IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

PONTIAC GENERAL EMPLOYEES RETIREMENT SYSTEM, on Behalf of Itself and All Others Similarly Situated and on Behalf of Nominal Defendant HEALTHWAYS, INC., Plaintiff, v. JOHN W. BALLANTINE, J. CRIS BISGARD, MARY JANE ENGLAND, BEN R. LEEDLE JR., C. WARREN NEEL, WILLIAM D. NOVELLI, ALLISON TAUNTON-RIGBY, DONATO TRAMUTO, JOHN A. WICKENS, KEVIN WILLS and SUNTRUST BANK, Defendants, and HEALTHWAYS, INC., Nominal Defendant.	PUBLIC VERSION FILED ON: SEPTEMBER 22, 2014 C.A. No. 9789-VCL

PLAINTIFF'S COMBINED ANSWERING BRIEF IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

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Plaintiff Pontiac General Employees Retirement System ("Pontiac" or "Plaintiff") submits this combined answering brief in response to (i) the Opening Brief in Support of Healthways, Inc. and Individual Defendants' Motion to Dismiss ("Healthways Brief"), filed by defendants Healthways Inc. ("Healthways" or the "Company"), John W. Ballantine, J. Cris Bisgard, Mary Jane England, Ben R. Leedle Jr., C. Warren Neel, William D. Novelli, Allison Taunton-Rigby, Donato Tramuto, John A. Wickens and Kevin Wills ("Individual Defendants," and together with "Healthways," the "Healthways Defendants"), and (ii) the Opening Brief in Support of Defendant SunTrust Bank's Motion to Dismiss ("SunTrust Brief"), filed by SunTrust Bank ("SunTrust," and together with the Healthways Defendants, the "Defendants").

PRELIMINARY STATEMENT

In three decisions over the last five years – *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, 983 A.2d 304 (Del. Ch. 2009) ("*Amylin I*"), *San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171 (Del. Ch. Oct. 28, 2010) ("*Amylin II*"), and *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242 (Del. Ch. 2013) ("*Sandridge*") – this Court warned corporate boards, senior management and lenders of the fiduciary duty problem created by "Proxy Puts" – a provision in a corporation's debt instrument that "gives the noteholders the right to put back their debt after a vote that seats a new board that has not been approved by the ousted incumbents." *Sandridge,* 68 A.3d at 245 n.8. Then-Chancellor Strine explained in *Sandridge*:

> By definition, a contract that imposes a penalty on the corporation, and therefore on potential acquirers, or in this case, simply stockholders seeking to elect a new board, has clear defensive value. Such contracts are dangerous because, as will be seen here, doubt can arise whether the change of control provision was in fact sought by the third party creditors or willingly inserted by the incumbent management as a latent takeover and proxy contest defense.

Id. at 259.

At issue here is a Dead Hand Proxy Put, a provision in a bank credit agreement that entitles the lender to accelerate the debt if actual or threatened proxy contests result in the election of a majority of new directors – without any mechanism by which the incumbent directors can "approve" nominees and thus disable the proxy put. Vice Chancellor Noble explained the similarities and the distinction between two types of proxy puts in *Amylin II*:

> Although the continuing director provisions in the Credit Agreement and the Indenture are phrased differently, both impact Amylin's stockholders the same. ***They deter the stockholders from nominating and electing directors of their choosing to Amylin's board.*** The only material, functional difference is that the board can approve a nominee under the Indenture to avoid triggering that continuing director provision. The Credit Agreement lacks any comparable approval mechanism.

Amylin II, 2010 WL 4273171, at *3 (emphasis added).

A board bears a heavy burden to justify approval of a Dead Hand Proxy Put. Vice Chancellor Lamb wrote in *Amylin I* about "the troubling reality that corporations and their counsel routinely negotiate contract terms that may, in some circumstances, impinge on the free exercise of the stockholder franchise." 983 A.2d at 319. Vice Chancellor Lamb stated that a Dead Hand Proxy Put in a public debt instrument should "raise grave concerns" due to its "eviscerating effect on the stockholder franchise," and, therefore, "the court would have to closely consider the degree to which such a provision might be unenforceable as against public policy." *Id*. at 315. Of course, the same type of financial underperformance that triggers stockholder proxy activities provides reason for creditors of all sorts (public or bank lenders) to assert acceleration and default rights as leverage. In order to justify a board placing such power with lenders while undermining the stockholder franchise, "[t]he court would want, at a minimum, to see evidence that the board believed in good faith that, in accepting such a provision, it was obtaining in return extraordinarily valuable economic benefits for the corporation that would not otherwise be available to it." *Id.*

The board of directors of Healthways (the "Board") and its bank lenders, led by SunTrust, flouted this Court's warnings. In 2012, the Board approved an amended credit agreement with a Dead Hand Proxy Put – thereby obtaining a deterrent to a proxy contest just after the Company's stockholders had overwhelmingly voted to declassify the Board. Plaintiff's recent Section 220 demand revealed that the Board never considered whether Healthways obtained any economic benefit in return, much less a benefit commensurate with the franchise-eviscerating effect of the Dead Hand Proxy Put.

