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Case No. 3438-VCS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

CHARLES HOKANSON, JOHN HOKANSON, FOYE STANIFORD, CHARLES SEITZ and ELIZABETH SEITZ Plaintiffs, v. WILLIAM PETTY, M.D., TREVOR MOODY, BUZZ BENSON, MARC GALLETTI, CRAIG CORRANCE AND DAVID GRANT, and ALTIVA CORPORATION, Defendants.	: : : : : : : : : : : : : : :	 C.A. No.: 3438 VCS

PLAINTIFFS' ANSWERING BRIEF
<u>IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS</u>

Respectfully submitted,

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INTRODUCTION

This is a classic squeeze-out case. Plaintiffs were minority stockholders in the pre-merger, Altiva Corporation ("Altiva" or the "Company"), holding common stock totaling a nearly 3.5% ownership interest. The challenged transaction at issue—a merger between Altiva and Exactech, Inc.—(as defined in more detail *infra*, the "Merger"), cancelled all of Plaintiffs' common stock in Altiva and deprived them of any merger consideration whatsoever. All of the individual defendants in this action, except for David Grant, who was an officer, were directors of Altiva (collectively, the "Directors" or the "Board") at the time of the Merger. When the Merger closed in January of this year, the Directors were preferred shareholders of Altiva stock and owned a controlling interest in Altiva. These same Directors retained both their ownership interest and management positions in the post-Merger Altiva, and also received an additional financial interest in Exactech. In these ways, the Directors were self-interested in the Merger.

Additionally, one of the Directors, defendant William Petty, M.D. ("Petty"), was at the time of the Merger both the Chairman and CEO of Exactech and a director of Altiva. Following the Merger, Petty would become the superior of those Altiva directors who would retain their Altiva board and management positions. Therefore, when it came time to negotiate and approve the terms of the Merger which still remained open to negotiation in 2007, the Directors other than Petty lacked independence and were motivated to stay in Petty's good graces. Petty's domination of the Board improperly influenced the entire deliberative process regarding the Merger and ultimately dictated an amount of merger consideration that was grossly unfair to Plaintiffs and the other common shareholders of Altiva.

Despite these conflicts, and in violation of their fiduciary duties, the Directors did nothing to sanitize the Board's decision-making process surrounding the Merger. The Complaint alleges, and Defendants do not deny, that: (i) the Board failed to require Petty or the other conflicted directors to recuse themselves from participating in the Board deliberations regarding the Merger, (ii) the Board failed to establish a committee of independent directors to evaluate the Merger; (iii) the Board failed to obtain an opinion on the fairness of the Merger to Plaintiffs and the other common shareholders; and (iv) the Board failed to preclude self-interested directors from voting on the transaction. For these reasons, the deliberative process the Board employed in approving the amount of the Merger consideration violated the Directors' fiduciary duties of due care and loyalty. And for these same reasons, the entire fairness analysis—not the business judgment rule—governs the Court's evaluation of Plaintiffs' claims.

Similarly, because of the nature of their fiduciary violations, the Directors cannot rely on the exculpation provision in Section 102(b)(7) and Altiva's restated certificate of incorporation.

Finally, Defendants argue that Plaintiffs' claims are barred by the statue of limitations because the 2003 transaction between Altiva and Exactech, which gave rise to the Merger, occurred more than three years before Plaintiffs instituted this action. But this defense also fails. All of the factual allegations that form the basis of Plaintiffs' claims occurred in connection with the Board's misconduct leading up to and in approving the Merger in 2007. These events obviously occurred well-before the expiration of the three-year limitations period applicable to breach of fiduciary duty claims.

In light of the above, in accepting all of Plaintiffs' well-pleaded factual allegations as true and in giving Plaintiffs the benefit of all inferences that may be drawn from those facts, the Court can readily conclude that the Complaint states claims for fiduciary violations relating to and challenging the fairness of the Merger. The motion to dismiss should therefore be denied.

NATURE AND STAGE OF PROCEEDINGS

Plaintiffs' instituted this action on or about January 2, 2008, alleging claims for breach of fiduciary duty against the above-captioned individual directors in their then-capacity as directors of Altiva.

