a proxy contest, enlist the support of any other stockholder, or even publicly call for the Board to be replaced.

Relying on controlling precedent, including this Court's decision in *Grobow* v. *Perot*, 539 A.2d 180 (Del. 1988), the Court of Chancery correctly rejected Ryan's entrenchment theory. As the court correctly concluded, the Complaint does not allege particularized facts raising a reasonable inference that the directors' positions were actually threatened or that their "sole or primary motivation" for approving the challenged transactions was to retain their positions, both of which are required to excuse demand based on entrenchment. The court also correctly ruled that the Complaint does not adequately allege that the challenged transactions were not a valid exercise of the Board's business judgment, another potential basis for excusing demand.

On appeal, Ryan does not challenge the latter ruling. Instead, he challenges only the rulings that he did not adequately allege an "actual threat" or

that the directors were motivated by entrenchment. He relies primarily on two allegations to support his argument.

First, he points to pitch presentations that outside advisors made to the Board in December 2012 when the Board was considering whether to add Meister as a director. Ryan argues that the presentations demonstrate that the Board faced an actual threat of removal. But the presentations show no such thing. They stated that a proxy contest was one of several options Corvex might pursue. But they also noted that Corvex positioned itself as a traditional non-activist hedge fund that vowed to be less confrontational than Meister's former employer, Carl Icahn. None of the presentations stated that the Board faced an actual threat of removal or that Corvex was taking any steps in that direction.

Second, Ryan relies on his allegation that, in December 2012, the Chairman of ADT's Board told the other directors that, if they did not invite Meister to join the Board, Corvex would "likely" make a stockholder proposal to elect Meister and possibly others as directors at ADT's next Annual Meeting. But believing that Corvex might seek to elect Meister to the Board if the Board did not agree to invite him to join is not the same as believing that the directors faced an actual threat of being removed by Corvex if they did not agree to all of Corvex's proposals. Nor does it show that the directors' "sole or primary purpose" in approving the transactions that Ryan is challenging was entrenchment.

To the contrary, stripped of its overheated rhetoric, the Complaint actually shows that the Board was not intimidated by Corvex and largely rebuffed Corvex's proposals. For example, in October 2012, Corvex proposed that ADT increase its debt and reduce its equity by repurchasing shares. But, as Ryan himself acknowledges, the Board instead decided to increase ADT's leverage by substantially less than Corvex had proposed and adopted a share repurchase program that was substantially smaller than what Corvex had advocated.

Similarly, Ryan alleges that, in August 2013, Corvex told one of ADT's financial advisors that, if ADT did not accelerate its time frame for increasing its leverage ratio, Corvex would present an alternative capital allocation plan with even more leverage and would run a competing slate of directors at ADT's next Annual Meeting. Ryan does not and cannot allege that the Board acquiesced to that proposal. To the contrary, the Board did not agree, and Corvex exited ADT. Meister resigned from the Board and Corvex sold the majority of its stock back to ADT at the market price – with no premium at all – and agreed to extend its standstill with ADT for another six years.

Ryan's appeal presents no grounds for overturning the Court of Chancery's well-reasoned and well-supported opinion. The court's dismissal of the Complaint should be affirmed.

SUMMARY OF ARGUMENT

1. DENIED. The Court of Chancery applied the correct legal standard, which requires that a stockholder alleging entrenchment as a ground for excusing demand allege particularized facts showing the directors' positions were actually threatened. The Complaint does not allege facts showing that the Board faced an actual threat of removal, or that the directors believed they faced such a threat. This Court should reject Plaintiff's theory, unsupported by any legal authority, that demand is excused merely because a board thinks it possible, or even likely, that a minority stockholder may seek to elect one or more of its designees to the board – particularly where the challenged transactions are not defensive measures, but actions concerning the corporation's capital structure that are quintessential matters of business judgment.

2. DENIED. The Court of Chancery correctly ruled that the Complaint does not allege particularized facts raising a reasonable inference that the sole or primary motivation for ADT's independent directors to approve the challenged transactions was entrenchment. Contrary to what Plaintiff argues, the challenged Board actions themselves do not give rise to a reasonable inference that the directors were solely or primarily motivated by entrenchment, and the Court of Chancery did not improperly recast, ignore, or downplay any of Plaintiff's allegations in that regard.

COUNTER-STATEMENT OF FACTS[1]

A. The Parties

ADT is incorporated in Delaware and is a leading provider of electronic security and interactive home and business automation and related monitoring services. (A24 ¶¶ 16 &17.) Formerly a division of Tyco International, Inc., ADT became a standalone public company in September 2012. (A25 ¶ 19.)

Corvex is an investment firm with headquarters in New York. (A23 ¶ 14.) Between October 2012 and November 2013, it owned or controlled approximately 5% of ADT's outstanding common stock.[2]

Plaintiff Walter E. Ryan, Jr. owns approximately 0.01% of ADT's outstanding stock. (A17 ¶ 4.) Prior to bringing this action, Ryan made a books and record demand under 8 *Del. C.* § 220. (A13-14.) ADT provided him with hundreds of pages of board minutes and other board materials in response to the demand, which Ryan quotes selectively in the Complaint.

At the time Ryan commenced this action, ADT's Board of Directors had eight members. (A77 ¶ 109.) Naren Gursahaney, the CEO, was the only

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[1] Appellees treat all well-pleaded factual allegations in the Complaint as true for purposes of this appeal. *See Grobow*, 539 A.2d at 186. Conclusory allegations are not considered as expressly pleaded facts. *See Brehm* v. *Eisner*, 746 A.2d 244, 255 (Del. 2000).

[2] Corvex's 5% holding included shares held by Soros Fund Management LLC, which had a voting agreement with Corvex. (A27 ¶ 22.)

management director. (A18 ¶ 5.) The rest were non-management outside directors. (A18-22 ¶¶ 6-12.)