Neither the Healthways Defendants nor SunTrust moved to dismiss on the basis that the Complaint fails to state a claim for breach of fiduciary duty against the Individual Defendants. They undoubtedly recognize the futility of such a motion in the face of the precedents discussed above. Yet, the Healthways Defendants and SunTrust moved to dismiss on grounds that are similarly foreclosed by the same cases.

The Healthways Defendants argue that the absence of a pending proxy contest renders Plaintiff's challenge to the Dead Hand Proxy Put unripe. Vice Chancellor Noble's statement in *Amylin II*, quoted above, about the ongoing deterrent effect of a Dead Hand Proxy Put explains how stockholders are ***presently harmed*** by such provisions, and thus why any ripeness defense fails. Moreover, the ripeness defense is contradicted by abundant case law allowing challenges to the maintenance of poison pills, which similarly have a present effect on stockholders because they deter proxy contests and hostile takeovers. Indeed, requiring a pending proxy fight would immunize board conduct that has a strong deterrent effect on investor action.

SunTrust argues that it cannot be liable for aiding and abetting because it was not on notice of any breach of fiduciary duty and because it bargained at arm's-length against Healthways. SunTrust's arguments depend on illogical and unfounded propositions – that SunTrust acted in blissful ignorance of this Court's precedents and that SunTrust bargained for an entrenchment device, even though there is no record of any bargaining for it. SunTrust cannot escape the application of this Court's precedents, which negate the very inference of ordinary arm's-length bargaining that SunTrust asks this Court to assume.

In sum, this Court has repeatedly warned both fiduciaries and lenders about the problem that Dead Hand Proxy Puts pose. These Defendants ignored those warnings, and now say they cannot be held accountable. This Court should deny the Defendants' motions to dismiss, and make clear that a Dead Hand Proxy Put is subject to invalidation.

STATEMENT OF FACTS

A. This Court Puts Industry Participants on Notice

This Court's May 12, 2009 decision in *Amylin I* was widely reported in the financial press, law firm announcements and articles, and in legal periodicals.[1] For example, a director at Bass, Berry & Sims, PLC – the law firm that represented Healthways in connection with its 2012 credit agreement that contains the Dead Hand Proxy Put[2] – co-authored an article for *Directorship* recognizing that proxy puts "are no longer a dirty little secret" and "[c]ourts will likely apply greater hindsight scrutiny in future cases." Ryan Thomas and Thomas K. Wedeles, *What Amylin Means for Directors, Proxy Fights - Court Provides Guidance on the 'Poison Put' Provision in Debt Agreements During a Proxy Fight*, DIRECTORSHIP (Oct. 27, 2009) (Chapple Aff., Ex. H).

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[1] *See, e.g.*, *Target, Amylin and the Peak of Proxy Season*, N.Y. TIMES DEALBOOK (May 27, 2009) (attached to the Transmittal Affidavit of Benjamin Chapple ("Chapple Aff.") as Ex. A); *'Poison Puts' Undercut Mergers: The Bondholders Matter, Which Has Been Derailing Potential Deals*, WALL STREET JOURNAL (Apr. 14, 2009) (*Id*., Ex. B); *Icahn, Amylin and the New Nuances of Activist Investing*, N.Y. TIMES DEALBOOK (Apr. 20, 2009) (*Id*., Ex. C); *Delaware Court of Chancery Decision Casts Doubt on the Value of Continuing Director Change of Control Provisions for Lenders*, MAYER BROWN (June 23, 2009) (*Id*., Ex. D); *Delaware Court of Chancery Rules on "Poison Puts,"* GIBSON DUNN (June 8, 2009) (*Id*., Ex. E); *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, SULLIVAN & CROMWELL LLP (June 12, 2009) (*Id*., Ex. F).

[2] *See* Healthways' Fifth Amended and Restated Revolving Credit and Term Loan Agreement, dated June 8, 2012, § 3.1(b)(vii); *id.* § 10.1(a)(i) (Chapple Aff., Ex. G).

B. The Board Approves a Dead Hand Proxy Put

In advance of Healthways' 2012 annual meeting, the New York State Common Retirement Fund, one of the Company's largest institutional investors, submitted a precatory stockholder proposal to declassify the Company's classified board. (Compl. ¶ 34.) The proposal was included in the Company's proxy statement, and the Board opposed the proposal. (*Id.* ¶ 35.) On May 31, 2012, Healthways stockholders voted, by a ten-to-one margin, in favor of the proposal to declassify the Board. (*Id.* ¶ 36.)

