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IN THE SUPREME COURT OF THE STATE OF DELAWARE

MANTI HOLDINGS, LLC, MALONE MITCHELL, WINN INTERESTS, LTD., EQUINOX I. A TX, GREG PIPKIN, CRAIG JOHNSTONE, TRI-C AUTHENTIX, LTD., DAVID MOXAM, LAL PEARCE, and **JIM RITTENBURG**,	:	
Petitioners-Below/ Appellants/Cross-Appellees,	:	
v.	:	No. 354, 2020
AUTHENTIX ACQUISITION COMPANY, INC.,	:	Court Below: Court of Chancery of the State of Delaware
Respondent-Below/ Appellee/Cross-Appellant.	:	C.A. No. 2017-0887-SG

APPELLANTS' OPENING BRIEF

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NATURE OF PROCEEDINGS

The Delaware General Corporation law ("DGCL") is a flexible "enabling" statute, but it is not bereft of mandatory provisions. *Salzberg v. Sciabacucchi*, 227 A.3d 102, 115-116 (Del. 2020). Those provisions reflect Delaware's public policy and contain critical rights for stockholders. Nearly 25 years ago, Chancellor Allen correctly observed that "these mandatory provisions may not be varied by the terms of the certificate of incorporation *or otherwise*" and held that "[a]mong these mandatory provisions of Delaware law is Section 262, the appraisal remedy." *Matter of Appraisal of Ford Holdings, Inc. Preferred Stock*, 698 A.2d 973, 976 (Del. Ch. 1997) (emphasis added).

The trial court held that, in an agreement enforceable between the corporation and its own stockholders, an *ex ante* or *advance* "waiver of appraisal rights is permitted under Delaware law, as long as the relevant contractual provisions are clear and unambiguous" (Ex. B, p. 9), reasoning that the "ability to avoid appraisal would make the [corporation] more attractive to potential buyers." (Ex. A, p. 10.) This appeal seeks reversal.

Petitioners-Below/Appellants/Cross-Appellees ("Petitioners") are former common and preferred stockholders of Respondent-Below/Appellee/Cross-Appellant Authentix Acquisition Company Inc. ("Authentix" or the "Company"). This appeal involves the interpretation of a Stockholders Agreement, dated April 18,

2008 ("SA," JA0058-JA0123), entered into as part of a transaction where then-new investors (the "Carlyle Stockholders") became the majority stockholders. Significantly for purposes of this appeal, Authentix itself is also a party to the SA.

The SA contains "Bring-Along Rights" for the Carlyle Stockholders and an obligation on the part of Petitioners, under certain circumstances, to "refrain from the exercise of appraisal rights" during its life. It does not contain a "waiver" of appraisal rights. The SA governs *all* of the Company's stock (including assignments, transfers and future purchases), but none of its obligations is in the Authentix Charter.

The SA contains *no* survival provisions and it terminated in 2017 upon consummation of a merger in which Authentix became the surviving subsidiary of the buyer (the "Merger"). The SA was not enforced by the Company pre-closing/termination, nor by the Carlyle Stockholders at any time. The Merger was executed by written consent pursuant to 8 *Del. C.* § 228, with no notice, vote or other involvement by Petitioners. In that circumstance, per 8 *Del. C.* § 262(d)(2), everything related to appraisal rights occurs after the closing of a merger.

Per the SA, Petitioners "refrain[ed] from the exercise of appraisal rights" during its term and then filed an appraisal petition after it terminated. The trial court held that Petitioners "waived" their appraisal rights in the SA and that the buyer can enforce the waiver. The trial court reasoned that appraisal rights can only be

exercised post-closing and the obligation to refrain would be a "nullity" if it did not survive termination. (Ex. A, 5-6.) The trial court entered judgment for the buyer and ordered Petitioners to pay the buyer's fees under a "loser pays" provision in the SA.

This appeal presents several sub-issues, all related to two questions:

1. Does the language in the SA operate as an *advance* "waiver" of Petitioners' appraisal rights such that the obligation to "refrain" survived termination and is enforceable by the buyer?

   -and-

2. Did pre-Merger Authentix lack authority to limit its own stockholders' rights viz-a-vis the Company, rendering the SA illegal and unenforceable by pre- or post-Merger Authentix?

The trial court should be reversed on principles of contract interpretation because the SA did not "waive" appraisal rights. If this Court disagrees, it must then consider a critical corporate law question: Can a Delaware corporation (as distinguished from stockholders), enter into, secure rights for itself, and enforce a stockholders agreement that (i) binds all of its stockholders, (ii) governs all of its stock (including assignments, transfers and future purchases), (iii) provides for an advance restriction on the exercise of its own stockholders' mandatory rights under the DGCL, and (iv) operates outside of, and overrides, the long-recognized hierarchical contract between a Delaware corporation and its stockholders created by the DGCL, charter and bylaws? The trial court said "yes."

The answer is tremendously important to the consistency of Delaware law because the General Assembly used the word "shall" in Section 262 and appraisal is a "mandatory" stockholder right. This is not a question of a knowing waiver in the face of a live transaction, nor a question of what stockholders can do to each other by private agreement; it is a question of corporate authority and what corporations can do to their own stockholders. It is beyond cavil that any limitation on appraisal rights in a charter or bylaw is illegal and unenforceable. If, however, Delaware law permits a Delaware corporation to do to its own stockholders by separate agreement what it cannot do to them in a charter or bylaw, then it follows *a fortiori* that other mandatory provisions (*e.g.*, §§ 211, 220) can be eliminated or modified *ex ante* in similar fashion.

The trial court essentially held that freedom of contract is Delaware's preeminent public policy, that it trumps the General Assembly's chosen words and policy behind the DGCL, and that a corporation can override a mandatory right of its own stockholders so long as it does so by separate agreement with clear language. If affirmed, it would mean that a prospective investor/controller could be offered by a *corporation* as an incentive—or could demand (like here) that a *corporation* obtain—an agreement from all of the corporation's stockholders (enforceable by the corporation) that waives *ex ante* mandatory provisions of the DGCL and operates as a *de facto* charter that supersedes Delaware's hierarchical corporate contract. Even

if such an agreement is enforceable stockholder-to-stockholder, permitting creation and enforcement by the corporation itself against its own stockholders would mean that no principled barrier would prevent a Delaware corporation from using a separate agreement to create *for itself* second-class stockholders with rights not set forth in the charter (because it would be illegal to put them in the charter).

Respectfully, the DGCL, case law, and public policy compel this Court to reverse. No section of the DGCL authorizes a Delaware corporation to use a separate agreement to secure an *advance* waiver or limitation of its own stockholders' rights. The DGCL is a flexible enabling statute, but it is not so flexible that it can render a general corporation indistinguishable from what is authorized by Delaware's Limited Liability Company Act.

SUMMARY OF ARGUMENT

I. The trial court misconstrued the SA:

A. The trial court erred in holding that the "refrain" obligation operates as an absolute "waiver" rather than a temporary restraint. The plain language of the SA belies that reading. Waivers of rights must be clear and unequivocal. Here, the SA contains a narrow obligation to "refrain" from the exercise of appraisal rights during its life. This was intentionally different from other portions of the SA that use the word "waive." The word "refrain" recognizes the continuation of a right, as one need not "refrain" from exercising a right that has already been "waived." Pre-closing, Petitioners "refrain[ed] from the exercise of appraisal rights." That obligation did not survive termination and cannot be enforced by the buyer post-closing.