Contrary to Plaintiff's suggestion that ADT's directors had "little or no prior experience" (Op. Br. at 1)[3], the Chairman is also a director of CBS Corporation and Northrup Grumman Corporation and was formerly President and CEO of the NAACP. (B64.) The other directors include two CEOs, a former Executive Chairman of Sprint Nextel Corporation, a former Vice Chairman of PricewaterhouseCoopers LLP, an Executive Vice President of Merck & Co., a member of the Advisory Board for the National Association of Corporate Directors, and individuals who also serve or have served as directors of such companies as Eastman Kodak, Amerisource Bergen, and Covidien. (B64-65.) All of the directors received and held equity interests in ADT (A18-22 ¶¶ 6-12, A44 ¶ 42), and thus were ADT stockholders themselves.[4]

B. The Events at Issue

In November 2012, the Board approved a plan to adjust ADT's capital structure by increasing its debt-to-EBITDA ratio from approximately 1.5x to 2.0x. (A32 ¶ 34.) The Board also authorized a $2 billion program to repurchase shares from ADT's stockholders. (A30-31 ¶ 30; B1-2; B13.)

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[3] Citations to "Op. Br. at __" refer to Appellant's Opening Brief, D.I. 16, filed July 13, 2015.

[4] One of the directors, Richard Daly, was not on the Board at the time of the events at issue and is not a defendant. (A77-78 ¶ 109.)

Ryan alleges that the directors took this action as a result of pressure from Corvex, which several weeks earlier had filed a Schedule 13D with the SEC stating that it had acquired more than 5% of ADT's stock and believed ADT could benefit its stockholders by increasing its leverage and repurchasing stock. (A27-29 ¶¶ 23-25.)

Ryan does not allege that the Board failed to conduct its own analysis of the pros and cons of increasing leverage and repurchasing stock or failed to consult outside advisors. Moreover, Ryan acknowledges that the Board adopted a more modest share repurchase program than Corvex proposed (reducing ADT's outstanding share count by only about half the percentage reduction Corvex advocated) and adopted a leverage ratio target of 2.0x debt-to-EBITDA, rather than the 3.0x that Corvex sought. (A32 ¶ 34.)

The following month (December 2012), the Board met with outside advisors Goldman Sachs, Credit Suisse, and Lazard Freres, and its outside legal counsel, Simpson Thacher & Bartlett LLP, concerning Corvex's proposal that Meister be added to ADT's Board. (A33 ¶ 37.) The advisors made presentations concerning Corvex and Meister to help the Board evaluate the request. (*Id.*)

The Credit Suisse presentation stated, among other things, that Meister had "considerable experience" serving on boards, and that Corvex: (i) had "positioned itself as a traditional non-activist hedge fund," (ii) had "vowed to be

less confrontational" than Meister's former employer, Carl Icahn, and (iii) as a young fund, was "keen to establish a respectful reputation." (A36.)

The Lazard presentation laid out "a range of public and private alternatives" that Corvex might pursue, only one of which was launching a proxy contest. (A38.) The presentation further stated that, among all of Corvex's investments, Corvex had "[t]hreatened a proxy fight" on only one occasion, and that, if ADT were to appoint Meister to its Board, "Corvex would gain voice in boardroom, but still could not unilaterally implement proposals." (A36-39.) Board Chairman Bruce Gordon said that if Meister were not asked to join the Board, Corvex "will likely make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT" at the next Annual Meeting. (A33 ¶ 37.)

Thereafter, the Board agreed to add Meister to the Board, and also required Meister and Corvex to enter into a one-year Standstill Agreement, which limited Corvex's ability to buy additional stock and required it to support ADT's slate of directors, so long as Meister remained on the Board. (A43 ¶ 42.)

In July 2013, ADT announced another revision of its capital strategy. It stated that it would now target a leverage ratio of 3.0x debt-to-EBITDA, and that it expected to use proceeds from the incremental leverage "to pursue a flexible, balanced capital allocation plan, including investing in organic growth, completing

acquisitions, and returning excess cash to shareholders in the form of both dividends and share buybacks."[5] (A58 ¶ 66.)

Ryan does not allege any facts to show that any threats by Corvex prompted this revision. Nor does Ryan allege that the Board failed to obtain the advice of outside advisors or otherwise failed to exercise due care before adopting this new leverage target. To the contrary, he alleges that the Board received advice from consultant Centerview Partners. (A56 ¶ 62.)

Following the Board's adoption of this revised strategy, Corvex pressed the Board to go further. In September 2013, Centerview reported to the Board that Corvex had proposed an accelerated timeframe for increasing net leverage to 3.0x, with the majority of the proceeds to be used to repurchase shares. Centerview reported that "[a]doption of Corvex capital allocation timetable was presented as a condition to Keith Meister exit from the Board." (A61 ¶ 69.) It also reported that, "[s]eparately, Corvex has indicated that if its leverage timeframe is not adopted, it would present an alternative capital allocation framework (a 'Public LBO') and run a competing slate of directors to be voted on at ADT's 2014 [Annual Meeting]." (*Id.*)

[5] Contrary to what Ryan asserts (Op. Br. at 15), the revision in ADT's capital strategy was not "at odds with what [ADT] promised analysts just two months earlier." To the contrary, ADT told analysts it would likely revisit its strategy. (*See* B45-46.)

Ryan, however, alleges no facts to show that the Board acquiesced to Corvex's proposal. While he asserts in conclusory fashion that Meister "forced the Board to accelerate [ADT's] increase in net leverage" (A61 ¶ 69), he alleges no facts to support that assertion. The Complaint contains no allegation whatsoever that ADT adopted Corvex's accelerated timeframe for increasing its leverage.