Knowing that the stockholders' demand for the power to replace the full Board annually could not be ignored for long, the Board wasted no time implementing a new defense to a proxy contest, a Dead Hand Proxy Put. On June 8, 2012, just eight days after the annual meeting, Healthways entered into a Fifth Amended and Restated Revolving Credit and Term Loan Agreement (the "2012 Loan Agreement") with SunTrust as administrative agent. (*Id*. ¶ 38; Chapple Aff., Ex. G.)[3]

The Loan Agreement provides Healthways with (i) a $200 million revolving credit facility, including a $20 million swing-line sub facility and a $75 million sub facility for letters of credit, terminating on June 8, 2017; and (ii) a $200 million

[3] The parties entered into three subsequent amendments to the 2012 Loan Agreement on February 5, 2013, March 15, 2013, and July 1 2013 (collectively with the 2012 Loan Agreement, the "Loan Agreement"). (Compl. ¶ 38.)

term-loan facility maturing on June 8, 2017. (*Id*. ¶ 39.) As part of the Loan Agreement, the Board agreed to a Dead Hand Proxy Put that allows the lenders, through the administrative agent, to declare a default if half of the incumbent directors are replaced through an actual or threatened proxy contest. (*Id*. ¶ 40.) Such a default would cause any outstanding principal and accrued interest on loans made pursuant to the Loan Agreement to become immediately due and payable – a potentially catastrophic event for Healthways. (*Id*. ¶ 40.)

The Dead Hand Proxy Put operates through several interrelated provisions of the Loan Agreement. Section 8.1 states that upon the occurrence of an "Event of Default" and throughout its continued existence:

> [T]he Administrative Agent may, and upon the written request of the Required Lenders shall, by notice to the Borrower, take any or all of the following actions, at the same or different times: (i) terminate the Commitments, whereupon the Commitment of each Lender shall terminate immediately; (ii) declare the principal of and any accrued interest on the Loans and all other Obligations (excluding the Hedge/Cash Management Exposure) to be, whereupon the same shall become due and payable immediately, without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Borrower and (iii) exercise all remedies contained in any other Loan Document[.]

(*Id*. ¶ 41; Chapple Aff., Ex. G.) Section 8.1(m) defines a "Change in Control" as an Event of Default. (Compl. ¶ 41; Chapple Aff., Ex. G.)

Section 1.1 of the Loan Agreement, as amended by the third amendment[4] to the 2012 Loan Agreement, defines Change in Control as:

> [T]he occurrence of one or more of the following events: . . . (c) during any period of 24 consecutive months, a majority of the members of the board of directors or other equivalent governing body of the Borrower cease to be composed of individuals who are ***Continuing Directors***; . . . .

(Compl. ¶ 42; Chapple Aff., Ex. G (emphasis added).) Section 1.1 defines Continuing Directors as follows:

> [W]ith respect to any period, any individuals (A) who were members of the board of directors or other equivalent governing body of the Borrower on the first day of such period, (B) whose election or nomination to that board or equivalent governing body was approved by individuals referred to in clause (A) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body, or (C) whose election or nomination to that board or other equivalent governing body was approved by individuals referred to in clauses (A) and (B) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body ***(excluding, in the case of both clauses (B) and (C), any individual whose initial nomination for, or assumption of office as, a member of that board or equivalent governing body occurs as a result of an actual or threatened solicitation of proxies or consents for the election or removal of one or more directors by any person or group other than a solicitation for the election of one or more directors by or on behalf of the board of directors)***.

(Compl. ¶ 43; Chapple Aff., Ex. G (emphasis added).)

[4] None of the amendments to the 2012 Loan Agreement have modified the relevant provisions at issue in this suit. (Compl. ¶ 44.)

By operation of these provisions, Healthways risks default under the Loan Agreement if, at any point during a given 24-month period, half of the Board is replaced by individuals who were nominated by, ***or threatened to be nominated by***, a stockholder. (Compl. ¶ 45.) Even if the Company reaches an agreement with a stockholder who threatened a proxy contest to add one or more of the stockholder's proposed directors to the Board, such newly appointed directors would not be deemed "Continuing Directors" under the Loan Agreement until they have served as directors for 24 months. (*Id*.) Simply stated, the Board irrevocably gave lenders the option to declare a default in the event that half of the Healthways directors are replaced within 24 months due to actual or threatened proxy contests.

C. The Board Had No Justification for Agreeing to the Dead Hand Proxy Put

On March 20, 2014, Plaintiff served a Demand to Inspect the Books and Records of the Company pursuant to Section 220 of the DGCL (the "220 Demand"). (*Id*. ¶ 31.) In the 220 Demand, Plaintiff sought Company documents and records relating to the Board's reasons and justifications for agreeing to the Dead Hand Proxy Put. (*Id*.) These documents demonstrate not only that the Board did not get any extraordinary economic benefit for entering into a proxy put, but that the Board did not even consider the Dead Hand Proxy Put at the time the 2012 Loan Agreement was approved. (*Id*. ¶ 55.) The documents Healthways produced in response to the 220 Demand do not reflect any extraordinary economic benefit or even any consideration of the Dead Hand Proxy Put when the 2012 Loan Agreement was thrice amended in 2012 and 2013. (*Id*.)