The trial court further erred in concluding that the "refrain" obligation would be a "nullity" if not construed as a "waiver." Rights and restrictions attached to stock are narrowly construed. The Merger could have been structured in a way that enforced the SA as written, such that Petitioners would have been required to demand appraisal prior to closing, when they would have been contractually-obligated to "refrain" from doing so. Because the Board and the Carlyle Stockholders chose to effectuate the Merger by written consent and terminate the SA before Petitioners' appraisal rights were

triggered by 8 *Del. C.* § 262(d)(2), there was no contractual impediment to Petitioners' filing of their appraisal petition. The SA could have avoided this outcome by including survival provisions but did not.

The trial court's construction makes the buyer a beneficiary with rights under the SA, which was never intended. This is evident from the fact that, by its express terms, the SA terminates the instant there is a change of control. Petitioners did not enter into the SA with *the buyer*. They did not agree *nine years in advance* to "waive" their appraisal rights or be subject to fee-shifting in a future dispute with some then-unknown buyer. The plain language of the SA belies any such notion.

B. The trial court also erred in holding that the restrictions in the SA applied in the first place. For the restrictions to apply, the acquisition of Petitioners' stock must be on the "Same Terms and Conditions" (defined as "same *price*") as that of the Carlyle Stockholders' stock. Petitioners did not receive the same price.

The trial court held that the "same price" condition applies only to direct stock sales, not mergers, because the SA "differentiates" between the two. That is incorrect. Under the SA, the "same price" condition applies to *any* "sale of Equity Securities," a concept used in the SA to refer to both mergers and direct stock sales (which have the same economic effect). Rather

than differentiate between mergers and direct stock sales, the SA differentiates between transactions that do not involve the disposition of stock (like a substantial asset sale) and transactions that do (like mergers and direct stock sales). The distinction matters. Unlike a merger or direct stock sale, a "same price" condition is irrelevant to an asset sale because the stockholders are not being taken out; they remain invested in a company that holds undistributed cash from the sale. It would make little sense to distinguish between stock sales and mergers with respect to a "same price" condition because they both have the same economic effect and both involve an exchange of stock. The trial court's misreading of the SA is most evident from the fact that the section it said applies only to direct stock sales explicitly requires Petitioners to "execute" a "merger agreement" (if requested), which makes no sense if it does not apply to mergers.[1]

[1] The trial court disagreed with Petitioners' reading of the "same price" definition, but then held that it did not have to decide the issue because the condition does not apply to mergers. (Ex. A, p. 7.) A remand on this issue is likely to result in a ruling that the "same price" condition was satisfied, that the SA applies and, therefore, the same outcome—*i.e.*, that Petitioners "waived" their appraisal rights.

II. The trial court erred in holding that the SA can be enforced *by the Company*:

A. The SA is unenforceable because it binds *all* outstanding shares of Authentix stock and, therefore, violates 8 *Del. C.* § 151(a), which states that "special rights … limitations or restrictions" on stock viz-a-vis a company and its stockholders "shall be stated and expressed in the certificate of incorporation."

B. The SA is also unenforceable by the Company because it violates 8 *Del. C.* § 262(a). Petitioners' satisfaction of the statutory prerequisites is not in dispute and Section 262(a) states that any stockholder who complies with the statute "shall be entitled to an appraisal." The appraisal remedy is a "mandatory" right that cannot be eliminated or restricted by a corporation in a charter, bylaws "or otherwise." Stockholders can waive appraisal rights in connection with an actual transaction (*i.e.*, a *knowing* waiver), but no provision of the DGCL authorizes a Delaware corporation to use an ancillary agreement, operating as a *de facto* charter that supersedes the DGCL, to secure an advance waiver of its own stockholders' mandatory rights.

C. The SA is likewise unenforceable by the Company for lack of statutory authorization in violation of 8 *Del. C.* § 218. Stockholder agreements derive their validity *solely* from Section 218. A Delaware

corporation can be a party to a stockholder agreement for the purpose of respecting and following the lawful/enforceable agreements between its stockholders, but Section 218 refers only to agreements "between 2 or more stockholders." There is no authority anywhere in the DGCL for a Delaware corporation to enter into a stockholder agreement that secures rights for *itself* or restricts the rights of its own stockholders with respect to *itself*.

STATEMENT OF FACTS

A. The Stockholders Agreement

In 2008, in connection with a capital raise, the Company's Board recommended to *all* of its then-stockholders (*i.e.*, Petitioners) that they enter into the SA as part of a transaction by which the Carlyle Stockholders became the Company's majority holders. Not all of the Company's stockholders were represented by counsel, but they were all required to signed the SA. (JA1601-JA1604.)

Section 3 contains "Bring-Along Rights" for the Carlyle Stockholders and an obligation for Petitioners to "refrain from the exercise of appraisal rights" *if*: (i) a transaction is approved by a majority of the Carlyle Stockholders; and (ii) the acquisition of Petitioners' stock is at the "same price" as that of the Carlyle Stockholders' stock. (JA0073-JA0074; JA0069.) The SA does not contain a "waiver" of appraisal rights. Pursuant to Section 3(e), if the required conditions are satisfied, Petitioners must "consent to and raise no objections to such transaction" and take specified actions (*e.g.*, deliver written consents, execute necessary documents, etc.) that the Carlyle Stockholders or the Board "reasonably deem necessary or desirable in connection with consummation of such transaction." (JA0073-JA0074.)

It is undisputed that: (i) the SA binds *all* outstanding shares of Authentix stock (it was binding upon *all* of the Company's then-stockholders at the time of execution in 2008 and Section 13(b) states that it "shall be binding upon … assigns and any other transferee and shall also apply to any securities acquired by a Holder after the date hereof" (JA0089)); and (ii) *none* of the SA's obligations and restrictions (that run with the stock) is in the Company's Charter.

Pursuant to Section 12 of the SA, titled "Termination," *all* of "the respective rights and obligations of the Parties, shall terminate" upon "consummation of a Company Sale." (JA0089.) Section 12 contains *no* survival provisions, and thus, neither the obligation to "refrain from the exercise of appraisal rights," nor anything else in the SA, survive the closing of a "Company Sale." (JA0066.)

B. The Merger and Termination of the Stockholders Agreement

On September 13, 2017, Authentix was acquired by an affiliate of Blue Water Energy, LLP in a transaction where Authentix was the surviving entity. There is no dispute that the Merger constituted a "Company Sale" and that its closing terminated the SA. The Petitioners were wiped out and did not receive the "same price" for their shares that the Carlyle Stockholders received.

Significantly, the Merger was approved by written consent and closed the same day with no notice, vote, or involvement of Petitioners. (JA0164-JA0274.) In that circumstance, under 8 *Del. C.* §§ 228 and 262(d)(2), everything related to the "exercise of appraisal rights" occurred *after* the closing of the Merger and *after* the SA terminated by its express terms, such as notice to stockholders within 10 days of closing and service of the statutorily-required letter demanding appraisal within 20 days of notice.