Instead, Ryan alleges that, on November 20, 2013, ADT announced it had entered into an accelerated share repurchase program with JPMorgan Chase Bank to complete the repurchase of shares remaining to be purchased under the initial November 2012 share repurchase authorization, and was increasing the share repurchase authorization by an additional $1 billion. (A66-67 ¶ 80.) But ADT had already announced in July 2013 that it would be increasing its leverage target, in part to fund additional share repurchases. (A58 ¶ 66.) Ryan does not allege that either of these actions reflected an adoption of the accelerated timeframe that Corvex was proposing, rather than merely a continuation of the more gradual increase in leverage that the Board had previously approved.

ADT reported its Fourth Quarter and Fiscal Year 2013 results in the same November 20, 2013 press release that announced the expansion of the share repurchase authorization. (A65 ¶ 80.) Five days later, after the market had time to digest ADT's results, ADT agreed to repurchase 10.24 million of Corvex's shares at the market price of $44.01 per share, which was the closing price on the last

trading day before the agreement. (A67-68 ¶ 83.) ADT also announced that Meister had agreed to resign from the Board and that Corvex had agreed to extend its Standstill Agreement for another six years. (A68-69 ¶¶ 83 & 87.)

Again, Ryan does not allege that the Board failed to seek or consider the advice of outside advisors or otherwise failed to exercise due care before agreeing to the buyback from Corvex. Nor does he appeal from the Court of Chancery's conclusions that "the Director Defendants considered the merits of all of the challenged decisions, receiving information from expert advisors and holding meetings to deliberate each of them," and that the Complaint failed to allege particularized facts suggesting that the buyback from Corvex and the other challenged transactions were not a valid exercise of the Board's business judgment. (Op. Br., Ex. A (hereinafter, "Mem. Op.") at 22-25.)

While Ryan quotes from various ADT financial disclosures and alleges that the share price had been "artificially inflated" (A18 ¶ 5), he does not allege facts showing that any of ADT's financial results or other disclosures were false or misleading or explain how they could have caused the market to mistakenly overvalue ADT's stock. The Court of Chancery found that the Complaint does not adequately allege that the buyback from Corvex included any "overpayment" or "premium" (Mem. Op. at 24), and Ryan does not appeal from that ruling, either.

ARGUMENT

I. THE COURT OF CHANCERY APPLIED THE CORRECT STANDARD FOR DETERMINING WHETHER RYAN'S ENTRENCHMENT ALLEGATIONS ARE SUFFICIENT TO EXCUSE DEMAND AND CORRECTLY DETERMINED THAT THEY ARE NOT SUFFICIENT

A. QUESTION PRESENTED:

Did the Court of Chancery apply the correct standard in ruling that demand is not excused because the Complaint does not adequately allege that the ADT directors' positions were actually threatened by Corvex, which owned only 5% of ADT's stock? (*See* B87-96; B112-35 (issue preserved below).)

B. SCOPE OF REVIEW:

Review is *de novo*. *Brehm*, 746 A.2d at 253.

C. MERITS OF THE ARGUMENT:

1. The Applicable Standard

Under Court of Chancery Rule 23.1, a stockholder seeking to bring a derivative action must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." Del. Ct. Ch. R. 23.1. The demand requirement reflects the "fundamental precept that directors manage the business and affairs of corporations," including deciding whether to initiate litigation. *Aronson* v. *Lewis*, 473 A.2d 805, 812 (Del. 1984).

Where, as here, a plaintiff does not make a pre-suit demand, the Complaint must be dismissed unless it alleges particularized facts showing that demand would have been futile. *Id.* at 813-14. Under the familiar *Aronson* test, to demonstrate demand futility, a plaintiff must plead particularized facts that create a reasonable doubt as to whether: (1) the directors made the challenged decision with disinterestedness and independence; or (2) the challenged decision or transaction was otherwise the product of a valid exercise of business judgment. *Id*. at 814; *see also Wood* v. *Baum*, 953 A.2d 136, 140 (Del. 2008).

Here, the Court of Chancery found that the Complaint does not satisfy either prong of the *Aronson* standard. (Mem. Op. at 13-25.) Ryan appeals only from the court's rulings in regard to Prong 1, arguing that he adequately alleged that the directors were not disinterested because they were purportedly motivated by entrenchment.

To satisfy Prong 1 of the *Aronson* standard by alleging entrenchment, a plaintiff must allege particularized facts tending to show the "directors' positions were actually threatened," *Grobow*, 539 A.2d at 188,[6] and that entrenchment was "the sole or primary purpose" of the directors' actions. *Pogostin* v. *Rice*, 480 A.2d

[6] *See also Kahn ex rel. DeKalb Genetics Corp.* v. *Roberts*, 679 A.2d 460, 466 (Del. 1996) ("Absent an actual threat to corporate control or action substantially taken for the purpose of entrenchment, the actions of the board are judged under the business judgment rule.").

619, 627 (Del. 1984).[7] Determining whether directors' positions are "actually threatened" requires a context-specific analysis in which one consideration is the size of the dissident stockholder's ownership stake. *See*, *e.g.*, *Grobow*, 539 A.2d at 188 (0.8% stockholder); *Kahn ex rel. Dekalb Genetics Corp.* v. *Roberts*, 679 A.2d 460, 466 (Del. 1996) (33% stockholder); *Green* v. *Phillips*, 1996 WL 342093, at *4 (Del. Ch. June 19, 1996) (10.7% stockholder). And, because the complaint must make specific factual allegations from which it would be reasonable to infer that entrenchment was the directors' "sole or primary purpose," demand is not excused if it appears from the complaint that the challenged action "could, at least as easily, serve a valid corporate purpose as an improper purpose, such as entrenchment." *Cottle* v. *Standard Brands Paint Co*., 1990 WL 34824, at *8 (Del. Ch. Mar. 22, 1990).[8]

2. The Court of Chancery Applied the Correct Standard in Ruling that the Complaint Did Not Adequately Allege the Directors' Positions Were "Actually Threatened"

Ryan argues that the Court of Chancery misapplied the "actual threat" test by focusing exclusively on actions taken by Corvex, rather than on the

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[7] *See also Unocal Corp.* v. *Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) ("The restriction placed upon a selective stock repurchase is that the directors may not have acted solely or primarily out of a desire to perpetuate themselves in office.") (citations omitted).

