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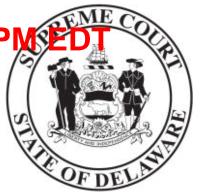

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JOANNA SWOMLEY and LAWRENCE BROCCHINI, Plaintiffs below, Appellants, v. MARTIN SCHLECHT, JOSEPH MARTIN, KENNETH BRADLEY, and SYNQOR HOLDINGS, LLC, Defendants below, Appellees.	No. 180, 2015 On Appeal from C.A. No. 9355-VCL in the Court of Chancery of the State of Delaware

APPELLANTS' OPENING BRIEF

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NATURE OF PROCEEDINGS

This appeal raises an issue about the interpretation of *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014). It seeks review of the judgment of the Court of Chancery dismissing the Amended Class Action Complaint (the "Complaint") of Plaintiffs below Joanna Swomley and Lawrence Brocchini ("Plaintiffs") challenging the fairness of a merger (the "Merger") that squeezed out the minority stockholders of SynQor, Inc. ("SynQor" or the "Company") in favor of SynQor Holdings, LLC ("Holdings"), which is controlled by SynQor's founder, Chairman and CEO, Martin Schlecht.[1] Despite allegations in the Complaint challenging the fairness of both the price and the process leading to the Merger, the Court below held Defendants successfully invoked the unified standard.

On February 17, 2014, Plaintiffs filed a class action complaint seeking: (i) to enjoin the proposed Merger until corrective proxy disclosures were made; and (ii) compensatory damages resulting from Defendants' violations of their fiduciary duties. On February 18, 2014, the Court of Chancery scheduled a hearing on Plaintiffs' motions to expedite and for a preliminary injunction, and informed the parties that Plaintiffs had presented a "colorable application for expedited treatment." Defendants agreed to postpone the vote on the Merger and issue

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[1] "Defendants" below who are the subject of this appeal include Mr. Schlecht, Holdings and the two members of SynQor's "Special Committee," Joseph Martin and Kenneth Bradley.

corrective disclosures in order to moot the need for a hearing.

After supplemental disclosures were issued and a vote was held, the Merger closed on March 10, 2014. Plaintiffs then filed the amended Complaint on April 17, 2014, which continued to challenge the fairness of the Merger. In response, Defendants moved to dismiss. The Court of Chancery granted the motion from the bench on August 27, 2014, holding that Defendants structured the Merger to comply with the requirements for obtaining business judgment review under *M & F Worldwide*, by requiring the approvals of both an independent special committee and a majority of SynQor's unaffiliated stockholders. *See* Ex. A.

On September 10, 2014, the Court entered an Order Granting Defendants' Motion to Dismiss, which dismissed the Complaint, retained jurisdiction to consider an application by Plaintiffs' counsel for attorneys' fees in connection with the supplemental disclosures and mooting of the disclosure-based claims asserted in the original complaint, and stated that the Court of Chancery would enter its final order and judgment after ruling on such motion. *See* Ex. B.

The parties subsequently worked out an agreement whereby Defendants agreed to pay Plaintiffs a mootness fee and the Court of Chancery's September 10 order became final and appealable on April 3, 2015. *See* Ex. C.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred when it held that the Complaint failed to allege facts showing that it was reasonably conceivable Plaintiffs could have prevailed on any of the six factors established by *M&F Worldwide*. Based on its allegations, the Complaint should not have been dismissed.

2. The Special Committee was composed of two directors who had served over a decade on the Board of this private Company without ever standing for election or persuading Mr. Schlecht to provide information to the stockholders. It failed to negotiate a fair price and failed to replicate arm's-length bargaining by not informing itself about alternatives and acting as a supine, ineffective negotiator. The Merger price was unfair because (i) Defendants believed that this was the wrong time to sell the Company, (ii) the Merger gave the stockholders no value for the Company's patent portfolio, technology or a valuable patent suit, and (iii) the financial advisor only found the Merger price fair after taking steps to artificially depress its value conclusions and adding an extra 20% discount in order to reach the price range dictated by the controlling stockholder. The Merger also was not subject to a majority-of-the-minority approval condition *ab initio*. Finally, the Merger vote was coerced owing to Mr. Schlecht's threat of retributive dilution if the Merger were not approved.

STATEMENT OF FACTS

I. The Parties and Background on SynQor

Ms. Swomley and Mr. Brocchini have held SynQor stock since the Company was incorporated in 2000. Before that, they were investors in the Company's predecessor LLC, which was formed in 1997. A258 ¶15.

Mr. Schlecht founded SynQor and has been Chairman of its Board, President and Chief Executive Officer since its incorporation in 2000. As of January 27, 2014, Mr. Schlecht beneficially owned 43.29% of the outstanding stock of SynQor on a common stock equivalent basis. A259 ¶17. Mr. Schlecht and certain other members of SynQor management (the "Founder Group") contributed all of their SynQor shares to Holdings such that Holdings held 46.38% of SynQor's outstanding stock on a common stock equivalent basis as of the date of the Merger. A260 ¶¶18-19. With the Merger complete, Holdings now wholly owns SynQor.