It is also undisputed that prior to termination: (i) Petitioners "refrain[ed] from the exercise of appraisal rights"; and (ii) neither the Carlyle Stockholders, nor the Board, made a *pre-closing* determination or request that Petitioners do anything they "reasonably deem[ed] necessary or desirable in connection with the consummation of [the Merger]." The Carlyle Stockholders, who were never parties to these proceedings, *never* sought to enforce the SA.

C. The Buyer's Post-Termination Enforcement

Subsequent to the closing/termination of the SA, the surviving entity sent Petitioners an Information Statement and Notice of Action by Written Consent ("Information Statement"), which gave them "notice" of appraisal rights and simultaneously informed them that they "contractually agreed to refrain from exercising any appraisal rights in the [SA]." (JA0469.)

The Information Statement was internally inconsistent and misleading. No Petitioner was ever asked pre-termination to deliver "written consents" pursuant to Section 3(e) of the SA, none consented "in writing," and they were told *post-Merger* that "stockholders who do not consent in writing to the Merger may be entitled to certain appraisal rights under Section 262 of the DGCL in connection with the Merger." Yet, Petitioners were also told *post-Merger* that they "contractually agreed to refrain from exercising any appraisal rights." According to the Company, the "refrain" obligation operated as a "waiver" and not a single recipient of the notice of appraisal rights actually had appraisal rights because the SA governed all of the stock.

The buyer also demanded that Petitioners "execute written consents" (JA0044)—an "unnecessary" action for the already-closed Merger—with language stating that they "waive" their statutory appraisal rights, even though Section 3(e) contains no such "waive" language and the SA contains *no* post-termination obligations.

Petitioners filed a petition for appraisal of their shares pursuant to 8 *Del. C.* § 262. Authentix filed counterclaims seeking a judgment that Petitioners (i) waived appraisal rights in the SA and (ii) are liable for attorney's fees under the "loser pays" provision in the SA.

D. The Trial Court's Rulings

The trial court granted summary judgment for Authentix and held, in three separate opinions, that:

1. The SA is unambiguous, the obligation to "refrain from the exercise of appraisal rights" is enforceable by the buyer because none of the Carlyle Stockholders "have an interest in enforcing" it, the SA operates as a "waiver" because "the 'exercise of appraisal rights' … is meaningless until the transaction is accomplished," appraisal rights can only be exercised post-closing, and the obligation to refrain would be a "nullity" if it did not survive termination, notwithstanding the clear lack of survival provisions in the SA (Ex. A, pp. 5-6);

2. The SA "differentiates" between mergers and direct stock sales, and the "same price" condition applies only to stock sales (*id*., pp. 8-9);

3. The SA's restriction on appraisal rights does not have to be in the Charter to be enforceable by the Company because it "is not the equivalent of imposing limitations on a class of stock," notwithstanding that the SA runs with and governs all of the Company's stock (*id.*, p. 11);

4. The Board determined that "attracting capital was in the interest of the Company" and Section 262 permits a corporation to secure an *advance* waiver of appraisal rights against its own stockholders as long as it is in an ancillary agreement because "the ability to avoid appraisal would make the Company more attractive to potential buyers" (*id.*, p. 10);

5. A "waiver of appraisal rights is permitted under Delaware law, as long as the relevant contractual provisions are clear and unambiguous" and that any such waiver applies to both preferred and common stock, notwithstanding that the former is contractually-based and the latter is not (Ex. B, p. 9);

6. The DGCL authorizes corporations to enter into stockholder agreements and to secure for themselves limitations on their own stockholders' statutory rights, notwithstanding that 8 *Del. C.* § 218 refers only to "stockholders" and reference to the corporation is conspicuously absent (Ex. C, p. 20);

7. The Information Statement was not misleading (*id.*, pp. 21-22); and

8. Petitioners owe Authentix $1,481,53.80 in attorneys' fees and costs (Ex. D, pp. 4-5).

ARGUMENT

I. THE TRIAL COURT MISCONTRUED THE STOCKHOLDERS AGREEMENT

A. Question Presented

Whether the obligation to "refrain from the exercise of appraisal rights" operates as a "waiver" that survived termination of the SA and whether the "same price" condition applies to mergers? (Preserved at JA0669-JA0950; JA0984-JA0990.)

B. Standard and Scope of Review

This Court reviews summary judgment decisions and questions of contract interpretation *de novo*. *Salzberg*, 227 A.3d at 112 (reviewing summary judgment); *Borealis Power Hldgs. Inc. v. Hunt Strategic Util. Inv., L.L.C.*, 233 A.3d 1, 8 (Del. 2020) (reviewing contract interpretation).

C. Merits of Argument

1. Applicable Principles of Contract Construction

Under Delaware law, courts construe an agreement "as a whole" and apply "the plain and ordinary meaning of the words used by the parties." *In re Verizon Insurance Coverage Appeals*, 222 A.3d 566, 573 (Del. 2019).

"Waiver is the intentional relinquishment of a known right." *Minna v. Energy Coal S.p.A.*, 984 A.2d 1210, 1214 (Del. 2009). "A contractual waiver of a statutory right, where permitted, is effective only to the extent clearly set forth in the parties'

contract." *Halpin v. Riverstone Nat'l, Inc.,* 2015 WL 854724, at *8 (Del. Ch. Feb. 26, 2015); *see also In re Appraisal of Metromedia Int'l Grp., Inc.*, 971 A.2d 893, 900 (Del. Ch. 2009) ("[I]n the case of unclear or indirect drafting, this Court will not cut stockholders off from a statutory right to judicial appraisal of their preferred shares"). A waiver of a known right "must be unequivocal" and "[a]n express waiver exists [only] where it is clear from the language used that the party is intentionally renouncing a right that it is aware of." *DiRienzo v. Steel Partners Holdings L.P.*, 2009 WL 4652944, at *4 (Del. Ch. Dec. 8, 2009).

Rights/obligations attached to stock are also "strictly construed." *Harbor Fin. Partners Ltd. v. Butler*, 1998 WL 294011, at *6 (Del. Ch. June 3, 1998), *rev'd sub nom. on other grounds Elliott Assocs., L.P. v. Avatex Corp.*, 715 A.2d 843 (Del. 1998) ("It also is clearly established under Delaware law that the special contractual rights or preferences of preferred stock must be strictly construed.").

2. <u>Nothing Survived the "Termination" Provision</u>

The SA imposed an obligation to "refrain" from the exercise of appraisal rights while the SA remained in effect. It did not accomplish a "waiver" of those rights that survived termination and the trial court erred in holding that it did.

Section 3(e) does not use the term "waive" or iteration thereof, which is in contrast to other provisions in the SA where the parties did use that term. For example, Section 13(d) provides that "[e]ach Party <u>*waives*</u> any right to a trial by jury

in any such suit or proceeding." (JA0090 (emphasis added)); *see also id.* §10(a)&(i) ("the Carlyle Majority may <u>waive</u>, …" (JA0081: JA0088 (emphasis added).) The Court must presume that the "choice of [distinct terms]" was intended and must give "the distinct usage meaning." *Davis Broad. of Atlanta, L.L.C. v. Charlotte Broad., LLC*, 134 A.3d 759 (Del. 2016). Instead of "waive," which means to "relinquish,"[2] Section 3(e) uses the narrower term "refrain," which means "to keep oneself from doing."[3] One does not have to "refrain" from exercising a right they already "waived."