[8] *See also Levine* v. *Smith*, 591 A.2d 194, 207 (Del. 1991) ("If a board's decision can be attributed to any rational business purpose, a court will not substitute its judgment for that of a board. When the challenged transaction is approved by a board, the majority of whom are outside, nonmanagement directors, a heavy burden falls on [plaintiffs] to avoid presuit demand.") (citations & internal quotations omitted).

directors' own "belief" or "perception" as to whether they faced an actual threat of removal. (Op. Br. at 20-21.) Ryan is incorrect. The Court of Chancery stated three times that the Complaint did not sufficiently allege that the Board "perceived" an actual threat of being removed. (Mem. Op. at 15, 18, 19.) And the Court's ruling on that issue was correct, because the Complaint does not adequately allege either that Corvex posed an actual threat or that the Board perceived such a threat. Indeed, the Complaint itself alleges that the directors acted to avoid "theoretical proxy battlements." (A80 ¶ 116.)

In connection with what Ryan calls the "first entrenchment acts" (Op. Br. at 23) – that is, the initial adoption of the share repurchase program in 2012 and appointment of Meister to the Board – the Complaint does not allege that Corvex made any threat, either publicly or privately, to mount a proxy contest, or that Corvex took any steps toward doing so. As the Court of Chancery noted, "[t]he Complaint does not even allege that Meister or Corvex publicly advocated for the Board's removal." (Mem. Op. at 18.) Ryan argues that no such allegations are necessary, and that he can rely instead on: (i) the materials that Credit Suisse and Lazard presented to the Board in December 2012, and (ii) Mr. Gordon's statement at a December 2012 Board meeting that, if Meister were not asked to join the Board, Corvex "will likely make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT" at the next Annual Meeting. (Op. Br. at 3-4.)

As an initial matter, Credit Suisse and Lazard made their presentations nearly three weeks after the Board adopted the share repurchase program and increased its leverage ratio target to 2.0x. Thus, they provide no evidence as to what the Board perceived when it made those decisions.[9] And, in any event, neither the presentations nor Mr. Gordon's statement demonstrate the Board was actually threatened with removal or that the directors perceived any such threat.

As the Court of Chancery correctly concluded, the Credit Suisse and Lazard presentations merely acknowledged the possibility that Corvex might mount a proxy contest. (Mem. Op. at 18.) They also noted that Corvex had "positioned itself as a traditional non-activist hedge fund," had "vowed to be less confrontational" than Meister's former employer, Carl Icahn, and that, as a young fund, it was "keen to establish a respectful reputation." (A36.)

The presentations showed there were other major stockholders who "*may* be open to" Corvex's arguments. (A39 ¶ 40 (emphasis added).) But they did not state that Corvex had communicated with any other stockholders regarding a proxy challenge or that any were in fact supporting such a challenge. In fact, in its

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[9] Similarly, Ryan relies on several news articles to show that Corvex has a history of "threaten[ing] and/or remov[ing] board members who did not acquiesce to [its] demands." (Op. Br. at 9-10.) But the Complaint does not refer to these articles and, even in his brief, Ryan does not claim that the ADT directors ever saw them. Moreover, the only article that describes Corvex as "ousting" a board concerns a removal of a board that occurred in March 2014, several months after the events at issue in this case. (*See id*. (citing Karlee Weinmann, *CommonWealth Ousts Entire Board, Sealing Win for Activists*, LAW 360 (Mar. 15, 2014)).)

slide concerning the willingness of ADT's top 20 shareholders to challenge the Board or management, Credit Suisse concluded that only three stockholders, including Corvex, holding a total of 8.2% of ADT's shares, would likely have "greater willingness" to do so, while one stockholder (ADT's second largest) would likely have "less willingness" to do so. (A40 ¶ 40.) Credit Suisse assessed the other sixteen stockholders as falling into neither category. (*Id*.)

At most, the presentations show the Board was advised that Corvex might mount a proxy challenge, and were inconclusive even as to that. As in *Grobow*, "[s]uch allegations are tenuous at best and are too speculative to raise a reasonable doubt of director disinterest." 539 A.2d at 188.

Ryan's allegation concerning Mr. Gordon's statement fares no better. Mr. Gordon observed that, if Meister were not asked to join the Board, Corvex "will likely make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT…." (A33 ¶ 37.) Corvex's request for a single board seat was not an actual threat to the Board's control,[10] and Mr. Gordon's statement does not suggest that he perceived it as such.

Ryan's allegations concerning the so-called "second entrenchment acts" (Op. Br. at 30) – that is, ADT's buyback of Corvex's shares and Meister's

[10] *See*, *e.g.*, *Greenwald* v. *Batterson*, 1999 WL 596276, at *6 (Del. Ch. July 26, 1999) ("The board consisted of five persons. Adding a sixth would hardly have affected defendants' control.").

exit from the Board in November 2013 – similarly fail to demonstrate that the directors' positions were actually threatened or that the Board perceived such a threat.

Ryan argues that the Court of Chancery disregarded his allegation that, in August 2013, Corvex presented its accelerated timeframe for increasing net leverage to 3.0x "as a condition to Keith Meister's exit from the Board," and separately "indicated that if its leverage timeframe [was] not adopted, it would present an alternative capital allocation framework (a 'Public LBO') and run a competing slate of directors to be voted on at ADT's [Annual Meeting]." (A61 ¶ 69.)