On February 22, 2008, Defendants filed a motion to dismiss all of Plaintiffs' claims. Thereafter, on April 23, 2008, Plaintiffs timely responded to the motion to dismiss by filing an amended complaint (the "Complaint") pursuant to Court of Chancery Rule 15(aaa).

Subsequently, Plaintiffs served Defendants with discovery requests. In light of Defendants' anticipated motion to stay discovery pending the outcome of their motion to dismiss, the parties agreed to a limited stay of discovery in exchange for Defendants' production of a limited amount of discovery materials. The balance of Plaintiffs' extensive discovery requests have been held in abeyance pending this Court's decision on the motion to dismiss.

On May 6, 2008, Defendants filed a second motion to dismiss. Defendants filed their opening brief in support of the second motion to dismiss on June 20, 2008.

This is Plaintiffs' answering brief in opposition to Defendants' new motion to dismiss.

FACTUAL BACKGROUND

Plaintiffs Enter the Spinal Devise and Implant Industry

In or around 2001, Plaintiffs formed Vertebral Systems ("Vertebral"), a company created to enter the spinal devise and implant industry. (Compl. ¶ 20) In December 2001, for a purchase price of $1,500,000, Vertebral acquired from Surgical Dynamics certain assets, intellectual property and FDA approvals relating to the spine industry. (Compl. ¶ 20) Following this acquisition, in January 2002, Vertebral entered the market and began to build a distribution network for its spinal implants, with the aid and counsel of Dr. Walter Simmons of Texas, and Dr. Finn of Florida, both well-known and highly respected spine surgeons. (Compl. ¶ 20)

Vertebral Sells its Assets to Altiva

In May of 2003, after a series of extensive negotiations, Vertebral agreed to sell to Altiva certain assets in exchange for $350,000 and a 3.5% ownership interest in Altiva ("the Vertebral-Altiva Transaction"). (Compl. ¶ 24) Their 3.5% ownership in Altiva represented the bulk of the Vertebral Shareholders' compensation from the Vertebral-Transaction. The transaction was consummated on August 29, 2003. (Compl. ¶ 24)

The Vertebral-Altiva Transaction was vital to Altiva's existence because it allowed Altiva to pivot from its failing dental implant business to the far more lucrative spinal fusion market. (Compl. ¶ 25) Indeed, at the time of the Vertebral-Altiva Transaction, Altiva was on the brink of financial ruin. (Compl. ¶ 25) If not for the Vertebral Shareholders and, specifically, Altiva's acquisition of Vertebral's Simmons Plate and Screw system, Exactech would never have thrown Altiva the financial life-line it so desperately needed. (Compl. ¶ 25) Thus, the Vertebral Shareholders kept Altiva afloat and paved the way for the Merger. (Compl. ¶ 25)

The Altiva-Exactech Financing Transaction

Shortly after closing on the Vertebral-Altiva Transaction, however, on or about October 7, 2003, Plaintiffs received a letter issued to Altiva stockholders, which (i) announced its entry into the spine market, and (ii) acknowledged that this was made possible by Altiva's acquisition of Vertebral's assets and technology, along with its surgical experience, technical expertise and the prestige of the Simmons name and reputation. (Compl. ¶ 26) This letter also announced that, as a consequence of the Vertebral-Altiva Transaction, negotiations were underway with a potential corporate investor to provide greater funding for further development in the spine market. (Compl. ¶ 26)

The October 7, 2003 letter was the first time Plaintiffs learned of Altiva's negotiations with this potential corporate investor. (Compl. ¶ 27) Indeed, Altiva and its then-board of directors (hereinafter, the "2003 Board") did not disclose to Vertebral that Altiva and Exactech were on the verge of closing a financing transaction—a transaction that depended entirely on Altiva acquiring Vertebral's assets, and one that would seriously dilute the value of Plaintiffs' Altiva shares. (Compl. ¶ 27) Given that the complex transaction between Altiva and Exactech was executed only several weeks after the Vertebral-Altiva Transaction, there can be no doubt that the 2003 Board knew of—but concealed—the existence and terms of its impending financing transaction with Exactech during Altiva's negotiations with Vertebral. (Compl. ¶ 27) And, thus, the 2003 Board knew full-well when the Vertebral-Altiva Transaction closed that Plaintiffs' Altiva shares would become worthless in the likely event that Exactech exercised its option. (Compl. ¶ 27)