Section 12 of the SA contains no survival provisions and all restrictions contained in it terminated upon consummation of the Merger. The Company could have structured the Merger in a way that utilized the SA as written—*e.g.*, by scheduling a vote and triggering Petitioners' appraisal rights during a period when they would have been obligated to "refrain," which means the "refrain" obligation is not a "nullity"—but the Carlyle Stockholders and the Board chose not to. Instead, they closed the Merger and terminated the SA before Petitioner's appraisal rights were triggered under 8 *Del. C.* § 262(d)(2).

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[2] "Waive" means "to relinquish (something such as a legal right)." *Merriam-Webster Online Dictionary*, https://www.merriam-webster.com/dictionary/waive.

[3] "Refrain" means "to keep oneself from doing." *Merriam-Webster Online Dictionary*, https://www.merriam-webster.com/dictionary/refrain.

This situation is analogous to *Riverstone*, where the respondent had the right to "drag-along" stockholder votes if it provided advanced notice of any "proposed" merger, which would have had the effect of "waiving" the petitioner's appraisal rights. 2016 WL 854724 at *9. Instead, respondent never exercised that right, closed the merger by written consent, and thereafter sought to use the drag-along to obtain post-closing written consents. *Id.* The Court held that respondent was "charged with knowledge as to the various ways [it] could have carried out a merger under Delaware law," *id.*, and "with full awareness that it could consummate a merger by written consent, without the Minority Stockholders' knowledge or involvement, Riverstone agreed to drag-along rights that by their unambiguous terms did not apply to [a] retrospective scenario." *Id.* at *10. The Court concluded that "the unambiguous language of the Stockholder Agreement at issue only provides for the drag-along rights to be exercised prospectively[,] not after a merger has been accomplished." *Id.* at *1. As in *Riverstone*, Petitioners' narrow obligation to "refrain" cannot be revived post-termination.

The trial court reasoned that "none of the signatories to the [SA], other than the Company itself via its purchasers, have an interest in enforcing the contract" (Ex. A, p. 10), but even the signatories have no right to enforce the SA post-termination. 7A C.J.S. *Contracts* § 451 ("The termination of a contract by a condition subsequent has the effect of a mutual rescission, because it is a term agreed to by the parties to

bring the contract to an end upon the occurrence of the condition."); *Restatement (Second) of Contracts* § 230 (1981) (same).

Moreover, it is axiomatic that "only parties to a contract and *intended* [] beneficiaries may enforce an agreement's provisions." *NAMA Hldgs., LLC v. Related World Mkt. Ctr, LLC*, 922 A.2d 417, 434 (Del. Ch. 2007) (emphasis added). Here, the SA is being enforced by Authentix in the hands of a buyer, following a change of control, when the Company in that state *is not*, *and never was*, an intended beneficiary with exercisable rights per the plain language of Section 12. The fact that Authentix was the surviving entity makes no difference. By operation of 8 *Del. C.* § 259, all rights/liabilities of constituent corporations are assumed by the surviving entity, but the SA the buyer assumed when it took control had terminated by its terms. Petitioners did not "waive" appraisal rights and did not agree (nine years in advance) to pay the attorneys' fees of some then-unknown buyer for asserting appraisal rights in response to an Information Statement issued after the SA terminated.

The trial court also reasoned that because the Board's approval of the Merger occurred prior to termination of the SA, the "consent to and raise no objections to" language in Section 3(e) was immediately triggered upon such approval. From that, the trial court concluded that Petitioners formally consented to the Merger (presumably nine years in advance) and that such "consent" vested and survived

closing/termination. (Ex. A, pp. 5-6.) Even if that construction were correct (it is not), the Section 3(e) "consent to" language is irrelevant to Section 262. To be cut off from appraisal rights, the "consent" must be "pursuant to § 228." *See* 8 *Del. C.* § 262(a) (stockholder must have "neither voted in favor of the merger … nor consented thereto in writing *pursuant to § 228*") (emphasis added). Petitioners neither voted for the Merger nor consented pursuant to Section 228.

Finally, the trial court's ruling that appraisal rights can *only* be "exercised" *post-closing*, and that the obligation to "refrain" must survive termination to avoid it being a "nullity," is also wrong. Obviously, unless a merger closes, a petition for appraisal cannot be filed and the Court of Chancery will not make a "fair value" determination. But, the "exercise" of appraisal rights is not limited to the filing of the petition pursuant to Section 262(e); it includes all aspects of Section 262, such as the appraisal demand pursuant to Section 262(d). Indeed, the exercise of serving a timely demand is no less significant than the exercise of filing a petition within 120 days after closing. A failure of either is fatal.

Delaware courts use the term "exercise" to include the act of demanding appraisal, and some deals can be terminated between approval and closing if too many stockholders "exercise" appraisal rights. In *In re Books-A-Million, Inc. Stockholders Litig.*, the Court of Chancery observed the following with regard to *pre-closing* events:

> The Committee rationally could have believed that if stockholders felt aggrieved over a price that implied a minority discount, they could protect themselves by pursuing appraisal, and that if enough stockholders *exercised their appraisal rights*, then the Anderson Family might rely on the *appraisal condition to back out of the deal*.

2016 WL 5874974, at *17 (Del. Ch. Oct. 10, 2016) (emphasis added); *see also Kahn v. Stern*, 2017 WL 3701611, at *5 (Del. Ch. Aug. 28, 2017) (recounting that "the deadline to seek appraisal was June 20, 2016," with the merger set to close on July 21, 2016, and "Plaintiff did not *exercise* statutory appraisal rights by the June 20, 2016 deadline.") (emphasis added); *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd., et al.*, 177 A.3d 1, 1 (Del. 2017) (observing that petitioners "exercised their appraisal rights instead of voting for a buyout"); *Matter of ENSTAR Corp.*, 604 A.2d 404, 407 (Del. 1992) (observing that "[m]any of ENSTAR's stockholders had exercised their statutory rights and demanded an appraisal…."). This understanding is supported by the form demand letter of the largest holder of record of stock of Delaware corporations, Cede & Co. (JA0994 (stating that we "hereby assert appraisal rights").)

Accordingly, the narrower "refrain" obligation can be given effect without interpreting it as an advance "waiver" that survives closing. The trial court's reading of the SA is strained, ignores its plain language and the law, and demonstrates that it does not operate as a clear and unequivocal "waiver."

3. The "Same Price" Condition Applies to Mergers

The trial court erred in holding that the obligation to "refrain" from the exercise of appraisal rights was triggered in the first place. For the obligation to apply, the acquisition of Petitioners' stock must be on the "Same Terms and Conditions" (defined as "same *price*") as that of the Carlyle Stockholders' stock. It was not.