The Court of Chancery did not disregard the allegation (*see* Mem. Op. at 7) and it does not support Ryan's theory. Again, there is no allegation that Corvex took any steps to carry through on this proposal or that the directors believed their positions were actually threatened. Indeed, the only reasonable inference is that the Board did not believe their positions were threatened, because Ryan does not allege that the Board acquiesced to Corvex's proposed accelerated timetable for increasing leverage. Instead, Corvex exited from ADT without achieving that goal, with no premium for its shares. (A67-69 ¶¶ 83 & 87.) If there was capitulation by anyone, it was by Corvex, not the Board. Thus, the Court of Chancery correctly concluded that the Complaint does not adequately allege that

the directors' positions were actually threatened, or that the Board perceived such a threat.

The cases Ryan relies upon (Op. Br. at 20-21) do not support his position.

In *Greenwald*, the Court of Chancery rejected demand futility allegations where a stockholder alleged that a board accepted financing from one source as a means of entrenching itself against threats from a 7% stockholder who proposed an alternative form of financing that was contingent on replacement of the board and management. The court ruled that "[a] successful claim of demand futility requires an allegation that an actual threat to the directors' positions on the board existed," and further ruled that the dissident's ownership of 7% of the company's stock "did not give him the power to remove the board, and he is not alleged to have been acting in concert with any other . . . stockholder." 1999 WL 596276, at *5 (citation omitted). The same is true of Corvex, a mere 5% stockholder that also is not alleged to have been acting in concert with other ADT stockholders.

Similarly, in *Kahn*, this Court rejected a stockholder's argument that enhanced scrutiny was required under *Unocal* in connection with a board decision to buy back one-third of the company's stock from a disgruntled stockholder when there was no "real probability" of a threat to the board's control. 679 A.2d at 466.

II. THE COURT OF CHANCERY CORRECTLY RULED THAT THE COMPLAINT DOES NOT ADEQUATELY ALLEGE THAT THE DIRECTORS WERE MOTIVATED BY ENTRENCHMENT

A. QUESTION PRESENTED:

Did the Court of Chancery correctly determine that Plaintiff failed to allege particularized facts showing that the director defendants' sole or primary motivation in approving the challenged transactions was entrenchment? (*See* B87-96; B112-35 (issue preserved below).)

B. SCOPE OF REVIEW:

Review is *de novo*. *Brehm*, 746 A.2d at 253.

C. MERITS OF THE ARGUMENT:

1. The Applicable Standard

As discussed above, to satisfy Prong 1 of *Aronson* by alleging entrenchment, a complaint must contain particularized allegations showing that entrenchment was "the sole or primary purpose" of the challenged transactions. *Pogostin*, 480 A.2d at 627. Simply alleging that directors were motivated to protect their ordinary director compensation is not sufficient. *See Grobow*, 539 A.2d at 188.

2. The Court of Chancery Correctly Ruled That the Complaint Does Not Adequately Allege That the Directors' Sole or Primary Motivation Was Entrenchment

The Court of Chancery correctly determined that the Complaint does not adequately allege that the director defendants' sole or primary motivation in

approving the challenged transactions was entrenchment. The court found that the only allegations bearing on the directors' motivation was that they sought to entrench themselves in order to maintain their director compensation. But, the court found, the Complaint does not allege that the directors' compensation was extraordinary or excessive, or identify why the court should conclude that the compensation package unduly influenced their decision-making.[11] (Mem. Op. at 19-21.)

Plaintiff does not challenge the Court of Chancery's findings as to his failure to allege extraordinary compensation as a motivation for entrenchment. Rather, he argues that the court should have inferred an entrenchment motivation from the nature of the challenged transactions themselves and the surrounding circumstances, including Corvex's purported track record as an activist investor and the timing of the transactions in relation to Corvex's proposals. (Op. Br. at 30-34.)

Plaintiff's arguments fail because none of the challenged transactions, considered individually or taken as a whole, suggest any entrenchment motivation whatsoever, much less that the director's "sole or primary motivation" was entrenchment. As an initial matter, the Court of Chancery found that "the Director

[11] To the contrary, all of the directors were themselves stockholders, which aligned their interest with other stockholders and gave them "a personal incentive to fulfill their duties effectively." *LC Capital Master Fund, Ltd.* v. *James*, 990 A.2d 435, 452 (Del. Ch. 2010) (citations omitted).

Defendants considered the merits of all of the challenged decisions, receiving information from expert advisors and holding meetings to deliberate each of them," and that the Complaint fails to create a reasonable doubt that the challenged transactions were the product of a valid exercise of business judgment. (Mem. Op. at 22-25.) Those findings, which Ryan does not challenge, cannot be reconciled with Ryan's argument that the director's sole or primary motivation was entrenchment.

In addition, the challenged transactions are not inherently defensive measures. In the words of *Cottle*, each of them "could, at least as easily, serve a valid corporate purpose as an improper purpose, such as entrenchment." 1990 WL 34824, at *8.

Thus, for example, with respect to the authorization of the stock repurchase program in November 2012, there is nothing inherently suspicious about a new public company, immediately after its spinoff from a parent corporation, reviewing the capital structure set up by the parent and deciding to take on more debt and reduce equity by repurchasing shares, which boosts the per-share value of the remaining outstanding shares.[12] Notwithstanding Plaintiff's repeated references to share repurchase programs as "financial engineering" and to

[12] *See*, *e.g.*, *In re Cox Radio, Inc. S'holders Litig.*, 2010 WL 1806616, at *18 (Del. Ch. May 6, 2010) ("[T]he prevailing view regarding stock repurchases is that they benefit all shareholders by increasing the remaining shareholders' percentage of equity ownership and supporting the stock's market price.") (citation omitted), *aff'd*, 9 A.3d 475 (Del. 2010) (TABLE).

