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Case No. 6354-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SOUTHEASTERN PENNSYLVANIA TRANSPORTATION AUTHORITY, individually, and on behalf of all those similarly situated, Plaintiff, v. ERNST VOLGENAU, JOHN W. BARTER, LARRY R. ELLIS, MILES R. GILBURNE, W. ROBERT GRAFTON, WILLIAM T. KEEVAN, MICHAEL R. KLEIN, STANTON D. SLOANE, GAIL R. WILENSKY, SRA INTERNATIONAL, INC., PROVIDENCE EQUITY PARTNERS LLC, PROVIDENCE EQUITY PARTNERS VI L.P., PROVIDENCE EQUITY PARTNERS VI-A L.P., STERLING PARENT INC., STERLING MERGER INC. and STERLING HOLDCO INC., Defendants.	C.A. No. 6354-VCN **REDACTED VERSION** **DATED: APRIL 3, 2012**

PLAINTIFF'S ANSWERING BRIEF IN OPPOSITION TO THE SRA DEFENDANTS' MOTION FOR JUDGMENT ON THE PLEADINGS AS TO COUNT IV OF THE SECOND AMENDED COMPLAINT

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I. PRELIMINARY STATEMENT

Plaintiff, Southeastern Pennsylvania Transportation Authority, was a stockholder of SRA International Inc., ("SRA" or the "Company") until SRA was taken private in a buyout (the "Buyout") led by Providence Equity Partners LLC ("Providence"), and SRA's founder and controlling stockholder, Dr. Ernst Volgenau ("Volgenau").[1] The public, class A shareholders of SRA received $31.25 per share in the Buyout, which was announced April 1, 2011 and which closed on July 20, 2011. On the other hand, Volgenau, who owns nearly all the Company's class B shares, received the cash payment for some of his shares, but has also received the right to remain invested in SRA as a "rollover" investor with substantial post-merger governance rights. No other shareholder received similar consideration in the Buyout. That disparate treatment in the Buyout, approved by the SRA Board of Directors (the "Board" or "SRA Board"), is in direct violation of SRA's Certificate of Incorporation (the "Certificate").[2] The Certificate creates a contractual entitlement of equal treatment of class A and B stockholders in any merger. The Board's approval of the Buyout that gave Volgenau preferential merger

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[1] The Buyout was governed by the Agreement and Plan of Merger among Sterling Parent Inc. ("Sterling Parent"), Sterling Merger Inc. ("Sterling Merger," and together with Sterling Parent and Sterling Holdco. Inc., "Merger Subs") and SRA International, Inc., dated as of March 31, 2011 (the "Merger Agreement"), which provided, among other things, that Sterling Merger will be merged with and into the Company, with the Company surviving the Buyout as a wholly owned subsidiary of Sterling Parent. (2AC ¶¶1, 72).

[2] In addition, Plaintiff claims that the Buyout was a product of a breach of the directors' fiduciary duties of care and loyalty, was not entirely fair and that those breaches were aided and abetted by the Providence Defendants ("Providence Defendants" refers to Providence Equity Partners LLC ("Providence Equity"), Providence Equity Partners VI L.P., and Providence Equity Partner VI-A L.P.).

consideration was, thus, disloyal to SRA's stockholders. The Board's failures with respect to the Certificate followed on the heels of a process throughout which Volgenau was explicitly permitted by the Board to manipulate the pool of bidders away from strategic buyers (who could potentially offer greater consideration based on synergies) and toward private equity firms to serve Volgenau's interest in maintaining SRA's "name, values and culture" and credo of "honesty and service."

Count IV of Plaintiff's Verified Second Amended Class Action Complaint ("2AC"),[3] sets forth a claim that the Buyout is invalid because it violates the equal protection provision of the Certificate and is the product of the Board members' breaches of their fiduciary duties. The SRA Defendants[4] have moved, pursuant to Rule 12(c), for judgment on the pleadings on Count IV.[5] The SRA Defendants' theorize they are entitled to that relief under 8 *Del. C.* §124 ("§124"), which prohibits claims arising under the *ultra vires* doctrine except in limited circumstances. Their Motion amounts to a moot court exercise and should be denied. The SRA Defendants mischaracterize Plaintiff's claim. Plaintiff does not allege that the Buyout is invalid as an *ultra vires* corporate act, but rather that it is voidable as the product of the Board's breach of the Certificate's provision directing how consideration must be distributed to SRA shareholders in a merger and the breach of the Board members' fiduciary duties by favoring Volgenau in

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3 The 2AC is attached hereto as Exhibit A for the Court's convenience.

4 "SRA Defendants" refers to Defendant SRA and Defendants John W. Barter, Larry R. Ellis, Miles R. Gilburne, W. Robert Grafton, William T. Keevan, Michael R. Klein, Dr. Stanton D. Sloane, and Dr. Gail R. Wilensky.