Shortly after the issuance of the October 7, 2003 letter, and less than 40 days following Altiva's acquisition of Vertebral's assets, Exactech and Altiva closed on a Securities Purchase

Agreement in which Exactech invested $1 million in Altiva, and loaned Altiva $5 million in the form of loans convertible to Altiva Series C Preferred Stock (the "Securities Purchase Agreement"). (Compl. ¶ 28)

In exchange for this financing, Altiva granted Exactech an option which permitted Exactech to purchase all outstanding shares of Altiva common stock, preferred stock and securities (the "Buy-Out Option"). (Compl. ¶ 29) The Buy-Out Option was exercisable within a three-year period, from October 29, 2005 to October 28, 2008. (Compl. ¶ 29) The Securities Purchase Agreement provides that Exactech's purchase of Altiva would be based on a valuation of Altiva which could be ***no less than*** *$25 million*, plus any cash held by Altiva, less certain of its liabilities. (Compl. ¶ 30)

At the same time, October 2003, Altiva and Exactech also executed a Stockholders' Agreement (the "Stockholders' Agreement"). (Compl. ¶ 31) The Stockholders' Agreement set forth the number of shares issued by Altiva for each series of Altiva stock and also stated a valuation for Altiva's stock. (Compl. ¶ 31) In particular, Section 3.4(a) defines Altiva's valuation as follows:

> (a) "Altiva Valuation" means an amount equal to the Buyout Multiple multiplied by the Altiva Trailing Twelve Months Revenue as of the date the Purchase Price is calculated (the "Calculation Date"), ***provided, in no event shall the Altiva Valuation be less than $25 million***.

(emphasis added) (Compl. ¶ 31). This provision allowed the Board to set Altiva's valuation at a sum commensurate with Altiva's current fair value at the time Exactech exercised the Buy-Out Option, if it did so. (Compl. ¶ 31)

Despite the fact that the Stockholders' Agreement worked to substantially dilute Plaintiffs' once-significant interest in Altiva, the 2003 Board failed to inform Plaintiffs of either the Securities Purchase Agreement or the Stockholders' Agreement. (Compl. ¶ 32) As a result, until recently, Plaintiffs were unaware of the terms of Exactech's Buy-Out Option. (Compl. ¶ 32)

In anticipation of the impending transactions with Exactech, the 2003 Board approved a measure to amend Altiva's Certificate of Incorporation and, in particular, to allow for an increase in the number of shares of Altiva stock. (Compl. ¶ 34) The 2003 Board sought stockholder approval of this proposed action via a written consent action. (Compl. ¶ 34)

Charles Hokanson is the only Altiva shareholder among Plaintiffs who signed this written consent. But, Mr. Hokanson was misinformed of the impact the proposed merger would have on the Vertebral Shareholders. (Compl. ¶ 35) In particular, before signing the written consent, Mr. Hokanson sought counsel regarding the proposed written consent action from defendant Grant, Altiva's then-CFO, and later, from Altiva's then-CEO, Jim Robson. (Compl. ¶ 35) Both Grant and Robson represented to Mr. Hokanson that, while some minimal dilution of common shares would result, the Exactech transaction would ultimately increase the value of Plaintiffs' Altiva shares. (Compl. ¶ 35) Further, both Grant and Robson assured Mr. Hokanson that, in the event Exactech exercised the Buy-Out Option, Plaintiffs would be able to convert their Altiva shares to Exactech stock. (Compl. ¶ 35) Not once, however, did Grant or Robson ever suggest that Plaintiffs would be altogether squeezed-out and receive no consideration for their shares if Exactech exercised the Buy-Out Option. (Compl. ¶ 35)

Exactech Exercises the Buy-Out Option

More recently, in December 2007, Altiva and Exactech entered into a Plan of Merger wherein Altiva and Exactech Spine, Inc. (a wholly owned subsidiary of Exactech) merged, which resulted in the surviving Altiva entity becoming a wholly owned subsidiary of Exactech. (Compl. ¶ 37)