The credit markets were strong when the Board approved the 2012 Loan Agreement. (*Id*.) The press release disclosing the 2012 Loan Agreement touted the favorable financial conditions in the market and for the Company. (*Id*.).

D. The Election of a New Board Risks Acceleration of All of Healthways' Debt, With Serious Consequences for the Company

In July 2013, Healthways issued $125 million of 1.50% Cash Convertible Senior Notes, and in October 2013, Healthways issued a $20 million Convertible Senior Subordinated Note. (*Id*. ¶¶ 46-47.) These notes do not contain Dead Hand Proxy Puts, but the indentures governing both sets of notes provide that it is an Event of Default if the Company defaults on any other loans in excess of $10 million. (*Id*.). In other words, a default under the Loan Agreement would result in a cross default of these notes. (*Id*.)

According to Healthways' annual report filed on March 14, 2014, the Company had $283.6 million in Long-Term Debt outstanding as of December 31, 2013. (*Id*. ¶ 48.) As of the same date, it had Total Current Assets of $119.2 million and Total Assets of $749 million. (*Id*.) A default on all of its debt could have serious consequences for Healthways.

E. Election of Just Three Directors At the Next Annual Meeting Would Trigger the Dead Hand Proxy Put

Healthways has been the subject of a recent proxy fight due to its underperformance. For seven months beginning in December 2013, North Tide Capital LLC ("North Tide"), which owned approximately 11% of Healthways' outstanding common stock, expressed, through public letters and proxy filings, its strong displeasure with the Company's recent performance and the Board's management. (*Id*. ¶ 59.) North Tide demanded that the Board remove CEO Ben Leedle, who had overseen an 80% decline in the Company's market value since 2008, and repeatedly failed to meet internally-set performance targets over the last three years and in six of the last ten years. (*Id*. ¶ 60.)

The Board resisted North Tide's demands and refused to replace Leedle. (*Id*. ¶ 61.) In response, North Tide announced its intention to wage a proxy fight and nominate its own directors to the Board. (*Id*. ¶ 62.) On February 28, 2014, North Tide rejected the Board's offer that would have provided North Tide with two seats on an expanded board of directors and instead nominated four director candidates.[5] (*Id*. ¶¶ 64-66.)

[5] As the Board was not yet declassified, only four directors were up for reelection at the 2014 Annual Meeting. (Compl. ¶ 69.)

In the midst of this public battle, Healthways co-founder, former CEO and former Chairman, Thomas Cigarran, resigned from the Board. (*Id*. ¶ 63.) His resignation letter stated in full:

> It is with great regret that I must resign from the Board of Directors of Healthways, Inc. effective immediately. Over the last 3 years, I have tried directly through you, at board meetings and directly with our CEO to have the necessary steps taken to improve the Company's unacceptable operating and financial performance. Healthways is very well positioned strategically, has many great and dedicated people and can still become not just a good but a great company. As a director and shareholder, I do not believe this can be accomplished without changes in company focus and direction. ***I am no longer willing to continue as a director and watch this company fail to meet its potential and the reasonable expectations of its shareholders***.

(*Id*. (emphasis in original).)

On June 3, 2014, North Tide and Healthways agreed that the Board would nominate three of the four North Tide nominees for election at that month's annual meeting. (*Id*. ¶ 68.) The three nominees were elected by the Company's stockholders at the 2014 annual meeting held on June 24, 2014.

Healthways has an eleven-member board of directors. (*Id*. ¶ 69.) Because the definition of Continuing Directors excludes persons who were nominated to the Board as a result of an actual or threatened proxy fight, the three North Tide directors are ***not*** considered Continuing Directors. (*Id*. ¶ 72.) Therefore, the Dead Hand Proxy Put currently precludes stockholders from initiating action to replace any more than two of the five non-North Tide incumbent directors up for reelection at next year's annual meeting. (*Id.*)

ARGUMENT

I. PONTIAC'S CLAIMS ARE RIPE, AND PONTIAC HAS STANDING

The Healthways Defendants assert that Pontiac's claims are not ripe and that Pontiac lacks standing. They are wrong.

Pontiac seeks declaratory relief. Delaware's "Declaratory Judgment Act [the "Act"] is remedial in character and . . . the term 'actual controversy' should be liberally interpreted to give wide scope to the provisions of the act within the purposes thereof." *Rollins Int'l., Inc. v. Int'l Hydronics Corp.*, 303 A.2d 660, 662 (Del. 1973). The Act seeks "to settle and afford relief from uncertainty and insecurity with respect to rights, status and other legal relations." *KLM Royal Dutch Airlines v. Checchi*, 698 A.2d 380, 382 (Del. Ch. 1997) (internal citation omitted).