ADT's program as "economically questionable" (Op. Br. at 16, 22, 25), Delaware grants boards wide authority to repurchase company stock, *see* 8 *Del. C.* § 160, and Delaware courts and others applying Delaware law have repeatedly rejected demand futility allegations in connection with challenges to such programs.[13]

In addition, contrary to what one would expect if the Board were motivated solely by entrenchment, the directors did not approve increasing ADT's leverage ratio to 3.0x EBITDA as Corvex was advocating (A29 ¶ 25); rather, they authorized raising the leverage target to only 2.0x, and authorized a share repurchase program that would result in a reduction of the number of outstanding shares that was roughly half the size that Corvex sought. (A32 ¶ 34.) ADT then decided to increase its leverage target again in July 2013, but Ryan does not allege any facts to suggest that the July 2013 decision was motivated by any threat from Corvex. In fact, Corvex was already bound by a standstill at that point. (A43 ¶ 42.)

The December 2012 Standstill Agreement with Corvex, and the later extension of that agreement, do not suggest a sole or primary purpose of entrenchment, either. Rather, they served the obvious purpose of limiting

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[13] *See*, *e.g.*, *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 137 (Del. Ch. 2009); *Ravenswood Inv. Co., L.P.* v. *Winmill*, 2011 WL 2176478, at *5 & n.54 (Del. Ch. May 31, 2011); *Staehr* v. *Mack*, 2011 WL 1330856, at *3 (S.D.N.Y. Mar. 31, 2011); *In re Textron, Inc. S'holder Deriv. Litig.*, 811 F. Supp. 2d 564, 576-77 (D.R.I. 2011); *In re Am. Int'l Grp., Inc. Deriv. Litig.*, 700 F. Supp. 2d 419, 441-42 (S.D.N.Y. 2010), *aff'd*, 415 F. App'x 285 (2d Cir. 2011).

Corvex's ability to pressure the Board to adopt its alternative strategies – an outcome Ryan would presumably favor. Indeed, this Court has repeatedly found standstill agreements to be a benefit to a corporation in similar circumstances, not an entrenchment device. *See*, *e.g.*, *Grobow*, 539 A.2d at 190; *Ivanhoe Partners* v. *Newmont Mining Corp*., 535 A.2d 1334, 1345-46 (Del. 1987).

Ryan's so-called "second entrenchment acts" (Op. Br. at 30) – that is, the buyback of Corvex's shares at the market price and Meister's exit from the Board in November 2013 – also do not raise a reasonable inference that the Board's sole or primary motivation was entrenchment.

First, as discussed above, Ryan alleges that Corvex indicated to the Board's financial advisor in August 2013 that, if the Board did not accelerate its timeframe for increasing ADT's leverage as Corvex proposed, Corvex would present an alternative capital allocation framework and run a competing slate of directors. (A61 ¶ 69.) But Ryan does not allege that the Board acquiesced to the proposal by accelerating its timeframe for increasing leverage. Instead, Meister resigned from the Board and Corvex sold back its stock to ADT without having achieved that goal and without obtaining any premium for its shares over the market price. Nothing about those circumstances suggests that the Board was motivated by entrenchment.

This Court's decision in *Grobow*, a remarkably similar case, forecloses a finding of entrenchment in these circumstances. There, the Court found entrenchment allegations insufficient to excuse demand where the defendant directors allegedly bought back a dissident stockholder's shares at a premium above the market price and obtained not only a five-year standstill agreement with him, but also a "hush mail" provision that required the dissident to stop criticizing company management. 539 A.2d at 184-85, 188-89.

The Court ruled in *Grobow* that "[s]peculation on motives for undertaking corporate action are wholly insufficient to establish a case of demand excusal," and that "[n]ot one of the asserted grounds would support a reasonable belief of entrenchment based on director self-interest." *Id.* The Court concluded that the stock buyback "must be viewed as any other repurchase by a corporation, at a premium over market, of its own stock held by a single dissident shareholder or shareholder group at odds with management, [which] have repeatedly been upheld as valid exercises of business judgment." *Id.* at 189 (citations & internal quotations omitted).[14] Here, the Court of Chancery correctly concluded that Ryan's arguments are, "if anything, weaker than the argument the Supreme Court

[14] After the plaintiffs in *Grobow* purported to have newly discovered evidence, they filed a second amended complaint. The Court of Chancery again found that demand was not excused, *see Grobow* v. *Perot*, 1990 WL 146 (Del. Ch. Jan. 3, 1990), and this Court again affirmed the Court of Chancery's ruling, *sub nom. Levine* v. *Smith*, 591 A.2d 194, 205-08 (Del. 1991).

rejected in *Grobow*," since the ADT Board bought back Corvex's shares at the market price, not at a premium.[15] (Mem. Op. at 23.)

Kahn, discussed above, also forecloses Plaintiff's entrenchment argument. In *Kahn*, the company "sought to repurchase its own shares in a situation where there was no hostile bidder" and nothing in the record indicated any "real probability of any hostile acquiror emerging or that the corporation was 'in play.'" 679 A.2d at 466 (footnote omitted). This Court explained that, unlike a self-tender, a stock repurchase is "not the type of response to a threat to corporate control which implicates the concerns of entrenchment and conflict requiring heightened judicial scrutiny." *Id*.

Ryan's attempt to portray the challenged transactions as "manipulation of [ADT's] corporate machinery" (Op. Br. at 32), a phrase used in *Pogostin*, 480 A.2d at 627, is unavailing. In *Pogostin*, this Court cited four cases as examples of "manipulation of corporate machinery." *Id.* Those cases all involved changes to voting procedures or other actions that made it more difficult

[15] Ryan's efforts to distinguish *Grobow* (Op. Br. at 27-28) are unavailing. He argues that, in *Grobow*, a Special Review Committee, chaired by an outside director, approved the stock buyback. (*Id*. at 28.) But here, similarly, a nine-member board with seven independent directors (and an eighth director, Meister, not voting) approved the transaction, and the Complaint does not challenge the approval process in any way. Ryan also argues that the dissident in *Grobow* held less than 1% of the company's shares, with no indication he was aligned with or would likely align with a majority of other stockholders. (*Id*.) But here, too, Corvex held only 5% – not an appreciable difference in regard to the ability to oust a board – and, while Credit Suisse reported a year earlier that certain other stockholders "may be open" to Corvex's proposals (A39 ¶ 40), the Complaint does not allege any communications at all (let alone an agreement) between Corvex and other stockholders.

for stockholders to challenge incumbent directors and management.[16] None of the challenged transactions here involved any such "manipulation of corporate machinery," and none made it more difficult for ADT's stockholders to vote the directors out of office if the stockholders disapproved of any of the transactions.