The Special Committee members, Kenneth Bradley and Joseph Martin, were directors of SynQor from 2002 until the Merger closed. A261 ¶¶21-22. Messrs. Bradley and Martin were placed on the Board in 2002 by majority written consent. A265 ¶33. The Company never disclosed how they were selected to serve on the Board, but it is reasonable to infer that Mr. Schlecht chose them. They were re-elected, again by written consent, in 2004 and 2011. *Id*. Neither has ever stood for election by a vote in which the Company's minority stockholders participated;

indeed, the Company never held an annual meeting or provided financial reports to its stockholders. *Id.* Messrs. Bradley and Martin also never took any actions during their 12 year tenure indicating that they considered the interests of the minority stockholders, such as calling an annual meeting or communicating with stockholders about the Company. The Company provided essentially no financial information to its minority stockholders from its formation until the Merger. *Id.*

II. The IBA Patent Litigation

SynQor's primary assets are several valuable patents over technology it developed. Enforcing and collecting judgments on those patents has created more profits for SynQor than its actual operating business. A265 ¶34. For example, the '497 Litigation (as described below) brought the Company more cash than the operating enterprise value as calculated by the Special Committee's financial advisor. A273 ¶54. Thus, the Company's patent litigation efforts have become the most significant part of its business and not merely incidental to it.

A. The '497 Litigation

In 2007, SynQor filed suit in the Eastern District of Texas against industry suppliers of unregulated and semi-regulated bus converters, alleging infringement of one or more of the Company's five IBA Patents. In December 2010, a jury upheld the validity of the IBA Patents, found that each of the defendants had infringed one or more of SynQor's patents, and awarded damages in excess of $95

million. Thereafter SynQor was awarded over $21 million in supplemental damages, sanctions and additional settlements due to the continuing infringement by certain of the defendants. The court also issued a permanent injunction in SynQor's favor to prevent continued infringement. A266 ¶¶35-36.

One of the defendants settled for an "undisclosed sum" rather than appeal. Others appealed, and in March 2013, the Federal Circuit affirmed the decision of the District Court and issued its mandate in May 2013 after denying a request for rehearing. In November 2013, the United States Supreme Court declined to review the decision. That same month the Company received payment of approximately $89.7 million for the damages due from the non-settling defendants. A267 ¶38.

B. The '054 Litigation

In 2011, SynQor again filed suit in the Eastern District of Texas over infringement of the IBA Patents, this time against Cisco Systems, Inc., Vicor Corporation and Ericsson Inc. In addition to the patents at issue in the '497 Litigation, SynQor added one additional patent related to the IBA technology. A268 ¶40. In SynQor's words, the '054 Litigation "is directly related to" the '497 Litigation in which the company recovered over $95 million and obtained a permanent injunction. A269 ¶44 (quoting '054 Litigation Amended Complaint), A279¶72(a). Ericsson settled all outstanding claims early in exchange for paying an undisclosed sum and agreeing to be bound by an injunction precluding the sale

of specified bus converters to third parties in the United States. A268 ¶41.

SynQor has litigated the remainder of the '054 Litigation with a large and well-known law firm handling the litigation, to the tune of hundreds of docket entries, substantial expert discovery, and over $3 million of the stockholders' money spent on pre-Merger legal fees. A268 ¶42, A269 ¶44, A279 ¶¶71-72. The '054 Litigation was valuable at the time of the Merger: the validity of the IBA Patents had been confirmed, the '054 Litigation had passed summary judgment and claim construction, and was scheduled for a pretrial conference in June 2014 with jury selection starting July 7, 2014. A268 ¶42, A279 ¶72. The Special Committee, however, failed to ascribe any value to the '054 Litigation and the minority stockholders received no value for this asset in the Merger. A269 ¶44, A279 ¶71.

C. The '444 Litigation

SynQor's continuing causes of action for post-injunction damages and sanctions against certain defendants in the '497 Litigation were severed into a separate case that was tried in July 2013. The "Contingent Consideration" for the Merger is comprised of the damages awarded in the '444 Litigation. A267 ¶39. After the Merger closed, SynQor was awarded approximately $2.9 million in damages, which it then appealed.

III. SynQor Repurchases Stock and the Founder Group Decides to Pursue the Merger

SynQor began to accumulate significant cash after the settlement with

Ericsson in 2011 and as a result of royalty payments related to the patent litigation. According to SynQor, given "this surplus [of] cash in hand and the possibility of significant additional damage awards or settlements in the future"—*i.e.*, from the '054 Litigation—management began considering various alternatives for providing liquidity to stockholders, including a public offering or sale of the Company, cash dividends and stock repurchases. A270 ¶45.

Management determined in 2011 that a public offering or sale of the Company would be inappropriate because "<u>a sale of the Company was considered premature from a potential value perspective</u>." *Id.* ¶46 (emphasis added). Instead, management concluded that cash dividends would be a viable strategy, but the Company's Series B Preferred, all of which was held by Morgan Stanley Dean Witter ("MSDW"), restricted SynQor's ability to pay dividends to the common stockholders or repurchase securities junior to the Series B Preferred. *Id.* ¶47.

On July 25, 2012, SynQor agreed to repurchase all of the common and preferred shares held by MSDW to permit payment of dividends to the other stockholders. MSDW's designee to the Board then resigned, leaving Messrs. Schlecht, Bradley and Martin as the Company's only directors. A271 ¶49. As a result of the repurchase, Mr. Schlecht and the Founder Group's ownership stake in the Company rose from 41% to 46%. A045.

The next day, July 26, 2012, in one of the few communications the Company

ever sent to its minority stockholders, Mr. Schlecht said that SynQor had completed the "first step in our share repurchase/cash dividend liquidity strategy," and stated its intention to "consider additional offers to repurchase capital stock from the Company's remaining shareholders and/or make cash dividend payments at the earliest practicable time." A271 ¶50; A011-12. Mr. Schlecht said that "[t]he timing of such events will most likely be triggered by a positive outcome in SynQor's patent lawsuit," and reiterated that a sale of the Company at "the present time would be <u>premature from a value perspective</u>. . . ." *Id*. (emphasis added).