A. Pontiac's Claims Are Ripe

Determining whether a request for declaratory relief is ripe is a matter of practical common sense. *See Hoechst Celanese Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa*, 623 A.2d 1133, 1137 (Del. Super. 1992). Relevant factors include an evaluation of the plaintiff's legitimate interests in prompt resolution of the question presented, the hardship that further delay may threaten, the prospect that future factual development might affect the determination made, the need to conserve resources and due respect for identifiable policies of law touching upon the subject matter in dispute. *See id.*; *Schick Inc. v. Amalgamated Clothing & Textile Workers Union*, 533 A.2d 1235, 1238 (Del. Ch. 1987).

The Healthways Defendants argue that "there is a trove of 'uncertain and contingent events that may not occur.'" (Healthways Br. at 11.) The Healthways Defendants ignore the present deterrent effect of the Dead Hand Proxy Put on Healthways' stockholders. They also ignore the cases most on point.

Virtually identical ripeness arguments to those the Defendants make here have repeatedly been rejected in the context of poison pills. In the leading case of *Moran v. Household International, Inc.*, 490 A.2d 1059, 1069 n.3, 1072 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985), a stockholder challenge to the validity of a poison pill was held to be ripe "because [] its deterrent features presently affect[] shareholders' fundamental rights[.]" *Id.* at 1072.

Subsequent cases rejected ripeness defenses to poison pill challenges. *See Leonard Loventhal Account v. Hilton Hotels Corp.*, 2000 WL 1528909, at *2-3, *10-11 (Del. Ch. Oct. 10, 2000) (holding declaratory relief claim challenging the validity of a provision of Hilton Hotels' poison pill was ripe, even though no current takeover threat existed and there was not any indication that the plaintiff stockholder was interested in or capable of running a proxy contest); *Carmody v. Toll Bros., Inc.*, 723 A.2d 1180, 1187-88 (Del. Ch. 1998) (rejecting ripeness defense to challenge to validity of dead hand poison pill); *KLM Royal Dutch Airlines v. Checchi*, 698 A.2d 380, 384 (Del. Ch. 1997) (deciding challenge to a poison pill's application was ripe because the stockholder's rights were ***presently*** curtailed, even though the option was not yet exercisable and defendants' application of the poison pill was still contingent); *In re Chrysler Corp. S'holders Litig.*, 1992 WL 181024, at *3 (Del. Ch. July 27, 1992) ("Clearly ripe is the complaint's claim for rescission of the board's . . . amendments to the Rights Plan (including the trigger reduction), ***even absent an actual or threatened proxy contest***.") (emphasis added).

In *Carmody*, Vice Chancellor Jacobs explained that a ripeness defense was "easily disposed of" in the context of a challenge to the validity of a dead-hand poison pill. *Carmody*, 723 A.2d at 1187-88. The defendants in *Carmody* "urge[d] that because none of [certain] events has occurred, the plaintiff's claims are not ripe for adjudication." *Id.* "The ripeness argument runs as follows: the harm claimed to flow from the 'dead hand' provision is improper interference with the shareholders' right to vote. That harm cannot occur unless there is a specific hostile takeover proposal that involves a proxy contest in which the acquiror seeks to replace the incumbent board with its own nominees who, if elected, would redeem the pill." *Id*. at 1187.

Vice Chancellor Jacobs rejected the defendant's argument because, "[h]ere, as in *Moran*, the plaintiff complains of the Rights Plan's (specifically, its 'dead hand' feature's) *present* depressing and deterrent effect upon the shareholders' interests, in particular, the shareholders' *present* entitlement to receive and consider takeover proposals and to vote for a board of directors capable of exercising the full array of powers provided by statute, including the power to redeem the poison pill." *Id.* at 1188 (emphasis in original). Accordingly, "[b]ecause of their alleged *current* adverse impact, the plaintiff's claims of statutory and equitable invalidity are ripe for adjudication." *Id.* (emphasis in original). *See also id.* 1187-88 ("[T]he plaintiffs' suit involves the alleged ***present depressing effect*** of the Rights Plan on shareholder interests, ***regardless of whether the rights are in fact ever triggered***.") (emphasis added) (quoting *Moran*, 490 A.2d at 1072).

Pontiac here expressly alleged that the "Proxy Put has a ***present depressing effect*** on stockholder interests, ***regardless of whether the Proxy Put is ever triggered***." (Compl. ¶ 73 (emphasis added).) Pontiac's Complaint also alleges that "[b]ecause of its ***deterrent*** features, the Proxy Put presently affects fundamental stockholder rights." (*Id*. (emphasis added).)

Vice Chancellor Noble articulated the same point in *Amylin II*:

> Although the continuing director provisions in the Credit Agreement and the Indenture are phrased differently, both impact Amylin's stockholders the same. ***They deter the stockholders from nominating and electing directors of their choosing to Amylin's board.***

2010 WL 4273171, at * 3 (emphasis added). As was the case with the proxy puts at issue when Vice Chancellor Noble made the above observation, Healthways' Dead Hand Proxy Put deters stockholders from replacing ineffective management by means of a proxy contest at the next annual meeting, which will be held only a few months after the Court decides the pending motions.