The "same price" condition in Section 3(e) applies whenever a transaction is "structured as a sale of Equity Securities":

> In the event that (i) any Carlyle Stockholders exercise their rights pursuant to this Section 3 or (ii) a Company Sale is approved by the Board and either (x) the holders of at least fifty percent (50%) of the then-outstanding Shares or (y) the Carlyle Majority, each Other Holder shall consent to and raise no objections against *such transaction*, *and if any such transaction is structured as a sale of Equity Securities*, each Other Holder shall take all actions that the Board and/or the applicable Carlyle Stockholders reasonably deem necessary or desirable in connection with the consummation of such transaction; provided that the acquisition of the Equity Securities held by each Other Holder in connection with *such transaction shall be on the Same Terms and Conditions [defined as "same price"] as the acquisition of the Equity Securities held by the Carlyle Stockholders in connection with such transaction*.

(JA0073-JA0074 (emphasis added).) The trial court held that this condition did not apply because the SA "differentiates" between mergers and direct stock sales and a

merger is not a "sale of Equity Securities" under the SA. (Ex. A, pp. 8-9).[4] That ruling is also inconsistent with the plain language of the SA.

To start, the trial court overlooked the fact that there are two references to "such transaction" in the same sentence of Section 3(e)—*i.e.*, "such transaction, and if any such transaction"—because the Bring-Along Right also applies to stockholder approval of a substantial asset sale (if required by 8 *Del. C.* § 271). The second reference narrows the focus to mergers and direct stock sales. This is evident from the definition of "Company Sale," which discusses a "merger" and a "sale or transfer of the Company's capital stock" *in the same context* (and same subpart) and does *not* differentiate between the two. Instead, it differentiates between transactions involving acquisitions of the Company's stock and those that do not (*e.g.*, mergers and stock sales versus asset sales):

> [T]he consummation of any transaction or series of transactions pursuant to which one or more Persons or group of Persons (other than any Initial Carlyle Stockholder, Manti, Whitney or any of their respective Affiliates) acquires (i) *capital stock of the Company* possessing the voting power sufficient to elect a majority of the members of the Board or the board of directors or similar governing body of the successor to the Company (*whether such transaction is effected by merger, consolidation, recapitalization, sale or transfer of the*

[4] "Equity Securities" is defined as "the Shares, any options to purchase shares of Common Stock and any Convertible Securities." (JA0067.) "Shares" means "the shares of Preferred Stock and Common Stock currently issued and outstanding or that are hereafter issued to the Holders." (JA0069.)

> *Company's capital stock or otherwise*) or (ii) all or substantially all of the *assets of the Company* and its subsidiaries.

(JA0066 (emphasis added).)

Subpart "(i)" deals with the acquisition of stock and includes transactions effectuated "by merger, consolidation, recapitalization, sale or transfer of the Company's capital stock or otherwise," whereas subpart "(ii)" deals with the acquisition of "all or substantially all of the assets of the Company and its subsidiaries" (which does not involve a sale or transfer of stock). It makes sense that Section 3(e) would distinguish between the two situations because a transaction under subpart "(i)" will always involve a "sale of Equity Securities," have a stock price associated with it, and have the same economic effect.[5] The SA ensures uniform treatment with respect to that price. In contrast, a transaction under subpart "(ii)" will never have a stock price associated with it because the stockholders retain their stock and are left with equity in a corporation that holds cash exchanged for assets and, therefore, there is no need for a price match to protect against disparate treatment by the Carlyle Stockholders.

[5] A merger is a sale of all of a corporation's securities in a single transaction, and Petitioners' reading of Section 3(e) is consistent with long-standing case law. *See, e.g.*, *Mader v. Armel*, 402 F.2d 158, 160 (6th Cir. 1968) (statutory merger is a sale of securities); *Murphy v. Stargate Def. Sys. Corp.*, 498 F.3d 386, 391 (6th Cir. 2007) (same).

Finally, the trial court's holding is contradicted by the very language of the portion of Section 3(e) it found not to apply. Indeed, Section 3(e) goes on to enumerate acts Petitioners *might* be required to take (if requested) in connection with a transaction "structured as a sale of Equity Securities." Section 3(e) states that each Petitioner shall, "provided that such document is executed by each Carlyle Stockholder *selling Equity Securities* in such transaction, execute any purchase agreement, *merger agreement* or other agreement (other than a noncompetition agreement) in connection with *such transaction* …" (JA0074 (emphasis added).) The fact that Petitioners could have been required to execute a "merger agreement" for a transaction involving documents "executed by each Carlyle Stockholder *selling Equity Securities*" proves that, in the eyes of the SA, a merger is "a sale of Equity Securities."

II. THE TRIAL COURT ERRED IN HOLDING THAT THE STOCKHOLDERS AGREEMENT CAN BE ENFORCED BY THE COMPANY

A. Question Presented

Whether the SA violates 8 *Del. C.* §§ 151(a), 262 and 218? (Preserved at JA0893-JA0930; JA1229-JA1259; JA1567-JA1582; JA2267-JA2313.)

B. Standard and Scope of Review

This Court reviews summary judgment decisions and statutory interpretation *de novo.* *Salzberg*, 227 A.3d at 112.

C. Merits of Argument

1. The Stockholders Agreement Violates 8 *Del. C.* § 151(a)

The SA binds *all* outstanding shares of Authentix stock. Section 13(b) states that it "shall be binding upon … assigns and any other transferee and shall also apply to any securities acquired by a Holder after the date hereof." The rights and obligations in the SA are targeted at the stock itself, because they run with the stock, but they are not in the Charter.

The trial court ignored the breadth of the SA. Because the rights and limitations run with the stock, *the Company's* attempt at enforcement violates Section 151(a), which states that all such rights or limitations on stock "shall be stated and expressed in the certificate of incorporation …" 8 *Del. C.* § 151(a).

Section 151(a) ensures that the charter is the only place stockholders must look to ascertain their rights with respect to the corporation. *See Ellingwood v. Wolf's Head Oil Refining Co.*, 38 A.2d 743, 747 (Del. Ch. 1944) ("The Courts of this State have held that the rights of stockholders are contract rights and that it is necessary to look to the certificate of incorporation to ascertain what those rights are.").[6] If special rights or limitations purportedly related to stock are not set forth in the charter but can nonetheless be enforced by a corporation as long as they are in a separate agreement, there could never be a violation of Section 151(a) because such rights or limitations will always be set forth in writing somewhere, rendering Section 151(a) a nullity.

2. The Stockholders Agreement Violates 8 *Del. C.* § 262

The trial court attributed to the SA the generic purpose of furthering "the corporate interest to entice investment," and concluded that a Delaware corporation's "ability to avoid appraisal [through an ancillary agreement] would make the Company more attractive to potential buyers." (Ex. A, pp. 10-11.) That is troubling on many levels.

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[6] Section 202(b) is the *only* section of the DGCL that authorizes a Delaware corporation to alter rights attached to stock outside of its charter and by "an agreement," and it is limited to a restriction on the "transfer or registration" of stock. 8 *Del. C.* § 202(b).

a. Section 262 is Mandatory

The analysis starts with what a Delaware corporation's certificate of incorporation may contain:

> Any provision for the management of the business and for the conduct of the affairs of the corporation, and *any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders*, or any class of the stockholders, or the members of a nonstock corporation; *if such provisions are not contrary to the laws of this State*.