5 Count IV is directed against all members of the SRA Board, including Volgenau. Volgenau, however, has not sought judgment on the pleadings as to Count IV.

the distribution of merger consideration. As such, the SRA Defendants' pending Motion must be denied. [6]

[6] Even if the contractual aspect of Count IV arose under the doctrine of *ultra vires*, which it does not, the fiduciary duty claim raised by Count IV cannot be subject to judgment in favor of the SRA Defendants.

II. PROCEDURAL HISTORY

Plaintiff filed this action on April 7, 2011, following the announcement of the Buyout, challenging, among other things, the unfair sale process and price and the preferential treatment given to Volgenau.[7] The initial complaint and Plaintiff's First Request for Production of Documents Directed to All Defendants were served on April 13, 2011. Defendants filed a preliminary proxy statement with the S.E.C. on April 18, 2011, to which Plaintiff responded with an amended complaint setting forth disclosure claims, in addition to the underlying fiduciary duty and fairness claims. Plaintiff filed a Motion for Expedited Proceedings on April 29, 2011. Defendants did not oppose expedition of discovery, which commenced in May 2011 by agreement of the parties.[8] During late May 2011 and early June 2011, Defendants and third party Houlihan Lokey Capital Inc. ("Houlihan Lokey"), SRA's financial advisor, produced documents to Plaintiff. Plaintiff also took four depositions during that time period including Volgenau; the chairman of the Special Committee, Michael Klein; a representative of Providence; and a representative of Houlihan Lokey.

Following expedited discovery, on June 21, 2011, Plaintiff sought leave to file its 2AC, which includes facts developed during expedited discovery. Leave to amend was granted on June 23, 2011. In addition to bolstering facts based on discovery, the 2AC

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[7] One other case, *Sinioukov v. SRA International, Inc., et.al.*, No. 11-cv-447 (E.D. VA. filed Apr. 25, 2011), was filed in the United States District Court for the Eastern District of Virginia. That action is stayed.

[8] The scope of discovery during expedited discovery was necessarily limited by the time available prior to the SRA stockholder vote. Plenary discovery is now ongoing.

added Count IV arising from the Certificate's equal treatment provision and narrowed the disclosure claims to reflect supplemental disclosures made by Defendants during the course of litigation.[9] On June 22, 2011, Plaintiff filed a Motion for Preliminary Injunctive Relief based on the unresolved disclosure claims. Defendants agreed to make further supplemental disclosures and Plaintiff agreed to withdraw the preliminary injunction motion. On July 8, 2011, Defendants issued a Form 8-K (a true and correct copy of which is attached hereto as Exhibit B) that included, among other things, improved descriptions of the meetings between Volgenau and the then-remaining four potential bidders, between February 24, 2011 and March 11, 2011, including two strategic bidders. These meeting were arranged by, but not attended by, Houlihan Lokey. Instead, Houlihan Lokey and the Special Committee relied on Volgenau to describe what occurred during the meetings, including that he discussed his post-merger interests and role and indicated his desire to bidders that SRA's, "name, values, and culture" be preserved, even in a sale.

On July 8, 2011, all Defendants filed motions to dismiss the 2AC. Apparently realizing that those motions would be futile in the face of the 2AC's allegations, all Defendants withdrew their motions and filed Answers to the 2AC on December 23, 2011.

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[9] Defendants amended their preliminary proxy materials on May 23, 2011 and June 8, 2011. On June 15, 2011, Defendants filed their definitive proxy materials. (Attached as Exhibit C to the Transmittal Affidavit of Justin Morse to the Brief in Support of the SRA Defendants' Motion for Judgment on the Pleadings as to Count IV of the Second Amended Complaint "Morse Aff."). These evolving proxy materials mooted several of Plaintiff's disclosure claims, including by making material improvements in the description of the Company's financial projections and which of those projections were provided to bidders; clarification of the terms of a promissory note issued to Volgenau; and improved descriptions of the value of assets Providence intended to spin-off post-Buyout.

Thereafter, the parties negotiated a schedule covering completion of fact discovery, expert discovery and summary judgment briefing. The Court entered the Stipulation and Order Governing Case Schedule ("Scheduling Order") on March 2, 2012. The Scheduling Order also provides for briefing on the SRA Defendants' Motion for Judgment on the Pleadings as to Count IV of the 2AC. This is Plaintiff's Answering Brief in Opposition to that Motion.

III. STATEMENT OF FACTS

A. SRA's Background and Capital Structure

SRA is a government services contractor with a strong financial history. For each quarter during the last year prior to the Buyout, SRA announced year-over-year revenue growth. (2AC ¶¶38-41). That the Company became the target of the private equity sponsored Buyout was no surprise. SRA was debt free with strong cash flow from operations and $60 million cash on the books. (2AC ¶41). In addition, Defendant Sloane, the Company's CEO, characterized the Company's pipeline of opportunities as "robust." (2AC ¶41). SRA was also attractive due to its diversified mix of customers in both civil and defense sectors. (2AC ¶¶31-35).