But it was not until December 17, 2007, almost two weeks after the Plan of Merger and vote by written consent of the majority shareholder, that Altiva notified Plaintiffs of the pending Merger. (Compl. ¶ 38) The delay in notification left Plaintiffs only two weeks, during the holiday season, to react to protect their interests. (Compl. ¶ 38) The absence of notice together with the delay in notification speaks to Defendants' self-interest and bad faith. (Compl. ¶ 38)

A Conflicted Board & the Failure to Sanitize the Deliberative Process from the Taint of Self-Interest

At the time of the Merger, the Altiva Board was comprised of defendants Petty, Benson, Moody, Galetti and Corrance. (Compl. ¶ ¶ 11-15) Not only did these defendants comprise the Altiva Board, each of them have retained their respective management positions in the post-Merger Altiva. (Compl. ¶ ¶ 39-40)[1] Additionally, Exactech's Form 8-K dated December 7, 2007 (the "8-K") states on page 3 that "[t]he directors of [Altiva] prior to the Effective Time shall be the directors of the Surviving Corporation . . .". (A true and correct copy of the 8-K is attached hereto as Exhibit A.)[2] Also, a news release issued by Exactech announcing the Merger, which is attached to and incorporated in the 8-K, provides that "Exactech's first acquisition includes Altiva's experienced spinal management team…" Indeed, in their opening papers, Defendants acknowledge that defendant Corrance holds a management position in the newly-formed Altiva. (DOB at 5)

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[1] In their opening brief, Defendants contend that the Complaint fails to allege that any of Directors "actually maintained or assumed a management position post-Merger …' (DOB at 5 n. 7) Yet, on the very same page of their brief, Defendants quote an allegation in the Complaint, which plainly states that the Directors "… all will retain their management positions following the Merger."

[2] The Complaint incorporates by reference Altiva's and Exactech's Plan of Merger, which was attached to the 8-K.

In addition to these personal benefits, the SPA makes clear that Altiva's pre-Merger shareholders are to receive common stock of the post-Merger Altiva and Exactech entities. Thus, by virtue of the Merger, the Directors have not only preserved their substantial financial position in Altiva (Compl. ¶ 39), but have also improved their lot by obtaining a financial position in Exactech.

Compounding these serious flaws in the deliberative process is the equally troubling fact that Petty was an interlocking director, as he was a director of the pre-Merger Altiva and was also, at the time of the Merger, the chairman and CEO of Exactech. (Compl. ¶ 40) Therefore, the pre-Merger Altiva directors and officers, all of whom—according to the 8-K—have retained comparable positions in the post-Merger Altiva, were, upon information and belief, improperly influenced, dominated and otherwise beholden to Petty—their eventual superior. (Compl. ¶ 40) Thus, Petty occupied both sides of the Merger transaction. (Compl. ¶ 42)

Despite these conflicts of interest, and in violation of their fiduciary duties, Defendants did nothing to sanitize the Board's deliberations from the taint of self interest. The Complaint alleges, on information and belief, and Defendants do not suggest otherwise, that the Board failed to (i) establish a committee of independent directors to consider the Merger, (ii) obtain an opinion on the fairness of the Merger to Altiva's minority stockholders, and (iii) preclude self-interested directors from voting on the transaction. Moreover, as the Complaint alleges on information and belief, and again Defendants do not deny this allegation, Petty was permitted to participate in the negotiations of the terms of the Merger which were not fixed under the 2003 Altiva-Exactech Transaction. For these reasons, the Board's decision-making process concerning the Merger was unfair to Altiva's common stockholders and particularly Plaintiffs. (Compl. ¶ 39)

The Complaint also alleges that Defendants were not adversely impacted by accepting the proposed Merger consideration, which represented only a fraction of Altiva's present value, because they will more than make-up the deficit by virtue of their post-Merger positions and their continued ownership interest in the Company. (Compl. ¶ 40)