8 *Del. C.* § 102(b)(1) (emphasis added).

As recognized in *Jones Apparel Group Inc. v. Maxwell Shoe Co., Inc.*, the meaning of "contrary to the laws of this State" has been interpreted to "invalidate[] those charter provisions that 'transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation [Law] itself.'" 883 A.2d 837, 843 (Del. Ch. 2004) (quoting *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 118 (Del. 1952)). A court will "invalidate a certificate provision if it 'transgress[es]'—i.e., vitiates or contravenes—[1] a mandatory rule of our corporate code or [2] common law." *Id.* at 846. Where a charter provision violates a mandatory provision of the DGCL, the analysis stops and the provision is invalidated. *Id.*; *see also Marmon v. Arbinet-Thexchange, Inc.*, 2004 WL 936512, at *5, n.12 (Del. Ch. Apr. 28, 2004) ("[a] charter provision that conflicts with a statute is void.").

Section 262 is a mandatory provision:

> [U]nlike the corporation law of the nineteenth century, modern corporation law contains few mandatory terms; it is largely enabling in character. It is not, however, bereft of mandatory terms. Under Delaware law, for example, a corporation is required to have an annual meeting for the election of directors; is required to have shareholder approval for amendments to the certificate of incorporation; must have appropriate shareholder concurrence in the authorization of a merger; and is required to have shareholder approval in order to dissolve. *Generally, these mandatory provisions may not be varied by the terms of the certificate of incorporation or otherwise*.
>
> *Among these mandatory provisions of Delaware law is Section 262*, the appraisal remedy. . . .

Ford Holdings, 698 A.2d at 976 (emphasis added).

Ford Holdings focused on the word "shall" in determining that Section 262 is "mandatory," *id.*, consistent with settled law on contract and statutory construction. *See, e.g.*, *Arnold v. State*, 49 A.3d 1180, 1183 (Del. 2012) ("The mandatory 'shall' … normally creates an obligation impervious to judicial discretion") (quoting *Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26 (1998)).[7]

[7] Notably, the list of mandatory provisions identified in *Ford Holdings* was not exhaustive. *See, e.g.*, *Rainbow Nav., Inc. v. Pan Ocean Nav., Inc.*, 535 A.2d 1357, 1359 (Del. 1987) (holding that Section 220 creates mandatory inspection rights that "can only be taken away by statutory enactment").

Whether a stockholder can waive a mandatory right in connection with a specific transaction—*i.e.*, a "knowing" waiver or relinquishment—is not the issue here. The issue is whether such rights can be eliminated *ex ante*. With regard to a corporation's organizational documents, the answer is clearly "no," even if expressly approved or adopted by those affected. In *Ford Holdings*, the Court expressly found that "mandatory provisions may <u>not</u> be varied by the terms of the certificate of incorporation or otherwise." 698 A.2d at 976 (emphasis added); *see also Sterling*, 93 A.2d at 118.

With that as the law, the Court in *Ford Holdings* then held that the preferred stockholders in that case had no right to a judicial appraisal even though Section 262 applies equally to common and preferred holders. How is that possible? The answer lies in the contractual nature of preferred stock. 698 A.2d at 977 ("[P]referred stock is a very special case. … To the extent it possesses any special rights or powers and to the extent it is restricted or limited in any way, the relation between the holder of the preferred and the corporation is contractual.").

b. <u>Modification of Appraisal Rights is Limited</u>

No court has authorized an advance waiver or elimination of appraisal rights for common or preferred holders. The ability to alter the appraisal remedy is limited to preferred stock that has a "fixed consideration" substituting for "fair value."

The Court in *Ford Holdings* answered a specific question:

> [W]hether purchasers of preferred stock can, in effect, contract away their rights to seek judicial determination of the fair value of their stock, by accepting a security *that explicitly provides either a stated amount or a formula by which an amount to be received in the event of a merger is set forth*.

698 A.2d at 976 (emphasis added). The provision at issue provided a liquidation preference of $100,000 per share plus accumulated and unpaid dividends, "and no more." *Id.* at 978. This fact framed the Court's carefully cabined analysis. *Id.* at 977 ("[T]here is no utility in forbidding the parties *creating* a preferred stock … from establishing a security *that has a stated value* (or a value established by a stated formula) in the event of stated contingencies") (emphasis modified); *see also id.* ("I cannot conclude that a provision that *establishes the cash value* of a preferred stock in the event of a cash-out merger would violate *the public policy reflected in Section 262*, given the essentially contractual nature of preferred stock") (emphasis added). Importantly, the fixing of value in a certificate of designations is not an actual waiver of Section 262 rights, but rather "the amount so fixed or determined constitutes the 'fair value' of the stock for the purposes of dissenters' rights under Section 262." *Id.* at 974.

Over ten years later, in *In re Appraisal of Metromedia*, Chancellor Chandler arrived at the same conclusion: "Given the contractual nature of preferred stock, a clear contractual provision *that establishes the value of preferred stock in the event*

of a cash-out merger is not inconsistent with the language or the policy of § 262." 971 A.2d at 899–900 (emphasis added) (quotation marks omitted). Then-Chancellor Strine also read *Ford Holdings* the same way. *Shiftan v. Morgan Joseph Holdings, Inc.*, 57 A.3d 928, 942 (Del. Ch. 2012) (observing that "when determining the fair value of preferred stock, the court must consider the contract upon which the preferred stock's value was based"); *see also Hintmann v. Fred Weber, Inc*., 1998 WL 83052, at *10 (Del. Ch. Feb. 17, 1998) (holding the certificate must "clearly and unambiguously *fix the fair value* of … shares for purposes of an appraisal action.") (emphasis added).

Each decision affecting preferred stockholders' appraisal rights has relied upon an express mechanism in the certificate of designations or charter for establishing the value of the preferred stock. By contrast, no pre-defined amount was established in the SA. Petitioners bargained for a "same price" condition, but the trial court concluded it did not apply. That interpretation of Section 3(e) means that, *even if the terms were in the Charter*, the SA is not *Ford Holdings* compliant as to the Authentix preferred stock. The rationale in *Ford Holdings*—anchored to the contractual nature of preferred stock—also counsels against extending the holding to common stock.

c. Delaware Corporations Cannot Secure Advance Modifications of Mandatory Stockholder Rights Through Ancillary Agreements

General corporations are not indistinguishable from LLCs, and the DGCL does not authorize a Delaware corporation to do to its own stockholders by separate agreement what it cannot do to them in the charter and bylaws.