Between July 2012 and January 2013, SynQor repurchased 552,096 shares of common stock from one stockholder and 61% of the outstanding Preferred A stock from a different stockholder. A045-46. Thus, what Mr. Schlecht called the Company's "share repurchase strategy" consisted of (i) buying out SynQor's largest institutional stockholder and senior preferred holder, (ii) reducing SynQor's outstanding preferred stock by over 60%, (iii) buying out a common stockholder with one of the largest non-Founder Group stakes in the Company, and (iv) eliminating an outside director from the Board.

Once the Federal Circuit issued its mandate in May 2013, Mr. Schlecht and management determined they no longer wanted to make voluntary repurchases of shares or dividend out the cash that would be coming in from the '497 Litigation. A272 ¶52. Instead, management concluded that while it was still a bad time to

sell the Company, it would be a very good time for the Founder Group to use the proceeds from the '497 Litigation to squeeze out the minority holders. They were willing to be buyers only—not sellers.

IV. The Merger Negotiations

According to the minutes, at a Board meeting on May 29, 2013, Mr. Schlecht and SynQor's CFO and General Counsel, Arthur Hofmann, presented Messrs. Martin and Bradley with a term sheet for the proposed squeeze out the stockholders other than the Founder Group (the "Term Sheet," A019-23). Mr. Schlecht initially indicated that they would pay to the minority $1.10 to $1.20 a share with the right to receive a proportionate share of the proceeds resulting from the '444 Litigation and approximately $.04 per share held in escrow by the Company to cover legal expenses related to the '444 Litigation. A273 ¶54.

During the meeting, Messrs. Schlecht, Martin and Bradley appointed Martin and Bradley as the "Special Committee" to negotiate on behalf of the minority stockholders. *Id.* ¶55. Among other terms, the Term Sheet said that the Founder Group had not yet decided whether the minority of the majority condition would be non-waivable. A022 (conditioning the merger on approval by the minority holders but noting "(<u>Whether this condition can be waived remains to be determined</u>)" (emphasis added)). Mr. Hofmann, on behalf of the Founder Group, addressed the Special Committee about the approval condition:

> Mr. [Hofmann] stated that a material transaction such as the one proposed should [be] subject to special conditions to ensure its fairness to the unaffiliated stockholders. <u>Those special conditions are outlined in the[T]erm [S]heet</u> ….

A014 (emphasis added). The minutes reflect no discussion about making the approval condition non-waivable.

After the meeting, the Special Committee retained counsel and Shields & Co. ("Shields") as its financial advisor. On July 1, 2013, the Special Committee approved the Company paying the legal fees incurred by the Founder Group to pursue the proposed Merger, A275 ¶57, thus eliminating any possible downside to the Founder Group in connection with its desire to acquire the Company.

The Proxy Statement says that on August 16, 2013, management provided the Special Committee with a valuation of the Company it had commissioned and made a definitive offer to purchase all of the minority stockholders' shares for $1.10 per share of common stock equivalent (that is, at the bottom of the price range the Founder Group mentioned on May 29th), $.04 per share to be escrowed, plus the right to receive the Contingent Consideration. A275 ¶58.

Shields initially determined that the fair value of the Company was between $1.34 and $1.47 per share of common stock equivalent. (As discussed in greater detail below, this analysis appears to bend over backward to arrive at the lowest possible values.) The financial advisors for the Founder Group and the Special

Committee met over the next couple months, and Shields met with the Special Committee, to discuss the gap in the two sides' respective valuations. *Id.* ¶59.

At a meeting held on November 4, 2013, the Founder Group expressed willingness to raise the cash component of its offer to $1.25 per share. The Special Committee then shared Shields' fair value range with the Founder Group and indicated that, to be acceptable, the Founder Group's offer had to fall within that range. A275 ¶60; A047. In response, the Founder Group raised the cash component of its offer to $1.30 per share.

Three days later, on November 7, 2013, management and the Special Committee met again where the Committee "advised management that the Committee and its advisors did not believe there to be any justification for reducing the range of fair values arrived at by [Shields]." A047. On November 8, 2013, the Founder Group increased the cash component of its offer to $1.35 per share and removed the $.04 per share escrow. A276 ¶61. Once it had an offer one penny over the floor set by Shields' fair value range in hand, the Special Committee accepted. *Id*. The Proxy Statement reflects no counteroffer or other effort by the Special Committee to obtain any more consideration once the $1.35 offer was made.[2] The Proxy Statement also reflects no attempt on the part of the

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[2] Sometime after the Special Committee accepted the $1.35 per share offer and before the Proxy Statement was sent, Shields found a basis to lower the bottom bound of its fair value estimate (despite the Special Committee saying there was no basis to do so), lowering it from

Special Committee at any point in the process to press for alternatives to the squeeze out, or for the minority to receive value for the ‘054 Litigation or the Company’s patent portfolio.

At a meeting held on January 27, 2014, the Board voted to approve the Merger Agreement upon recommendation of the Special Committee and directed that it be submitted to SynQor’s stockholders for their approval at a special meeting to be held on February 21, 2014—in just three weeks. A277 ¶¶64-66. After receiving the Proxy Statement, Plaintiffs filed this action and moved for a temporary restraining order, which caused the Defendants to postpone the meeting and provide supplemental disclosures to the stockholders in a supplement. A238. The Company reconvened the special meeting on March 10, 2014 when the Merger was approved purportedly by 61% of the minority stockholders. The Merger closed that day. A278 ¶¶68-69.