The Merger Is Unfair to the Common Shareholders

To arrive at the total Merger consideration of $15,420,503.00, the Board used the *minimum $25 million* valuation for Altiva that was fixed some four years earlier, when Altiva had no negotiating power. (Compl. ¶ 41) The use of the minimum Altiva valuation resulted in a multiple of less than 2.0X of Altiva's trailing 12-month gross revenue. (Compl. ¶ 41) In today's market, comparable spine implant companies are commanding more than 4.0X trailing 12-month gross revenue. (Compl. ¶ 41) The Board even failed to obtain a current, independent valuation of Altiva, which it was free—and indeed, even duty-bound—to do given that the $25 million valuation was merely a floor—not a ceiling. (Compl. ¶ 41) The Board also failed to obtain a fairness opinion to evaluate the impact of the $25,000,000 floor valuation on Altiva's shareholders. (Compl. ¶ 41) Predictably, these failures yielded a grossly unfair amount of Merger consideration and constituted a breach of Defendants' fiduciary duties. (Compl. ¶ 41)

The Merger price is especially unfair to Plaintiffs, who, through the sale of their company's assets to Altiva in 2003, allowed Altiva to reposition itself from a failing dental implant enterprise to the far more lucrative spinal fusion market. (Compl. ¶ 42) If not for that transaction, Altiva would have likely died on the vine and never found a merger partner. (Compl. ¶ 42)

The facts outlined above, when viewed in a light most favorable to Plaintiffs, state sufficient breach of fiduciary claims which require the denial of Altiva's motion to dismiss.

ARGUMENT

I. THE APPLICABLE PROCEDURAL STANDARD OF REVIEW.

Defendants move to dismiss Plaintiffs' claims pursuant to Court of Chancery Rule 12(b)(6). A subdivision (b)(6) motion will be granted only where it appears with reasonable certainty that the plaintiff could not prevail on any set of facts that can be inferred from the pleading. *See Kohls v. Kenetech Corp.*, 791 A.2d 763 (Del. Ch. 2000). In passing on a motion to dismiss under Rule 12(b)(6), the Court is to assume the truthfulness of all well-pleaded facts in the complaint. *In re BHC Communications, Inc. Shareholder Litigation*, 789 A.2d 1 (Del. Ch. 2001). Similarly, on a motion to dismiss for failure to state a claim, the Court construes a complaint in the light most favorable to the plaintiff. *Morgan v. Wells,* 80 A.2d 504 (Del. Ch. 1951). Thus, if a complaint states a claim upon which the plaintiff might recover, the complaint should not be dismissed. *Cohen v. Mayor of Wilmington*, 99 A.2d 393 (Del. Ch. 1953).

Applying this standard of review here counsels in favor of denying Defendants' motion to dismiss.

II. THE ENTIRE FAIRNESS TEST GOVERNS THE SUBSTANTIVE REVIEW OF PLAINTIFFS' CLAIMS.

A. The Standard of Review Analysis—Business Judgment versus Entire Fairness.

Defendants contend that the standard of review which governs all of Plaintiffs' claims is the business judgment rule. (DOB at 15). For the reasons which follow, Defendants are wrong on this pivotal issue.

The business judgment rule is "not of universal application, nor without exception … [i]t does not irrevocably shield all corporate transactions." *Maldonado v. Flynn,* 413 A.2d 1251 (Del. Ch. 1980) *rev'd* on other grounds, 430 A.2d 779 (Del. 1981). A plaintiff can defeat the business judgment rule if the plaintiff can show that the majority of the directors who approved the challenged transaction: (i) had a personal interest in the subject matter of the transaction, or (ii) were under the domination and control of a person who had an interest in the subject matter, or (iii) were not fully informed in making the challenged decision, or (iv) did not act in good faith. *See Unitrin, Inc. v. American Gen. Corp.,* 651 A.2d 1361 (Del. 1995). Moreover, a breach of any one of the Directors' fiduciary duties sufficiently rebuts the business judgment presumption and permits a challenge to the Board's action under the entire fairness standard. *Emerald Partners v. Berlin,* 726 A.2d 1215, 1221 (Del. 1999) (citations omitted). A determination that entire fairness, rather than business judgment, is the appropriate standard of review of a challenged transaction will normally preclude the dismissal of a complaint on a motion to dismiss. *See Orman v. Cullman, et al.,* 794 A.2d 5, 20 (Del. Ch. 2002).