Ryan's allegation that Meister and Corvex escaped "a loss of more than $100 million which they would have suffered if they had been forced to sell the shares with the disclosure of all known information" (A72-73 ¶ 95) is based entirely on hindsight. The Complaint does not allege that, at the time of the buyback, either Corvex or ADT's directors were aware of any non-public information concerning what ADT's next quarterly results would be. The Court of Chancery correctly found (in another ruling Ryan does not contest) that Ryan's allegations in that regard were entirely "conclusory," and that, in any event, the Complaint does not even attempt to assert a disclosure claim.[17] (Mem. Op. at 24.)

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[16] *See*, *e.g.*, *Schnell* v. *Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) (directors refused to produce a list of stockholders and amended the by-law date of a stockholders' meeting to limit the time for contest); *Lerman* v. *Diagnostic Data, Inc.*, 421 A.2d 906, 914 (Del. Ch. 1980) (directors fixed date for annual meeting 63 days in the future, when the company's by-laws required stockholders to submit the names of nominees to the Board at least 70 days in advance); *Petty* v. *Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del. Ch. 1975) (directors used company funds to redeem all of the company's preferred shares except those held by the CEO and a company vice president/director, giving the incumbent directors and management full control of the board); *Condec Corp.* v. *Lunkenheimer Co*., 230 A.2d 769, 775-76 (Del. Ch. 1967) (directors authorized issuance of 75,000 shares of stock to thwart takeover by majority stockholder, in favor of merger with a company that was not planning to replace the existing directors and management).

[17] Notably, on June 4, 2015, the United States District Court for the Southern District of Florida dismissed a federal securities class action complaint against ADT in connection with these same

Finally, Ryan's argument that ADT agreed to the Corvex buyback "without any price protections that [ADT] obtained in similar repurchases completed during the same time period" (Op. Br. at 31) betrays a lack of understanding of those other stock repurchases. Ryan is referring to accelerated share repurchase agreements with Credit Suisse and JPMorgan Chase, which he incorrectly refers to as "agreements with two large ADT stockholders to repurchase their shares." (Op. Br. at 17.)

Credit Suisse and JPMorgan Chase were not "two large ADT stockholders." They are investment banks that ADT retained to repurchase ADT shares from the market pursuant to ADT's accelerated stock repurchase program. (A44 ¶ 43, A66 ¶ 80.) The agreements with the investment banks are average price contracts because the investment banks purchase shares from the market over a more than four-month period.[18] (*Id*.) The buyback from Corvex, in contrast, was a one-time purchase at a fixed price – the closing market price on the last trading day before the agreement. (A68 ¶ 83.) Thus, unlike the agreements with the

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transactions for failure to state a claim for relief. *See Henningsen* v. *ADT Corp.*, C.A. No. 14-80566-CIV (S.D. Fla. June 4, 2015) (ORDER) (attached hereto as Exhibit A).

[18] In a typical accelerated share repurchase program, a company purchases shares of its stock from an investment bank like Credit Suisse or JPMorgan, which borrows the shares from clients or share lenders. The investment bank then buys shares in the market over time to replace the borrowed shares. *See* Warren Gorham & Lamont, HANDBOOK OF SEC ACCOUNTING & DISCLOSURE, Financial Instruments, D10, 2008 WL 10879617, at *2; SEC Accounting Report, September 1999-02, "EITF Consensuses on Derivative Transactions and Share Repurchases," 2008 WL 10880082, at *2-3.

investment banks, which involved stock purchases over a lengthy period, there was no need for "price protection" or volume weighted average share pricing when purchasing Corvex's shares.

The main case that Ryan relies on to support his theory that the challenged transactions themselves suggest an entrenchment motivation is *Chrysogelos* v. *London*, 1992 WL 58516 (Del. Ch. Mar. 25, 1992). But *Chrysogelos* is readily distinguishable. There, upon the death of one of the founders of the corporation at issue, a plan was in place to convert the founder's shares such that control of the company would shift from members of the board to the public stockholders, and an investor group initiated discussions about a possible acquisition of the company. In response, the directors: (1) adopted a poison pill rights plan; (2) reduced the triggering ownership threshold of that rights plan in response to the acquiror's overture; (3) purchased a sizable block of the corporation's shares at a "substantial premium" two days after the acquiror's formal merger proposal, which was made before the company's annual meeting; (4) failed to disclose the acquisition proposal and its rejection until after the annual meeting; (5) proposed, but later withdrew, a charter amendment eliminating the stockholders' right to act by written consent, thus preventing the directors' removal by written consent; and (6) approved golden parachutes in the event of a change in corporate control. *Id*. at *2. Thus, in *Chrysogelos*, an actual change in control and

a potential acquisition were both imminent, and the directors took actions that were unambiguously defensive with the apparent goal of maintaining control. The allegations in this case are not remotely similar.[19]

Samuel M. Feinberg Testamentary Trust v. *Carter*, 652 F. Supp. 1066 (S.D.N.Y. 1987) (Op. Br. at 33), is also inapposite. As Delaware judges have pointed out in at least two decisions (including the Court of Chancery's opinion in *Grobow*), *Feinberg* was not decided under Delaware law, and the court there found that the directors' receipt of ordinary director compensation furnished the requisite "adverse interest" to establish demand futility, 652 F. Supp. at 1074, which is directly contrary to Delaware law.[20]