V. Shields’ Valuation

Shields’ valuation of the operating business appears primarily to be an effort to justify an unfairly low price. The Complaint devotes 12 pages to detailing how, even without its eleventh-hour reduction to its fair value estimate, Shields’ analysis seriously undervalued the Company in a number of ways:

$1.34 per share to $1.32 per share, thus fostering the impression that the price the committee accepted was slightly above the bare minimum. A279 ¶59.

- Shields' share count was high, depressing its calculated per-share value. A282-83 ¶¶77-79.
- Shields cherry-picked SynQor's 2013 EBITDA for use in its comparable companies and transaction analysis, which was about half of both SynQor's actual EBITDA in 2012 and its projected EBITDA in 2014. A285 ¶83. This use of temporarily depressed EBITDA reduced one of Shields' value conclusions by $25 million, or approximately 40 cents per share, which is nearly 30% of the deal price. A286 ¶87. Shields also used an unreasonably low EBITDA multiple. A287 ¶88.
- The comparable transactions multiple (which used the same unduly low EBITDA figure) was flawed because only three of Shields' nine supposedly comparable transactions involved companies that generated any EBITDA at all, which meant that the analysis had little if any validity. A288 ¶89.
- Shields' DCF analysis has multiple flaws. Among other things, it appears to be driven by a questionable assumed terminal year increase in working capital of $1.424 million, thus perpetually reducing cash-flows for what should be a one-time event at most. *Id*. ¶¶90-91. That can be seen when comparing Shields' apparent terminal value with

that calculated by an EBITDA multiple. The terminal value represents an EBITDA multiple of approximately 3.9 times final year's EBITDA, A290 ¶94, about half of the already-low multiple generated by its comparable company analysis. If the comparable company multiple had been used in the terminal value calculation, SynQor's DCF would increase by approximately $24 million or approximately 39 cents per share, again close to 30% of the deal price. *Id*. ¶93.

- Shields' analysis assumes that the Company is in a net debt position despite having at least $12 million more cash than debt. Using its actual cash position, this would add close to another $5 million, or approximately 8 cents per share, in value. A291 ¶¶96-97.

After artificially depressing the Company's price by around $30 million, Shields then took an additional 20% "specific company discount." The same factors that were used to justify this additional discount were also relied upon by Shields to justify its earlier discounts, and thus at its best it is an exercise in double counting. Without that discount, the bottom end of Shields' fairness range would have increased from $1.32 per share to $1.65—an increase of 25%—or almost $10 million over the Merger price. A292-93 ¶¶98-100.

ARGUMENT

I. The Court of Chancery Erred in Holding that Business Judgment Review Was Restored to the Merger Under *M & F Worldwide*.

A. Question Presented

Whether Plaintiffs pled facts from which it may conceivably be inferred that Defendants did not restore business judgment review to the Merger under this Court's decision in *M & F Worldwide* such that the Merger was subject to entire fairness review and the Complaint was not dismissible under Court of Chancery Rule 12(b)(6). Plaintiffs preserved the question presented in their answering brief in response to Defendants' motion to dismiss (A306-374), and during oral argument held on August 27, 2014 (A405-422).

B. Scope of Review

This Court "review[s] *de novo* a decision to grant a motion to dismiss under Court of Chancery Rule 12(b)(6), to 'determine whether the trial judge erred as a matter of law in formulating or applying legal precepts.'" *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009). "When reviewing a ruling on a motion to dismiss, [this Court] (1) accept[s] all well pleaded factual allegations as true, (2) accept[s] even vague allegations as 'well pleaded' if they give the opposing party notice of the claim, (3) draw[s] all reasonable inferences in favor of the non-moving party, and (4) do[es] not affirm a dismissal unless the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances." *Cent. Mortg. Co.*

v. Morgan Stanley Mortg. Cap. Hldgs. LLC, 27 A.3d 531, 535 (Del. 2011).

C. Plaintiffs Alleged Facts Showing that Defendants Failed to Restore the Protections of the Business Judgment Rule Under *M & F Worldwide*.

This Court's decision in *M & F Worldwide* governs whether the Merger is to be evaluated under the entire fairness standard or the business judgment rule. "Delaware courts are skeptical of the fairness of transactions involving a corporation and its controlling stockholder because of the latter's ability to flex its control and unilaterally dictate unfair terms to the former." *Hamilton P'rs, L.P. v. Highland Cap. Mgmt., L.P.*, 2014 WL 1813340, at *12 (Del. Ch. May 7, 2014) (citation omitted). "[T]he underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny." *Ams. Min. Corp. v. Theriault*, 51 A.3d 1213, 1241 (Del. 2012) (quoting *Kahn v. Tremont Corp.*, 694 A2d 422, 428 (Del. 1997)). Thus, self-dealing mergers involving controlling stockholders are reviewed for entire fairness *ab initio*, with the defendants bearing the burden of proving fairness. *See M & F Worldwide*, 88 A.3d at 642.

Under *M & F Worldwide*, Defendants may only restore the protection of business judgment to a self-dealing merger and avoid entire fairness review if they establish six elements:

> [I]n controller buyouts, the business judgment standard of review will be applied *if and only if*: (i) the controller

> conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

Id. at 645 (emphasis in original). If any one of those elements is not present, then the entire fairness standard of review remains applicable. Consequently, "[i]f a plaintiff can plead a reasonably conceivable set of facts showing that any or all of those enumerated conditions did not exist, that complaint would state a claim for relief that would entitle the plaintiff to proceed and conduct discovery." *Id.*

1. The Complaint Pleads that the Special Committee Failed to Meet its Duty of Care in Negotiating a Fair Price.

The Court of Chancery misapplied *M & F Worldwide* by finding that the Special Committee met its duty of care in negotiating a fair price. Ex. A at 11-12. The Complaint alleges particularized facts showing that the price negotiated was unfair and that the Special Committee otherwise failed to meet its duty of care to negotiate a fair price.

a. Allegations that the Merger Price Was Unfair Are Enough to Defeat the Unified Standard.