As established below, the Complaint states well-pleaded facts which justify the wholesale application of the entire fairness analysis in this case.

B. The Board Failed to Exercise Due Care in Approving the Merger Consideration.

A director's duty to exercise informed business judgment implicates the duty of care. *Smith v. Van Gorkom,* 488 A.2d 858, 873 (Del. 1985). The business judgment rule may only be invoked by directors who are found to be not only 'disinterested' directors, but directors who have both adequately informed themselves before voting the business transaction at hand and acted with the requisite care." *See Cede & Co. v. Technicolor, Inc.,* 634 A.2d 345, 367 (Del. 1993). "The duty of the directors of a company to act on an informed basis, as that term has been defined by this Court numerous times, forms the duty of care element of the business judgment rule." *Id.* at 367. Where directors violated their duty of care, the presumption that they were exercising business judgment in approving a challenged transaction is overcome and the burden then shifts to the directors to show the transaction was "entirely fair" to the company and its stockholders. *Id.* at 361. More specific to the instant case, our Supreme Court has recognized that "[i]n a merger or sale, … the director's duty of care requires a director, before voting on a proposed plan of merger or sale, to inform himself and his fellow directors of all material information that is reasonably available to them." *See Cede & Co.*, at 368 (citation omitted). The substantive protections of the business judgment rule can be claimed only by disinterested directors whose conduct otherwise meets the rule's procedural requirements. *See McMullen v. Beran,* 765 A.2d 910 (Del. 2000). Delaware law recognizes a number of time-tested measures which a board can employ to restrict the influence an interested director may exert over the decision-making process. Such techniques include: recusal of the interested director(s) from participation in board meetings; resignation from the board by the interested director(s); or establishment of a committee of disinterested, independent directors to review the proposal. *See Cede & Co.,* at 366 (citations omitted).

But in this case, as the Complaint alleges, none of these safeguards were used. The Complaint alleges, and Defendants do not suggest otherwise, that the Board failed to (i) establish a committee of independent directors to consider the Merger, (ii) obtain an opinion on the fairness of the Merger to Altiva's minority stockholders, and (iii) preclude self-interested directors from voting on the transaction. (Compl. ¶ 39) Moreover, as the Complaint alleges, Petty was permitted to participate in the negotiations of the terms of the Merger which were not fixed under the 2003 Altiva-Exactech Transaction. And here again, Defendants do not deny this allegation. Additionally, the Board was obligated to determine whether the Merger would maximize shareholder value for the minority shareholders. The 2003 Altiva Exactech Transaction does nothing to eliminate or dilute this fiduciary obligation. Yet, as discovery is expected to reveal, the Directors failed to determine whether the proposed merger consideration equaled or exceeded Altiva's appraisal value as a going concern. These failures and omissions constitute a breach of the duty of care. *See, e.g.*, *McMullen*, at 922 (finding in the context of a sale transaction a duty of care violation where directors failed to determine whether the merger consideration equaled or exceeded the seller's appraisal value as a going concern). *See also In re Walt Disney Co. Derivative Litig.*, 2005 LEXIS 113 (Del. Ch. Aug. 9, 2005) (recognizing that an intentional dereliction of duty and a conscious disregard for one's responsibilities is an appropriate standard for determining whether fiduciaries have acted in good faith).

For these reasons, the Board's decision-making process concerning the Merger violated the Directors' fiduciary duty of care and was unfair to Altiva's common stockholders, including Plaintiffs.

C. The Board Violated Its Duty of Loyalty to the Minority Shareholders and a Majority of the Directors Had a Personal Interest in the Merger.

The Directors also cannot invoke the business judgment presumption due to their self-interest and violation of the duty of loyalty. In particular, the Complaint challenges the independence of the Board and alleges the Directors violated their fiduciary duty of loyalty to the minority shareholders. (Compl. ¶ 48)

"A director is considered interested in a transaction if he receives 'a personal benefit from a transaction that is not equally shared by the shareholders.'" *In re: Ply Gem Industries, Inc. Shareholder Litigation*, 2001 WL 755133 *6 (Del. Ch. June 26, 2001) (quoting *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). "Essentially, the duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally." *Cede & Co.*, at 361 (citations omitted). "Independence 'means that director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.'" *Unitrin, Inc. v. American Gen. Corp. (In re Unitrin, Inc. Shareholders Litig.),* 651 A.2d 1361, 1376 (Del. 1995). *See also Cede & Co.*, at 361 (citations omitted) ("Classic examples of director self-interest in a business transaction involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally.")