Case law respecting bylaw challenges does not help the Healthways Defendants. This Court has found challenges to bylaws ripe. *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 946 (Del. Ch. 2013) (holding that the facial statutory and contractual validity and enforceability of these bylaws were "ripe legal issues," even though defendants had not sought to deploy the bylaws and the parties did not point to any litigation to which the bylaws might be applied). *Bebchuk v. CA, Inc.*, 902 A.2d 737 (Del. Ch. 2006), is not to the contrary. (*See* Healthways Br. at 18.) In *Bebchuk*, the Court refused to issue declaratory relief validating a ***proposed*** bylaw that had not been adopted. The Court held that "[t]he key event necessary to vest jurisdiction in this court is the adoption of the proposed bylaw." 902 A.2d at 741.

The Healthways Defendants rely on the disposition of the claims in *Amylin I*, in which the challenge to the Dead Hand Proxy Put in the Credit Agreement was dismissed as moot and the challenge to the Proxy Put in the Indenture was dismissed without prejudice as unripe. (Healthways Br. at 20-21.) That reliance is misplaced.

The Court's holdings in *Amylin I* as to mootness (based on a pretrial partial waiver of the Dead Hand Proxy Put) and as to lack of ripeness were not supported by any authority. *See* 983 A.2d at 312, 317-18, 319. Those holdings were also undercut by the subsequent proceedings in the case and the subsequent holding in *Amylin II*.

The stockholder plaintiff appealed *Amylin I*, including the trial court's mootness ruling. During the pendency of the appeal, the bank lenders completely waived the Dead Hand Proxy Put in the Credit Agreement, and Amylin subsequently "approved" the newly appointed directors for purposes of the Proxy Put in the Indenture. In *Amylin II*, Vice Chancellor Noble found that those subsequent actions removed a meaningful burden to the stockholder franchise, and thus created a specific and substantial corporate benefit for stockholders. *Amylin II*, 2010 WL 4273171, at *7-8. Vice Chancellor Noble also observed that the proxy puts in the Credit Agreement and in the Indenture "deter the stockholders from nominating and electing directors of their choosing to Amylin's board." *Id.* at *3. These holdings cannot be squared with the Defendants' assertion that this Court lacks subject-matter jurisdiction to hear challenges to proxy puts in the absence of a pending proxy contest.

B. Pontiac Has Standing

The Healthways Defendants contend that "[f]or essentially the same reasons that Pontiac's claims are not yet ripe, Pontiac lacks standing because it has not yet suffered any injury." (Healthways Br. at 22.) As explained above, Pontiac and other stockholders of Healthways are suffering the injury of the depressing effect on the stock due to the deterrent effect created by the Dead Hand Proxy Put on the ability of stockholders to participate in a proxy contest. For the same reasons, Pontiac has standing.

II. PONTIAC STATES A CLAIM FOR AIDING AND ABETTING

The legal rules governing a motion to dismiss for failure to state a claim are familiar:

> When considering a defendant's motion to dismiss, a trial court should accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof. Indeed, it may, as a factual matter, ultimately prove impossible for the plaintiff to prove his claims at a later stage of a proceeding, but that is not the test to survive a motion to dismiss.

Cent. Mortgage Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 536 (Del. 2011) (internal citations omitted). *See also Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 813 n.12 (Del. 2013) (reaffirming that "reasonable conceivability is the Rule 12(b)(6) pleading standard in Delaware").

A claim for aiding and abetting has four elements: (i) the existence of a fiduciary relationship, (ii) a breach of the fiduciary's duty, (iii) knowing participation in the breach by the non-fiduciary defendants, and (iv) damages proximately caused by the breach. *See In Re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54, 80 (Del Ch. 2014).

SunTrust concedes that the first element (the existence of a duty) is satisfied, and offers no substantive argument concerning the second element (the breach of a duty) or the fourth element (damages). Rather, SunTrust "focus[es] on knowing participation." (SunTrust Br. at 8.)

SunTrust's argument rests on two false premises. First, SunTrust insists that it can only be held liable if a Dead Hand Proxy Put in a Credit Agreement invariably "violates a borrowing board's fiduciary duties, and thereby exposes lenders to secondary liability." (*Id.*) Second, SunTrust asserts that a lender who obtains the benefit of a Dead Hand Proxy Put "should be treated no differently" than an acquirer who bargained to buy a target at a low price. (*Id.* at 10.)

The mere possibility that a Dead Hand Proxy Put may be "permissible in certain circumstances" is no basis for obtaining dismissal on Rule 12(b)(6). (*Id.* at 7.) Dismissal is only warranted if it is not reasonably conceivable that SunTrust knowingly participated in a breach of fiduciary duty.