In *M & F Worldwide*, this Court stressed the importance of the fairness of the merger price in determining whether the dual protection merger structure met its underlying purpose:

> The underlying purpose[] of the dual protection merger structure … [is] fulfilled at the … critical point: **price**. … The dual protection merger structure requires two price-related pretrial determinations: first, <u>that a fair price was achieved</u> by an empowered, independent committee that acted with care; and, second, that a fully-informed, uncoerced majority of the minority stockholders voted in favor of the price that was recommended by the independent committee.

88 A.3d at 644-45 (bold emphasis in original; underlining added; footnotes omitted). Thus, if there are non-conclusory allegations that the price achieved by the special committee is unfair—regardless of whether that committee was independent or empowered—the unified standard is not met and entire fairness applies. In this way, *M & F Worldwide* recognizes that Delaware law is concerned with substance—that is, price—over process. Just as an unfair process is evidence of unfair dealing, an unfair price must also be regarded as powerful evidence of a deficient process. *Cf. Tremont*, 694 A.2d at 432.

The complaint in *M & F Worldwide* would have survived a motion to dismiss under the unified standard because "allegations about the sufficiency of the price call[ed] into question the adequacy of the Special Committee's negotiations, thereby necessitating discovery on all of the new prerequisites to the application of the business judgment rule." 88 A.3d at 645 n.14.[3] Thus, this Court stated that

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[3] The allegations regarding price in *M & F Worldwide* that made it reasonably conceivable that the merger price was unfairly low included: (1) the offer valued the company at only four times profits per share and five times 2010 cash flow and those ratios were well below recent similar transactions; (2) the merger price was $2 per share lower than the trading price of two

allegations about the fairness of the price give rise to an inference that the process was unfair.[4]

Here, the Complaint challenges the sufficiency of the Merger consideration in light of: (a) the Special Committee's failure to ascribe any value to the '054 litigation and the Company's patent portfolio; and (b) facial defects in the valuation relied upon by the Special Committee, thereby calling into question the adequacy of the Special Committee's negotiations. From these allegations, it is reasonably conceivable that the Merger was not entirely fair and Defendants could not have restored business judgment review at the pleading stage.

i. The Merger Price Was Unfair Because No Value Was Given for the '054 Litigation.

There is no dispute that SynQor's minority stockholders received no value for the '054 Litigation. The Complaint, however, alleges facts showing it is reasonably conceivable that the '054 Litigation had substantial value to SynQor. *See* A279-80 ¶¶72-73. Among the factors detailed in the Complaint, (a) the '054

months previous; (3) MFW's share price was depressed because of factors not related to its intrinsic value; and (4) commentators thought that both the original offer and the final merger price were "surprisingly low." *Id.*

[4] The Court of Chancery found that Plaintiffs' allegations of an unfair price led not to an inference that the process was unfair, but indicated instead that "the stockholders' exclusive remedy was to seek an appraisal." Ex. A at 16. *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A.2d 1099 (Del. 1985), however, "holds that unfair dealing claims, based on breaches of the duty of loyalty and care, raise issues which an appraisal cannot address. … The concept of fair dealing includes issues of when the transaction was timed, how it was initiated, structured, negotiated, and disclosed…." *In re Shoe-Town, Inc. S'holders Litig.*, 1990 WL 13475 (Del. Ch. Feb. 12, 1990).

Litigation involves the same patents that resulted in substantial value to the Company in the '497 Litigation; (b) the Company has litigated the action vigorously, including spending over $3 million in legal fees; (c) the Federal Circuit had upheld the validity of the patents at issue, thus eliminating a substantial line of defense, much to the Company's "delight;" (d) the Company's case survived claim construction and summary judgment; (e) the '054 Litigation asserts another patent in addition to those at issue in the '497 Litigation, providing an additional avenue to recovery; and (f) Ericsson, an unquestionably sophisticated patent litigant, settled early "for an undisclosed sum." *Id*. The stockholders invested millions in the '054 Litigation, but the Special Committee allowed the Founder Group to keep it for no consideration.

ii. The Merger Price Was Unfair Because No Value Was Given for the Patent Portfolio.

The Complaint also alleges that much of SynQor's value is derived from its patent portfolio (A281 ¶74, A293 ¶101), and Defendants admit that SynQor possesses a valuable "patent portfolio that has provided the Company with the means to protect [itself] and many of its products from the infringing products of competitors[.]" A044. Indeed, one of the reasons the Special Committee gave for hiring Shields was because it had insisted that valuing the patent portfolio was important. A281 ¶74. Yet, the Special Committee did nothing to value SynQor's patent portfolio or provide the minority stockholders any value in exchange for it

despite its prior recognition that this was a key component of value.

iii. The Operating Business Was Undervalued.