In this case, the Complaint alleges that, at the time of the Merger, the Altiva Board was comprised of defendants Petty, Benson, Moody, Galetti and Corrance. (Compl. ¶ ¶ 11-15) Not only did these defendants comprise the Altiva Board, each of them have since retained their respective management positions in the post-Merger Altiva. (Compl. ¶ ¶ 39-40) Additionally, Exactech's 8-K reveals that the pre-Merger Altiva Board would all become members of the post-Merger Altiva Board. What is more, an Exactech news release, which is attached to and incorporated in the 8-K, indicates that Altiva's pre-merger management team would form the management of the newly-formed Altiva.

In addition to these personal benefits, under the SPA Altiva's Board are to receive common stock of the post-Merger Altiva and Exactech entities. Thus, by virtue of the Merger, the Directors have not only preserved their substantial financial position in Altiva (Compl. ¶ 39), but have also improved their lot by obtaining a financial position in Exactech.

Based on the allegations, the Court can reasonably infer that the benefits the Directors received as a result of the Merger conferred on them a personal benefit of a material nature. And these same benefits were unique to the Directors and not shared with the other shareholders. Thus, for purposes of this motion to dismiss, the Directors must be considered "interested."

The Directors' favored their self-interest in the Merger over their fiduciary duty of loyalty to Plaintiffs and the other common shareholders. This, too, warrants application of the entire fairness test in evaluating the merit of Plaintiffs claims.

D. The Board Was Under the Domination and Control of Petty, Who Sat on Both Sides of the Transaction.

The Complaint alleges that, at the time of the Merger, Petty stood on both sides of the transaction, as he was both the CEO of Exactech and a director of Altiva. (Compl. ¶ 42) There can be no doubt that Petty was in the position to exercise his dual fiduciary role to the detriment of Altiva's common stockholders—and that he ultimately did so. Exactech's Buy-Out Option, which was exercisable solely at the discretion of Exactech, provided Exactech, through Petty, considerable leverage in influencing the terms of the Merger which remained open to negotiation in 2007 following the 2003 Altiva-Exactech Transaction.

And as established above, Grant and the Directors other than Petty were particularly susceptible to such influence given that none of them were financially independent of Petty and Exactech and were motivated to do whatever would keep them in their future employer's good graces. Thus, even if Grant and the Directors other than Petty did not benefit directly from the Merger (which they clearly did), their loyalties ran primarily to Petty and Exactech. This is enough to show improper domination and control. *See, e.g., In re Emerging Communications, Inc. Shareholders Litigation*, 2004 WL 1305745, *39 (Del. Ch. June 4, 2004).

Even at this early stage of the litigation, there is sufficient evidence of Petty's improper influence over the Board to justify the application of the entire fairness test. The Board's failures to employ the safeguards necessary to ensure the integrity and fairness of the deliberative process and, in particular, the fact that Petty—as an interlocking director—was permitted to participate in the deliberations and decisions regarding the terms of the Merger, were products of Petty's domination over the Board.

But most illustrative of Petty's domination and control over the process is the fact that the Board used the $25 million floor valuation, which resulted in a multiple of less than 2.0X of Altiva's trailing 12-month gross revenue. This is despite the fact that the pre-Merger Altiva board was under no obligation to use the minimum $25 million valuation. This decision, which resulted in the cancellation of all of Plaintiffs' common stock without any merger consideration, could have only been influenced by Petty.

In light of these facts, the Directors' decision to approve the Merger and, in particular, the consideration element of the Merger, is not entitled to business judgment rule protection.