The DGCL, charters, and bylaws are hierarchical contracts between stockholders and Delaware corporations. *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.,* 73 A.3d 934, 940 (Del. Ch. 2013) ("[O]ur Supreme Court has long noted that bylaws, together with the certificate of incorporation and the broader DGCL, form part of a flexible contract *between corporations and stockholders*.") (emphasis added). "The components of [the corporate] contract form a hierarchy, comprising from top to bottom (i) the [DGCL], (ii) the certificate of incorporation, and (iii) the bylaws." *Sinchareonkul v. Fahnemann*, 2015 WL 292314, at *6 (Del. Ch. Jan. 22, 2015). "Each of the lower components of the contractual hierarchy must conform to the higher components….[a] bylaw that conflicts with the charter is void, as is a bylaw or charter provision that conflicts with the DGCL." *Id.*

Under this hierarchy, ancillary agreements are not exempt:

> When evaluating corporate action for legal compliance, a court examines whether the action contravenes the hierarchical components of the entity-specific corporate contract, comprising (i) the Delaware General Corporation Law, (ii) the corporation's charter, (iii) its bylaws, and (iv) *other entity-specific contractual agreements*, *such as* a

> stock option plan, other equity compensation plan, or, as to the parties to it, *a stockholder agreement*.

Quadrant Structured Prod. Co., Ltd. v. Vertin, 2014 WL 5465535, at *3 (Del. Ch. Oct. 28, 2014) (emphasis added). In addressing inspection rights under 8 *Del. C.* § 220, Delaware courts do not exempt separate contracts from the hierarchy:

> The directors are not free arbitrarily to pick and choose the shareholders to whom they will or will not make disclosure. *Nor can the corporation be heard to defend such a practice on the basis that it has bound itself contractually* not to make such disclosures. Arbinet's directors were not free to contract away disclosure obligations that they had a fiduciary duty to observe. *Nor could they rely upon a certificate provision* prohibiting disclosure to avoid a shareholder's inspection right conferred by statute. By so doing, Arbinet's directors and management made the corporation complicit in their violations of fiduciary, as well as statutory, law.

Marmon v. Arbinet-Thexchange, Inc., 2004 WL 936512, at *5 (Del. Ch. Apr. 28, 2004) (emphasis added).

Likewise, a Delaware corporation cannot pick and choose the stockholders entitled to appraisal. The General Assembly has already decided who is entitled to appraisal by using the indefeasible word "shall." *See Krieger v. Wesco Fin. Corp.*, 30 A.3d 54, 58 (Del. Ch. 2011) ("Stockholders can choose individually whether to perfect and pursue appraisal rights, but the underlying statutory availability of appraisal rights is not a function of individual choice."). There is no authority in the DGCL or case law for a *corporation* to modify stockholder rights—"contrary to the

laws of this State" in contravention of Section 102(b)(1)—simply by putting the modification in a stockholders agreement (a contract) and not denominating it a "certificate" (also a contract) in order to circumvent the Delaware corporate hierarchy.

Under the trial court's approach, whether a provision of the DGCL is mandatory or permissive is irrelevant so long as the corporation acts by separate agreement. By that logic, a corporation could enter into an agreement with all stockholders entitled "Governing Agreement (Charter Disclaimed) Among Corporation and Stockholders" and each stockholder signatory would be bound to abide by its terms, even if it disclaimed all mandatory provisions of the DGCL.

This case must be reversed because (i) Delaware law makes no exception for separate contracts when dealing with mandatory stockholder rights, *Marmon*, 2004 WL 936512 at *5, (ii) a stockholder agreement (if the corporation is a party) sits at the bottom of, *not the top of*, the corporate hierarchy, *Quadrant*, 2014 WL 5465535 at *3, and (iii) "mandatory" provisions of the DGCL "may not be varied by the terms of the certificate or incorporation *or otherwise*." *Ford Holdings*, 698 A.2d at 976 (emphasis added); *see also Insituform of N. Am., Inc. v. Chandler*, 534 A.2d 257, 270 (Del. Ch. 1987) (rejecting corporation's use of voting agreement to circumvent 8 *Del. C.* § 160(c): "the policy expressed in our corporation law in Section 160(c) would require a very clear intent to create such a right before a court would recognize

it."); *Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 404 (Del. Ch. 2008) ("Section 145(f) of the DGCL has been interpreted as not authorizing the use of contracts to grant advancement and indemnification rights that are 'contrary to the limitations or prohibitions set forth in the other section 145 subsections, other statutes, court decisions, or public policy.'") (citations omitted).

Relatedly, 8 *Del. C.* § 151(a), which contains the word "shall," mandates that rights impacting stock be in the charter to protect the corporate hierarchy by ensuring that corporations cannot impose impermissible provisions to create groups or sub-classes of second-class stockholders with separate agreements purporting to operate outside and above the DGCL and charter.

Finally, the policy underpinning appraisal rights is worthy of discussion. The Legislature determines the public policy of Delaware's corporation law and expresses its determination with the mandatory word "shall," which is "impervious to judicial discretion." *Arnold*, 49 A.2d at 1183.

The appraisal remedy is intended to "provide shareholders dissenting from a merger on grounds of inadequacy of the offering price with a judicial determination of the intrinsic worth (fair value) of their shareholdings." *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1186 (Del. 1988). Quite logically, the underlying public policy in Section 262 is that stockholders cannot be forced out and have their stock taken without receiving due compensation from a buyer—*i.e.*, "fair value."

The appraisal remedy has thus been analogized to eminent domain, *Francis I. DuPont & Co. v. Universal City Studios, Inc.*, 343 A.2d 629, 634 (Del. Ch. 1975), which is why stockholders' rights to appraisal are "absolute." *Kaye v. Pantone, Inc.*, 395 A.2d 369, 375 (Del. Ch. 1978). Moreover, "[t]he concept of fair value is freighted with policy considerations," *Finkelstein v. Liberty Digital, Inc.*, 2005 WL 1074364, *13 (Del. Ch. Apr. 25, 2005), and is designed "to protect against exploitation by insiders with the power to time mergers," *id.* at n.24.

As a matter of Delaware public policy, stockholders are <u>*entitled*</u> to faithful fiduciaries <u>*and*</u> an independent "fair value" proceeding when their stock is taken without their consent in a merger. These two rights are independent and <u>*co-equal*</u>. Nonetheless, the trial court held that Delaware permits parties to waive "absolute" rights *ex ante*, relying on *Libeau v. Fox*, 880 A.2d 1049 (Del. Ch. 2005), *Kortum v. Webasto Sunroofs Inc.*, 769 A.2d 113 (Del. Ch. 2000), and *Graham v. State Farm*, 565 A.2d 908 (Del. 1989). (Ex. B, p. 9.) Each of these cases is inapposite.

In *Libeau*, the Court recognized that while the right to partition "has been called an 'absolute' one … that word is more than a tad too strong." 880 A.2d at 1056. Indeed, the right to partition is permissively granted. *See* 25 *Del. C.* § 721 ("<u>*may*</u> present a petition") (emphasis added). *Libeau* analogized partition to 8 *Del. C.* § 273, noting that "the right to invoke § 273 to end a joint venture or to seek liquidation may be waived in the corporate context." 880 A.2d at 1056. Section

273(a) provides, in permissive fashion, that stockholders "may" file a petition for dissolution and expressly permits modification of this right "in the certificate of incorporation *or in a written agreement between stockholders*." (Emphasis added). In other words, the Legislature knows how to create a right under the DGCL that may be modified or eliminated by separate agreement but chose not to do so in Section 262.

In *Kortum*, the Court did not rule that a corporation can secure a waiver of mandatory rights from its stockholders, but instead held that a Section 220 demand was not limited to documents listed in the stockholders agreement at issue. 769 A.2d at 125.