As described in detail in the Complaint at paragraphs 76-99, Shields undervalued the Company's operating business "by tens of millions of dollars" through a series of management-friendly choices so pervasive that the only reasonable inference is that "the Special Committee's financial advisor leaned over backwards to reduce its value conclusions." A281 ¶75. Shields' use of facially inaccurate—and implausible—EBITDA figures and DCF inputs is strong evidence of an advisor trying to reach a predetermined conclusion. *See In re El Paso Pipeline P'rs, L.P. Deriv. Litig.*, 2015 WL 1815846, at *24 (Del. Ch. Apr. 20, 2015) (financial advisor's use and manipulation of incorrect DCF inputs undercut any claim that committee members acted in good faith); *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *13-14 (Del. Ch. Oct. 2, 2009) (unable to find the price fair at summary judgment when the company's financial advisor's analysis was wrong); *Nebel v. Sw. Bancorp, Inc.*, 1999 WL 135259, at *7 (Del. Ch. Mar. 9, 1999) (stating that the "improper manner at which the $41 merger price was arrived at" implies unfair dealing). Similarly, Shields' use of an additional, entirely subjective 20% discount from its already low fair value conclusion—a discount that was necessary to find that the Merger price was fair (A292 ¶¶98-99) —makes it reasonably conceivable that the price was unfair and

that the Special Committee knew or should have known that fact.[5]

b. The Special Committee Failed to Replicate Arm's-Length Bargaining.

The Court below also erred in dismissing the Complaint because it alleges numerous deficiencies in the care with which the Special Committee approached its charge. First, the Special Committee made no inquiry into the value of the '054 Litigation and the Company's patent portfolio. *See In re Tele-Commc'ns, Inc. S'holders Litig.*, 2005 WL 3642727, at *10-12 (Del. Ch. Dec. 21, 2005) (denying summary judgment because the special committee was not fully informed about material information relating to value). Shields valued neither the patent portfolio nor the patent litigation, and the Special Committee let the Founder Group get them for free. A279 ¶71. This failure is glaring in light of the minutes of the June 14, 2013 meeting of the Special Committee, which reflect that Shields was hired as the financial advisor in part precisely because it had "commented on the importance of valuing the Company's technology and patent portfolio." A281 ¶74. "Any board negotiating the sale of a corporation should attempt to value and get

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[5] *See Hamilton P'rs*, 2014 WL 1813340, at *13 (holding a 20-30% discount applied to a DCF sufficient for a reasonable inference that the merger price was unfair); *see also Del. Open MRI Radiology Assocs., P.A. v. Keller*, 898 A.2d 290, 339 (Del. Ch. 2006) ("the company specific risk premium often seems like the device experts employ to bring their final results into line with their clients' objectives, when other valuation inputs fail to do the trick"); *Solar Cells, Inc. v. True N. P'rs, LLC*, 2002 WL 749163, at *6 n.11 (Del. Ch. Apr. 25, 2002) (expert valuations "that incorporate subjective measures of company specific risk premia" are "suspicious" because they may be used "to smuggle improper risk assumptions into the discount rate so as to affect dramatically the expert's ultimate opinion on value").

full consideration for all of the corporation's material assets, including litigation assets." *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455, 486 (Del. Ch. 2013) (internal quotation marks omitted).

The proxy materials make no mention of the Special Committee even trying to extract anything from the Founder Group in exchange for those assets, despite being advised early in the process of the importance of them. *See Kahn v. Dairy Mart Convenience Stores, Inc.*, 1996 WL 159628, at *7 (Del. Ch. Mar. 29, 1996) ("Knowing that Dairy Mart may have been worth at least $1 per share more than the LBO price, the committee could have attempted to negotiate a comparable or higher price from the [buyer]. But, it did not, and the reasons why are unclear. For this Court to hold as a matter of law that the special committee functioned properly and independently, some adequate explanation of why the committee did not negotiate further is required.").

The Special Committee's failure in this regard is even more disturbing in light of the controller's informational advantage over the committee. *See In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *36 (Del. Ch. May 3, 2004) (describing bargaining by a special committee laboring under an "information imbalance" as "ineffective"). The Founder Group, including Mr. Schlecht as the person perhaps most versed in SynQor's technology, understood the Company's patent portfolio and patent litigation, ascribed it enough value to

invest millions in the '054 Litigation, and bought the Company to capture that value for themselves. *See* A249 ¶¶6, 9, 44, 54, 71-74, 119-21. The Special Committee thus failed to act with due care by not waiting until it could gather the valuation information that it lacked. Put simply, an effective arm's-length negotiator would have tried to get some value for the assets or concluded it was not a good time to sell them. *See Wiegand v. Berry Petroleum Co.*, 1991 WL 45361, at *7 (Del. Ch. Mar. 27, 1991) (discussing a claim of unfair dealing predicated on the merger being timed to deprive the minority of full pre-merger value).

The Special Committee's failures do not stop there. It also bargained in a way designed to facilitate the controller's desire for a merger rather to extract the highest possible price. *See Ams. Mining*, 51 A.3d at 1245 (describing the unfairness of similar bargaining). The Proxy Statement essentially admits that the Special Committee was more interested in finding ways to push Shields' valuation range down to what the controller wanted to pay rather than trying to get the controller's offer up. After Shields' valuation range had been pushed as low as possible, the Special Committee told the Founder Group Shields' range and said the offer needed to be above the bottom of the range. Unsurprisingly, the Founder Group bid one penny above the floor. The Special Committee made no attempt to get the Founder Group to bid again after getting the minimally "fair" offer, and of course, having revealed its bottom line it had no easy way to do so.

The process appears to have been designed to obtain the lowest possible offer within the cover of Shields' unduly depressed fairness range. There is no other reason for the Special Committee to have revealed the lowest price that it was willing to accept, nor to take the first offer that crossed the threshold without trying to bargain for more. As Chancellor Allen explained: "It is not sufficient for. . . directors to achieve the best price that a fiduciary will pay if that price is not a fair price. Nor is [it] sufficient to get a price that falls within a range of 'fair values' somehow defined, if the fiduciary (or another) would pay more." *In re First Boston, Inc. S'holders Litig.*, 1990 WL 78836, at *7 (Del. Ch. June 7, 1990).