E. Through Petty, Exactech was a Controlling Shareholder which Occupied Both Sides of the Transaction.

That Petty stood on both sides of the transaction at issue and was in a position to assert improper influence over the rest of the Altiva Board is, without more, enough to require the Directors to show the entire fairness of the Merger. *See Weinberger v. UOP, Inc., et al.,* 457 A.2d 701, 709 (Del. 1983) (citation omitted). A stockholder who holds more shares than any other stockholder, but less than a majority, is a controlling shareholder of that corporation. *Weinstein Enterprises, Inc. v. Orloff,* 870 A.2d 499 (Del. 2005). It is undisputed that Exactech held nearly a 17% interest in Altiva prior to the Merger, which was more than any other single stockholder. Exactech was, therefore, the controlling stockholder of Altiva. It is equally undisputed, and the Complaint alleges, that Petty was at all times relevant an interlocking director, as he was a director of Altiva and the Chairman and CEO of Exactech.

Under these circumstances, our Supreme Court has instructed that "[t]he requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts." *See Weinberger*, at 710.

III. SECTION 102(b)(7) DOES NOT INSULATE THE DIRECTORS FROM PERSONAL LIABILITY.

Defendants contend that Altiva's restated certificate of incorporation (the "Certificate") protects them from liability on Plaintiffs' duty of care claims pursuant to 8 *Del. C.* § 102(b)(7). (DOB at 14) Altiva's restated Certificate tracks Section 102(b)(7)—Delaware's director exculpation statue.

Section 102(b)(7) permits a corporation to shield directors from breaches of the duty of care only, not the duty of loyalty. *See Zirn v. VLI Corp.,* 621 A.2d 773 (Del. 1993). *See also Rosser v. News Valley Corp.,* 2000 Del. Ch. LEXIS 115 (Del. Ch. Aug. 15, 2000). The shield from liability provided by a provision adopted pursuant to subsection (b)(7) is in the nature of an affirmative defense and, thus, defendants seeking exculpation under such a provision will normally bear the burden of establishing each of its elements. *Emerald Partners v. Berlin,* 726 A.2d 1215 (Del. 1999). Typically, before the Court can determine whether an exculpatory charter provision protected interested directors from liability on a motion to dismiss for failure to state a claim, it is first necessary to determine, under the entire fairness test, whether violations of the duties of loyalty and good faith were in fact implicated and, then, only at that point, can there be a determination as to whether the exculpatory provision can be applied. *In re LNR Prop. Corp. Shareholders Litig.,* 2005 LEXIS 171 (Del. Ch. Nov. 4, 2005).

In the instant case, as established above, the Directors' conduct falls within the exceptions in Section 102(b)(7) inasmuch as the factual allegations which form the basis of Plaintiffs' claims do not solely implicate a violation of the duty of care. *See Arnold v. Society for Savings Bancorp.*, 650 A.2d 1270, 1288 (Del. 1994). Rather, the Complaint adequately pleads that the Directors' were self interested and violated their duty of loyalty and that their duty of care violations were the product of self-interest, not good faith errors in judgment.

Moreover, because the entire fairness standard of judicial review governs all of Plaintiffs' claims, it is premature to rule on the merits of Defendants' Section 102(b)(7) defense. *See In re Emerging Communications, Inc.* at 28 ("[W]hen entire fairness is the applicable standard of judicial review, a determination that the director defendants are exculpated from paying monetary damages can be made only *after the basis* for their liability has been decided.") (emphasis in original) (citations omitted).

Given the above, it is clear that the Complaint, together will all reasonable inferences drawn from the well-pleaded allegations therein, could state non-exculpated breach of fiduciary duty claims. Therefore, the exculpation provision in the Certificate cannot protect Defendants against Plaintiffs' duty of care claim.

IV. PLAINTIFFS' CLAIMS ARE NOT TIME-BARRED.

Defendants argue that Plaintiffs' claims are barred by the statute of limitations. (DOB at 26-27) In particular, Defendants contend that Plaintiffs' fiduciary claims are time-barred because they are grounded on alleged fiduciary violations committed by Altiva's 2003 Board. (DOB at 27) This argument fails, however, because the fiduciary violations which form the basis of all Plaintiffs' claims relate solely to the Directors' conduct at the time of the Merger in 2007.

CONCLUSION

For the foregoing reasons, and based on the standard of review required under Court of Chancery Rule 12(b)(6), Defendants' motion to dismiss should be denied.

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