In *Graham*, the Court upheld an arbitration provision in an insurance policy by observing that the *procedural* right to a jury in civil matters was *not* "absolute" and relying on the General Assembly's considered desire to promote arbitration agreements. 565 A.2d at 911 (citing 10 *Del. C.* § 5701). Importantly, arbitration is a substitute for a trial, not a waiver of a claim/remedy or due process.

Raising capital and approving stock issuances is part of a board's management of the corporation. *See, e.g.,* 8 *Del. C.* §§ 151, 152 and 242(b)(1). There is no permissible basis under Delaware law for directors to have their own stockholders grant an advance waiver of mandatory rights to *the corporation* in connection with a capital raise or stock issuance.

Permitting *a corporation* to secure an *ex ante*, or unknowing, advance waiver of its stockholders' appraisal rights, in derogation of Section 262, upsets the balance long struck by permitting mergers over the objection of minority stockholders and violates public policy. *See Libeau*, 880 A.2d at 1056 (a court should "dishonor[] [a] contract [when] required to vindicate a public policy").

There is no policy need to permit alteration of the DGCL's mandatory rights to ensure maximum freedom of contract for corporations because there are other Delaware entities that already permit such freedom. *See* 6 *Del. C*. § 18-1101(b) ("[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract…."). By branding itself a Delaware corporation, a firm signals that it "has certain core characteristics that provide basic protections to investors." Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 Del. J. Corp. L. 845, 865–67 (2008). One of those characteristics is the right to appraisal; but if these core characteristics can be eliminated *ex ante* by the corporation via contract, the value of the brand is lost.

3. The Stockholders Agreement Violates 8 *Del. C.* § 218

It has been the law of Delaware for over 75 years that "Voting trusts and Voting Trust Agreements with respect to Delaware Corporations derive their validity from limited statutory authorization." *Belle Isle Corp. v. Corcoran*, 49 A.2d 1, 4 (Del. 1946). In *Abercrombie v. Davis*, this Court explained that prior to the

enactment of a statute permitting voting trusts in 1925, any "stockholders' agreement provid[ing] for joint or concerted voting" was likely illegal at common law. 130 A.2d 338, 344 (Del. 1957).[8] The Court then stated:

> [I]t was determined that in Delaware, as in New York, voting trusts derive their validity solely from the statute. '*The test of validity is the rule of the statute. When the field was entered by the Legislature it was fully occupied and no place was left for other voting trusts.*' The statute lays down for voting trusts 'the law of their life'; compliance with its provisions is mandatory. Voting trusts not so complying are illegal.

Id. (emphasis in original) (citations omitted).

Now, "[Section] 218 of the [DGCL] provides the <u>*exclusive method*</u> for creating voting trusts of stock of a Delaware corporation." *Oceanic Exploration Co. v. Grynberg*, 428 A.2d 1, 5 (Del. 1981) (emphasis added). Section 218 "governs the relationship <u>*between*</u> [] shareholders," *In re Coffee Assocs., Inc.*, 1993 WL 512505, at *2 (Del. Ch. Dec. 3, 1993) (emphasis added), not between the corporation and

[8] *Abercrombie* cited *Perry v. Missouri-Kansas Pipe Line Co.*, which reviewed the status of the law and observed that "[t]he purport of this in [sic] necessarily to the effect that voting tursts [sic] generally are condemned as <u>*illegal*</u>, but that the state has granted a permissive power to create them to a limited extent." 191 A. 823, 826 (Del. Ch. 1937) (emphasis added). In *Smith v. Biggs Boiler Works Co.*, the Court stated that, "[w]hatever may have been the rule under the common law relative to validity of voting trust agreements, it is now clear, under Sec. 18 of the General Corporation Law, that their very existence now depends upon that statute. No voting trust may now be created in this state unless it complies with that statute." 91 A.2d 193, 197 (Del. Ch. 1952) (citing *Perry*).

shareholders. *Stockholders* may enter into agreements with *one another* provided they are not "illegal," 8 *Del. C.* § 218(d), but anything else is prohibited.

An agreement (like the SA) that separates voting rights from ownership or "interfere[s] with stock ownership rights" falls within the scope of Section 218(c). *Dweck, et al., v. Nassar, et al.*, 2005 WL 5756499, at *4-5 (Del. Ch. Nov. 23, 2005) (agreement held unenforceable because it fell within the scope of Section 218 and did not comply with its requirements).

Whatever agreements stockholders may make among themselves under Section 218, titled "Voting trust and other voting agreements," noticeably absent from Section 218—like Section 225(a)—is the corporation itself, let alone authority for a corporation to modify stockholder rights in such an agreement. Section 218 repeatedly refers *only* to "stockholders." *See, e.g.*, 8 *Del. C.* § 218(a) ("One *stockholder* or 2 or more *stockholders* may by agreement in writing …") (emphasis added), § 218(c) ("An agreement between 2 or more *stockholders*, if in writing and signed …") (emphasis added), and § 218(d) ("This section shall not be deemed to invalidate any voting or other agreement among *stockholders* …") (emphasis added).

By way of analogy, prior to 2008, corporations did not have standing under Section 225 and could not act until given express authority by the Legislature. *See In re Native Am. Energy Grp., Inc*., 2011 WL 1900142, at *5 (Del. Ch. May 19,

2011) (explaining history and citing 76 Del. Laws. Ch. 252, § 3, synopsis (2008)). Now, Section 225(b) provides: "Upon application of any stockholder or upon application of the *corporation itself*, the Court of Chancery may hear and determine the result of any vote of stockholders upon matters *other than the election of directors or officers*." 8 *Del. C.* § 225(b) (emphasis added). However, votes involving the "election of officers or directors" are governed by Section 225(a), which does not include the subject company as a permitted plaintiff. *Id.*, § 225(a) ("Upon application of any *stockholder* or *director*, or any *officer* …"). In *Insituform*, the Court rejected corporate standing under Section 225(a), stating: "Noticeably absent from this listing of parties with standing to institute such an action is the corporation itself." 534 A.2d at 270 n.11; *see also Law Debenture Trust Co. v. Petrohawk Energy Corp.*, 2007 WL 2248150, at *11 n.37 (Del. Ch. Aug. 1, 2007) (same).

The statutory language used in Section 218 warrants the same conclusion reached in *Insituform*, only in this instance the General Assembly has not amended any subsection of Section 218 to grant standing to corporations like it did with Section 225(b). Moreover, if stockholder agreements between stockholders were illegal at common law and, therefore, illegal absent statutory authorization, *see Abercrombie*, 130 A.2d at 344, they are surely illegal for corporations absent similar statutory authorization. *See State Farm Mut. Auto. Ins. Co. v. Kelty*, 126 A.3d 631,

635 (Del. 2015) (holding that courts should "read each relevant section of the statute in light of all the others to produce a harmonious whole.").

In sum, the SA is unenforceable by Authentix. There is no authority for a Delaware corporation to enter into and enforce a stockholders agreement for its own benefit and against its own stockholders, that governs *all* of its stock, dramatically impairs the rights of Delaware stockholders to seek redress in the courts, and shifts fees for doing so.

CONCLUSION

Respectfully, the trial court should be reversed.

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