Nor did the Special Committee ever explore the possibilities of an alternative to the Merger, such as a transaction with a third party or pursuing no transaction at all. A275 ¶60. There is not one word in the Proxy Statement about the Special Committee informing itself as to the relative merits of the Merger as compared to other options, nor to ascertain what the Company's value might have been on the open market. *See* A273 ¶55. These are obvious questions that a committee interested in being fully informed and bargaining effectively should have been asking, particularly in light of Mr. Schlecht's view that the market would not fully value the Company. If he was right, then an arm's-length negotiator should have ascertained whether the Founder Group was trying to take advantage of the market to buy the Company on the cheap; if Mr. Schlecht was

incorrect, then a market check (or auction) would have been beneficial.

The point here is not that the Special Committee chose one approach when another might have been superior as the Court of Chancery stated, Ex. A at 12—the point is that the Special Committee never informed itself about either option, and thus failed to act with due care. *See In re Loral Space & Commc'ns Inc.*, 2008 WL 4293781, at *16 (Del. Ch. Sept. 19, 2008) (criticizing a process that "quickly tunneled into consummating a deal with [the controller] and forewent any serious consideration of other alternatives"); *cf. M & F Worldwide*, 88 A.3d at 651 (observing that investigation of alternatives might have generated more value for the minority even though such alternatives were foreclosed by the controller). Furthermore, the Founder Group's blocking a dividend and its threat not to approve any alternative transaction hamstrung the Special Committee, depriving it of the power to bargain effectively. *See Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 465 (Del. Ch. 2011); *Dairy Mart*, 1996 WL 159628, at *8.

2. The Special Committee Was Not Independent.

It is also reasonably conceivable that the Special Committee lacked independence as required by *M & F Worldwide* based upon the members' performance for the 12 years before the Merger and on their conduct in connection with the Merger. During those 12 years, Messrs. Martin and Bradley never, for instance, stood for election by the minority stockholders, called an annual meeting,

caused the Company to report on its affairs to the minority stockholders or otherwise did anything that suggests that they considered the interests of the minority stockholders. The Court of Chancery rejected these allegations as bearing on the Special Committee's independence because they failed to "call into question from a traditional standpoint either the disinterestedness or independence of either member of the special committee." Ex. A at 10.

"Traditional" measures of independence mean very little, however, in the face of facts showing that the "independent" directors of a controlled, secretive and private corporation never actually functioned as independent directors should. The conduct of Messrs. Martin and Bradley throughout their tenure as directors shows insufficient care, attention and personal responsibility to the minority stockholders to indicate their independence. *See Tremont*, 694 A.2d at 430 (reversing summary judgment for directors whose conduct lacked the "'care, attention and sense of responsibility' necessary to afford them the status of independent directors"). Similarly, each of the defects in the Special Committee's due care detailed in the previous section is also indicative of its members lacking independence.

If the members of the Special Committee were loyal to the minority, rather than to the group who appointed them, one would have expected some effort to let the stockholders know the financial fortunes of the Company or otherwise communicate with them. *See TVI Corp. v. Gallagher*, 2013 WL 5809271, at *14-

15 (Del. Ch. Oct. 28, 2013) (finding a reasonable inference that board members were "controlled" where the controller was able "to exercise absolute authority as to who would serve on the Board"). It is thus reasonably conceivable under the Complaint, then, that during their 12 years in office, Messrs. Martin and Bradley internalized management's neglect (at best) of the minority stockholders and came to regard their job as assisting management to accomplish its purposes.

3. The Special Committee Was Not Empowered to Say "No" Definitively.

The analysis under the unified standard is not limited to looking at the Special Committee's stated mandate. *See In re MFW S'holders Litig.*, 67 A.3d 496, 508 (Del. Ch. 2013) (considering the special committee's conduct, not just its mandate). Although the resolution forming the Special Committee apparently empowered it to terminate negotiations with the Founder Group or pursue alternatives to the Merger, there is no indication that the Special Committee used that power. Once again, the Proxy Statement makes no reference that the Special Committee considered any alternatives to the Merger offers put forward by the Founder Group, and the Special Committee gave away assets without valuing them. In this regard, there is no substantive difference from the performance of the Special Committee here and one with a limited, inadequate mandate. *Cf. In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 765 (Del. Ch. 2011) ("Having been empowered only to evaluate what the controller put on the table and

perceiving that other options were off the menu because of the controller's own objectives, the special committee put itself in a world where there was only one strategic option to consider, the one proposed by the controller….").

The Proxy Statement makes clear that the Special Committee never actually said no. The Founder Group offered $1.10 per share, followed by extensive discussions between the two sides and their respective financial advisors about their differing views on valuing the Company. A047. After the discussions, the Founder Group raised its offer to $1.30 per share. Again, the Special Committee did not say no; it told the Founder Group that Shields' valuation could be lowered no further, so the Founder Group had to make an offer of at least $1.34 per share; the Special Committee then accepted the next offer of $1.35. This is not saying no, it is saying "meet the minimum requirements and I will say yes."