The facts of *Feinberg* are not analogous, either. There, the plaintiff alleged that a corporate raider had informed the defendant directors that he had acquired 4.9% of the company stock and planned to acquire as much as 30% the following week, and would thereafter consider teaming with others to pursue a controlling interest. *Id*. at 1069. After limited discussion, the directors secretly

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[19] *La. Mun. Police Emps. Ret. Sys.* v. *Berman*, No. 2:14-cv-01420-JAK-SS (C.D. Cal. Sept. 16, 2014) (Op. Br. at 33), is also inapposite. It involved a hostile takeover attempt, to which the defendant directors responded by (i) adopting a poison pill; (ii) entering into a standstill agreement with another large investor (that had called on the board to hold an auction for the company); and (iii) initiating a defensive self-tender offer. (Op. Br., Ex. B at 2-4.) The court concluded that the takeover threat and the directors' defensive reactions were sufficient to trigger enhanced scrutiny under *Unocal*, so demand was excused. Here, in contrast, there was no contest for control of ADT whatsoever and the Board took no defensive measures.

[20] *See Silverzweig* v. *Unocal Corp.* 1989 WL 3231, at *2 (Del. Ch. Jan. 19, 1989), *aff'd*, 561 A.2d 993 (Del. 1989) (TABLE); *Grobow* v. *Perot*, 526 A.2d 914, 923 n.12 (Del. Ch. 1987).

decided to repurchase the raider's stock at a 25% premium over the market price, extracted a promise of silence from the seller, and then "followed a continued policy of refusing to discuss or misrepresenting the transaction" to the company's stockholders. *Id.* at 1074. Here, in contrast, the Board did not acquiesce to Corvex's August 2013 proposal to accelerate its timetable for increasing leverage; it bought back Corvex's shares at the market price, not at a premium; and it fully disclosed the transaction immediately (A67-68 ¶ 83) – none of which suggests an entrenchment motivation.[21]

Finally, Ryan's argument that the Court of Chancery erred by ignoring or "recasting" his allegations and by failing to draw "reasonable inferences" in his favor (Op. Br. at 23-27) is meritless.

First, Ryan incorrectly argues that the Court of Chancery "ignored the significance of Meister's role as an activist investor and hedge fund manager, that ADT comprised his largest investment and the only investment where he was engaging in activism, and that Meister was ADT's largest stockholder up against a relatively new Board." (Op. Br. at 23-24.) In fact, the Court of Chancery considered the allegations concerning Meister's track record (Mem. Op. at 5-6) and

[21] *Lewis* v. *Curtis*, 671 F.2d 779 (3d Cir. 1982) (Op. Br. at 33) is also inapposite. It did not involve a stock repurchase, but rather an allegedly wasteful $750,000 payment to a corporate raider to cover the expenses associated with his proxy contest. 671 F.2d at 782. Moreover, as in *Feinberg*, the court applied federal rather than Delaware law, and the U.S. Court of Appeals for the Third Circuit has repudiated *Lewis*, confirming that state law, rather than federal law, governs demand futility. *See Garber* v. *Lego*, 11 F.3d 1197, 1206-07 (3d Cir. 1993).

correctly concluded that the potential threat that Corvex posed was not sufficient to excuse demand based on entrenchment. The information presented to the Board stated that Corvex was positioning itself as a "non-activist hedge fund." (A36.) Combined with the fact that Corvex owned only 5% of ADT's shares, the Court correctly concluded that, as in *Grobow*, the directors' positions were not "actually threatened." (Mem. Op. at 18.) Indeed, Ryan does not cite a single Delaware case in which demand was excused because of the possibility that a 5% shareholder might bring a proxy contest.[22]

Second, Ryan errs in arguing that the Court of Chancery "ignored the ADT Board's dramatic change to its capital allocation plan," and failed to draw the "reasonable inference" that the directors adopted it "to avoid a threat to their positions." (Op. Br. at 24-25.) "[D]irectors are entitled to a *presumption* that they were faithful to their fiduciary duties." *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, 845 A.2d 1040, 1048 (Del. 2004) (emphasis in original) (citation omitted). Accordingly, demand is not excused if it appears from the complaint that the challenged action "could, at least as easily, serve a valid corporate purpose as an improper purpose, such as entrenchment." *Cottle*, 1990 WL 34824, at *8. Here, ADT's revised capital allocation plan to boost shareholder

[22] Ryan's argument that ADT's Board was "relatively new" (Op. Br. at 24) adds nothing to his entrenchment theory. There is no reason a new board would be more prone to entrenchment than an old board. And, as discussed at p. 7 above, ADT's directors in fact have experience as directors and officers of other companies.

value by increasing leverage and repurchasing shares clearly could serve a valid corporate purpose at least as easily as an entrenchment purpose. And the Board's' reexamination and revision of the capital structure its former parent company set up is not "economically questionable." (Op. Br. at 25.)

Finally, Ryan errs in arguing that the Court of Chancery "glossed over" the allegation concerning Mr. Gordon's statement to the Board that, "if Mr. Meister is not asked to join the Board then Corvex Management will likely make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT." (Op. Br. at 25, 27.) The court referred to the allegation twice (Mem. Op. at 5, 15) and correctly ruled it does not show entrenchment. The statement solely concerns Mr. Gordon's assessment of Corvex's willingness to mount a proxy contest if Meister was not asked to join the Board. But the Board did invite Meister to join, and Corvex agreed to a standstill at the same time. Thus, the statement does not suggest that the directors believed their positions were threatened when they approved the initial stock repurchase program, the later expansion of the program, and the buyback of Corvex's stock, or that their sole or primary motivation in approving those transactions was entrenchment. Nothing in the Complaint suggests that these were anything other than legitimate business judgments made with due care and after appropriate consultation with outside advisors.

CONCLUSION

For the reasons stated above, Plaintiff's appeal should be denied and the Court of Chancery's Memorandum Opinion dismissing the Complaint should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on August 12, 2015, the foregoing was caused to be served upon the following counsel of record via File & Serve*Xpress*:

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