A. SunTrust Was On Notice That a Borrower's Approval of a Dead Hand Proxy Put Is Suspect

SunTrust argues, without supporting authority, that it lacks "imputed knowledge" of Delaware case law respecting proxy puts. (*Id*. at 6 n.2.) SunTrust cannot dispute that "parties are presumed to contract with knowledge of existing law." *Ramah Navajo Chapter v. Salazar*, 644 F.3d 1054, 1075 (10th Cir. 2011) (citing *In re Doctors Hosp. of Hyde Park, Inc.*, 337 F.3d 951, 959 (7th Cir. 2003), *aff'd*, 132 S. Ct. 2181 (2012); *Williams v. Stone*, 109 F.3d 890, 896 (3d Cir. 1997); *Storts v. Hardee's Food Sys.*, 2000 WL 358381, at *16 (10th Cir. Apr. 6, 2000); *Gen. Accident Ins. Co. v. First Nat'l Bank & Trust Co. of Tulsa*, 1993 WL 404229, at *4 (10th Cir. Oct. 12, 1993)). *See also Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 2005 WL 5757652, at *12 (Del. Ch. Apr. 1, 2005) ("[A]ll persons are presumed to know the law . . . .").

SunTrust is ill-situated to disclaim knowledge of Delaware law concerning proxy puts in debt instruments. SunTrust publicly touts that it "is one of the nation's largest bank[s]" with "in-depth market and industry experience," and holds itself out as "a leading, full-service corporate and investment bank" that utilizes "effective, innovative debt capital strategies" to provide "comprehensive expertise around all aspects of debt issuance."[6] Moreover, *Amylin I* was widely publicized. (*See* note 1 above).

SunTrust's reliance on *Weil v. Morgan Stanley DW Inc.*, 877 A.2d 1024 (Del. Ch. 2005), *aff'd*, 894 A.2d 407 (Del. 2005), proves the point that SunTrust is imputed with knowledge of applicable law. In *Weil*, the Court paid no heed to an allegation that Morgan Stanley must have known of a specific decision of the Delaware Supreme Court, because that decision "dealt with a very different, and highly unusual set of facts addressed under Delaware law," while the plaintiff's claims arose under California law, and "Morgan Stanley's customer contracts made plain that Morgan Stanley had the right to assign their accounts." *Id.* at 1035, 1039.

The operative principle of law is that a Dead Hand Proxy Put is inherently suspect and is subject to enhanced scrutiny on the question whether its presence in a debt instrument is a product of legitimate arm's-length bargaining or a breach of duty. Such a claim is not susceptible to dismissal. As then-Chancellor Strine explained in *Sandridge*:

> By definition, a contract that imposes a penalty on the corporation, and therefore on potential acquirers, or in this case, simply stockholders seeking to elect a new board, has clear defensive value. Such contracts are dangerous because, as will be seen here, doubt can arise whether the change of control provision was in fact sought by the third party creditors or willingly inserted by the incumbent management as a latent

[6] *About SunTrust Banks, Inc.* (Chapple Aff., Ex. I); *Who We Are* (*Id.*, Ex. J); *Debt Capital Markets* (*Id.*, Ex. K).

> takeover and proxy contest defense. *Unocal* is the proper standard of review to agree to a contract with such provisions ….

68 A.3d at 259. *Amylin I* similarly explained that it is "particularly troubling" to include a default provision in a debt agreement that can "impinge on the free exercise of the stockholder franchise." 983 A.2d at 319.

SunTrust makes no effort to explain why it should be entitled to the presumption of arm's-length bargaining over a contract provision that is subject to enhanced scrutiny. SunTrust relies heavily on *In re BJ's Wholesale Club, Inc. Shareholders Litigation*, 2013 WL 396202 (Del. Ch. Jan. 31, 2013), in which it was alleged "that the Buyout Group pressured the Board to accept a lower price and engage in a hasty sale." *Id.* at *14. The Court held that "nothing in the Complaint suggests that Buyout Group's actions were not otherwise hard bargaining of an arm's-length third party bidder." *Id.* Notably, the Court said the following about the deal protection measures in the merger agreement: "[U]nder Delaware law, these deal protection measures, individually or cumulatively, have routinely been upheld as reasonable …. The Plaintiffs do not contest this point of law." *Id.* at *13.

Here, no defendant is arguing that the Complaint fails to state a claim for breach of fiduciary duty respecting the Dead Hand Proxy Put. SunTrust's argument assumes the incompatible conclusion that obtaining a Dead Hand Proxy Put in a debt instrument is the equivalent of arm's-length bargaining over price terms. The existence of the provision hardly is proof of bargaining, particularly when both sides have an incentive to include the provision. Indeed, the Board minutes and other materials produced in response to Pontiac's 220 Demand reveal no evidence of bargaining, much less the "hard bargaining" that SunTrust asserts took place. *See In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 577 (Del. Ch. 2007) ("[I]t is more reasonable to infer that exculpatory documents would be provided than to believe the opposite: that such documents existed and yet were inexplicably withheld.").

B. A Dead Hand Proxy Put Is Not a Bargained-For Credit Protection

SunTrust postulates a model respecting negotiations over a Dead Hand Proxy Put that cannot be accepted as a matter of law or fact on a motion to dismiss. According to SunTrust, the Dead Hand Proxy Put is a "lender-favorable" provision, and SunTrust obtained it because "it is the job of bank negotiators to get the most favorable credit terms it can for its bank group." (SunTrust Br. at 10.)