4. The Controller Did Not Condition the Process on the Approval of a Majority of the Minority from the Outset.

In order to meet the unified standard under *M & F Worldwide*, the controller must condition the transaction *ab initio* on the non-waivable approval of an independent, properly empowered special committee and a majority of all of the minority stockholders. 88 A.3d at 644; *see In re Orchard Enters., Inc. S'holder Litig.*, 88 A.3d 1, 24 (Del. Ch. 2014) (stating that the controller must agree to these terms "up front, before any negotiations begin"). By requiring that these conditions be in place "from the get-go," the controller knows that it must put

forward a deal that is acceptable to both the special committee and a majority of the independent stockholders, and precludes the controller from using them as gives later in the process in lieu of offering a higher price. *M & F Worldwide*, 88 A.3d at 644; *MFW*, 67 A.3d at 530. Likewise, the special committee knows that its work will be reviewed, and must be ratified, by the stockholders, thus tending to "enhance" the special committee's motivation to negotiate a good deal for the minority. *MFW*, 67 A.3d at 528-29. It also strengthens the special committee's bargaining power, making the process more akin to genuine arm's-length bargaining, and reduces the possibility of a "retributive going private effort." *Id.* at 532; *see also John Q. Hammons*, 2009 WL 3165613, at *12.

Here, the Merger was not conditioned upon a non-waivable minority of the majority vote *from the outset*. The Founder Group's initial Term Sheet given to the Special Committee said that the Founder Group had not yet decided whether the majority of the minority vote condition could be waived. A022 ("**Whether this condition can be waived remains to be determined**."). And the minutes' statement that Mr. Hofmann discussed the "conditions outlined in the [T]erm [S]heet," without referring to any *changes* in those terms, demonstrates that the Founders Group had *not* at the time agreed to disable itself from waiving the majority of the minority vote requirement. The Term Sheet and May 29 minutes demonstrate that it is at least reasonably conceivable that the Founder Group had

not agreed to a non-waivable majority of the minority vote condition as of May 29.

The Court of Chancery acknowledged that "[i]t is true that the controller's initial proposal hedged on whether the majority-of-the-minority condition would be waivable or not," but nevertheless held that the Merger met this prong of *M & F Worldwide* because "from the first meeting, the board resolved that any deal would require both the approval of a special committee and a majority-of- the-minority vote[,]" and "[a]ll this went down before any negotiations took place, even before anything really started." Ex. A at 9. Under *M & F Worldwide*, however, it is not the Board's conduct that is primarily at issue—it is the *controller* that must disable itself from being able "to dictate the outcome of the negotiations and the s[tock]holder vote" in order to imbue controller mergers with the characteristics of an arm's-length transaction subjected only to business judgment review. 88 A.3d at 644. To that end, controllers must make an "enforceable commitment or credible commitment" not to go "around the table" at the director *or* stockholder level. *In re Sauer-Danfoss S'holder Litig.*, C.A. No. 8396-VCL, at 76-77 (Del. Ch. Oct. 23, 2013) (TRANSCRIPT). There is no evidence that the Founder Group had committed to disable themselves from circumventing the Board or the stockholder vote. *See id*. at 78 (an initial offer that "doesn't take off the table the possibility of an unfriendly non-negotiated transaction" will not meet the unified standard).

The resolutions relied upon by the Court of Chancery in support of this argument do not even establish that the Board (much less the controller) was disabled from removing the Special Committee or majority of the minority vote conditions, which they thus remained free to do by majority vote. *Cf. John Q. Hammons*, 2009 WL 3165613, at *12 (discounting the value of a majority of the minority vote condition that the special committee was empowered to waive). Furthermore, the standard of review is formalistic and literal such that, even if the non-waivability condition was not traded for any merger consideration, it was not "established up-front," and therefore the unified standard is not satisfied. *Sauer-Danfoss*, Tr. at 78-79; *accord Orchard*, 88 A.3d at 24.

5. The Minority's Vote Was Coerced.

Finally, the vote was coerced. Among the reasons that the Special Committee recommended the Merger was that the "members of the Founder Group have stated that they have no intention of selling their interests in SynQor in the foreseeable future or pursuing an initial public offering of the Company's stock or similar means of providing liquidity to its stockholders, and may seek to increase their stake in the Company if the Merger is not approved[.]" A050 (emphasis added). The Special Committee was further influenced by "the fact that many of the Company's stockholders have [] held their stock for more than ten years, with few or no opportunities to transfer or sell their shares[.]" *Id.*

Thus, even the Special Committee viewed the minority stockholders' options for receiving liquidity to consist of (a) the Merger or (b) nothing—with the added kicker that if the minority stockholders turned down the Merger, their illiquid minority stakes might be diluted into even smaller minority stakes. "That is, in each case the electorate was told that retribution would follow if the proposed transaction was defeated. Put differently, the electorate was not given an option to remain in their current position. They were put to a choice between a new position and a compromised position." *In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611, 621 (Del. Ch. 1999) (discussing cases in which coercion was present, but finding no coercion due to the absence of such a threat).

Moreover, the retributive dilution threat aside, the minority stockholders were not given a choice between the status quo and the Merger as the Court of Chancery found. Ex. A at 14-15. The status quo before the Merger saw the Company providing liquidity to stockholders through share buybacks and planned dividends. It is reasonably conceivable that the minority stockholders' votes were motivated not by the merits of the Merger, but the Founder Group's promise that the status quo was off the table now that they were interested in buying the Company.

CONCLUSION

For the foregoing reasons, the Court of Chancery erred in finding that Plaintiffs failed to allege facts showing that the Merger should be subjected to entire fairness review and that business judgment review was restored under *M & F Worldwide*. The order of the Court of Chancery should therefore be reversed.

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CERTIFICATE OF SERVICE

I hereby certify that on May 27, 2015, a copy of Appellants' Opening Brief and Appendix was caused to be served upon the following counsel of record by File & ServeXpress.

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