The problem with SunTrust's position is that a Dead Hand Proxy Put cannot be accepted as a matter of law or fact as a legitimate credit protection resulting from arm's-length bargaining. For one thing, the agents of the borrower are not incentivized to bargain for its elimination because it creates for the incumbent officers and directors a deterrent to an unwanted proxy contest.

Additionally, SunTrust nowhere explains how a Dead Hand Proxy Put is a true credit protection for the lender, such as covenants restricting excessive dividends, excessive debt or the sale of assets. Dead Hand Proxy Puts are not true credit protections. They are the historical descendants of "poison puts" that arose in the 1980s as defenses to hostile takeovers. *See* Marcel Kahan & Michael Klausner, *Anti-Takeover Provisions in Bonds: Bondholder Protection or Management Entrenchment*, 40 U.C.L.A. L. REV. 931, 933-35 (1993) (describing "bondholder contractual rights that at least purport to shield bondholders from takeover related losses," including change of control covenants) (Chapple Aff., Ex. L).

"[C]hange of control covenants can thus be similar to poison pills and other antitakeover devices in that they may provide management with insulation from the takeover threat – hence the term 'poison put.'" *Id.* at 945. Proxy Puts are a species of poison put that are "triggered only by takeover-related events that occur *without* the approval of management." *Id.* at 951. As Kahan and Klausner observed over twenty years ago, Proxy Puts "reflect[] an unabashed pursuit of management's parochial interests." *Id.* at 954 ("These covenants offer little bondholder protection and serve to entrench management.").

More recent publications are to the same effect. A Moody's publication on the subject of improving covenant protection discussed the efficacy of "continuing director event prongs" (*i.e.*, Proxy Puts), and said they are not useful for credit protection:

> This prong is typically phrased as the first day on which a majority of the issuer's board of directors are not "continuing directors," with a continuing director defined as a director at note issuance or a director who was nominated or elected with the approval of a majority of continuing directors who were board members at the time of such nomination or election. ***Designed to address hostile takeovers, this "event" prong is not particularly useful***.

Moody's Investors Services, *Credit Roundtable Adopts a Contract-Based Approach to Mitigating Event-Risk*, at 5 n.16 (Apr. 2008) (Chapple Aff., Ex. M) (emphasis added). An earlier Moody's publication discusses three groups of provisions respecting event-related risk: (1) restricted payments, (2) change of control and (3) restrictions on mergers/sales of all or most assets. Moody's Investors Services, *Moody's Approach to Evaluating Indenture Covenants and Assigning Covenant Quality Assessments*, at 8-10 (Nov. 2006) (Chapple Aff., Ex. N). Nowhere in the discussion of event-related risk is a Proxy Put mentioned.

This is not surprising. A change in the composition of a board of directors, without more, does not increase risk to creditors. Proxy contests to change a majority of a board of directors are more likely to occur when management is underperforming. Improved business performance can be good for stockholders and creditors alike.

A leading empirical study on the value of certain debt covenants concluded "that poison put provisions are not valued by investors." Joseph A. Fields, *et al*., *Coupon Resets Versus Poison Puts: The Valuation of Event Risk Provisions in Corporate Debt*, 3 FIN. SERV. REV. 143, 149 (1994) (Chapple Aff., EX. O). *See also id*. at 154 ("Overall, we find that investors . . . place virtually no value on poison puts."). This conclusion stands in contrast to the authors' finding that certain other event-risk covenants can and do provide value. *See id.* at 154-55.

There is no basis to infer, much less conclude, that a Dead Hand Proxy Put in a credit agreement provides credit protection to the bank lenders. The bank may simply see an opportunity to collect fees for hold-up value by threatening to withhold consent to a waiver and accelerate the debt.[7]

SunTrust cannot prevail on a motion to dismiss by asserting, without legal or factual support, that the Dead Hand Proxy Put is unimpeachable. The question over the legitimacy of Healthways' Dead Hand Proxy Put raises factual issues, at the very least. *See Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1130 (Del. Ch. 2008) (declining to dismiss after concluding that "issues raised by the motion . . . deserve careful consideration and will benefit from further factual development").

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[7] *See Amylin I*, 983 A.2d at 312 ("Amylin agreed to pay a 50 basis point fee on any outstanding balance under the Credit Agreement to the lenders, should the Continuing Directors provision be triggered by the 2009 director elections.").

CONCLUSION

For all the foregoing reasons, Pontiac respectfully requests that the Court deny Defendants' motions to dismiss.

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CERTIFICATE OF SERVICE

I hereby certify that on September 22, 2014, I caused a copy of the **Public Version of Plaintiff's Combined Answering Brief in Opposition to Defendants' Motions to Dismiss** to be served upon the following counsel by File & ServeXpress:

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