The Company's executive Chairman, Volgenau, owned approximately 20% of the Company's equity, but controlled 71% of the voting power by virtue of his ownership of most of the Company's class B common stock ("Class B Stock"), which held a ten-to-one voting preference over the Company's publicly traded class A common stock. (2AC ¶¶42, 44). The Class B Stock, of which Volgenau owned 93.8%, was subject to several restrictions that made it personal to the holder and limited its duration.[10]

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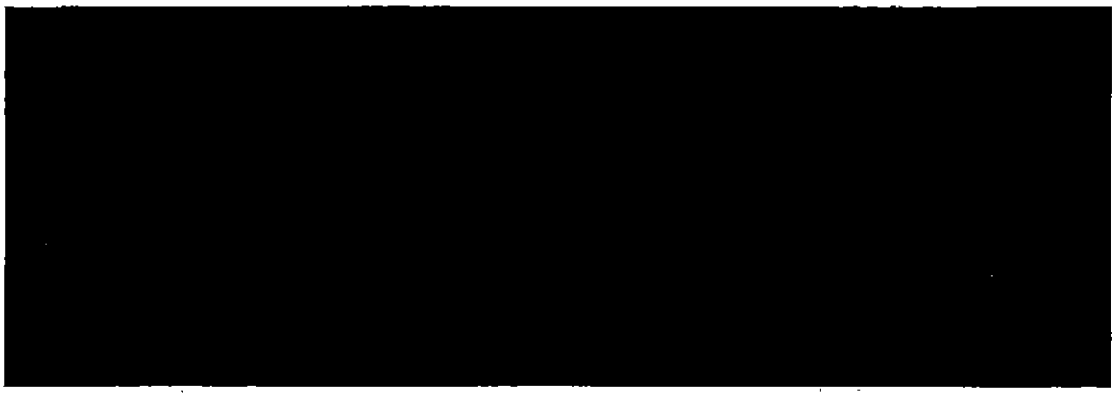
[10] For example, Class B Stock would be automatically converted to normal voting class A shares in the event of Volgenau's death. The Class B Stock would also convert on the later of Volgenau's 80th birthday retirement from SRA or permanent physical disability. (2AC ¶¶44, 46). The purpose of the Class B Stock was to prevent hostile takeovers and not to enable Volgenau to extract unique benefits or a premium above public stockholders in a sale of the Company. (2AC ¶45). At the time of the Buyout, Volgenau was 77 years old. Practically speaking, the clock was ticking on his control over the Company and the super-voting powers of his Class B Stock.

The SRA Certificate confirms this. Article Fourth, Section A.9 of the Certificate states as follows:

> Merger. Upon the merger or consolidation of the Corporation (whether or not the Corporation is the surviving entity), holders of each class of Common Stock will be entitled to receive equal per share payments or distributions, except that in any transaction in which shares of capital stock are distributed to holders of Common Stock, the shares of capital stock distributed to holders of Class A Common Stock and Class B Common Stock may differ as to voting and conversion rights, but only to the extent that the voting and conversion rights of the Class A Common Stock and the Class B Common Stock differ in this Certificate of Incorporation.

2AC ¶45).[11] Thus, under SRA's Certificate, no merger involving SRA could provide Volgenau with consideration that differs from what the public stockholders are receiving.

B. Providence Equity Pursues SRA Through Volgenau



Shortly thereafter, on March 2, 2010, Volgenau met with Richardson from Providence, to discuss a buyout of SRA. (2AC ¶49). That meeting began a series meetings and phone calls between Richardson and others from Providence and Volgenau and SRA's Senior management. (2AC ¶¶49, 51). Over the March 2010 to October 2010 time period, Volgenau, without Board authorization and pursuant to a defective

[11] The Certificate was submitted as Morse Aff. Ex. E.

confidentiality agreement, prepared without the aid of outside counsel, released confidential SRA information to Providence in furtherance of going private discussions. (Morse Aff. Ex. C at 18). During these meetings, Volgenau constantly emphasized the importance to him of SRA retaining its "name, values and culture" even if it was sold. (2AC ¶¶49-52). Despite the fact that (as discussed below) the Board had formed a Strategic Alternatives Study Team ("Study Team"), specifically tasked with studying the strategic alternatives available to the Company, the outside director members of the Study Team, their counsel and financial advisor were not involved in discussions with Providence. (2AC ¶¶49-52).[12] Moreover, prior to October 27, 2010, reflect did not tell the Board (other than insider Sloane) about his conversations with Providence. (2AC ¶¶50, 53).

C. The Study Team Determines to Pursue a Strategic Acquisition

Volgenau proposed the formation of a sub-committee of the Board during the May 3, 2010 Board meeting. The Study Team was comprised of Defendants Volgenau, Klein, Gilburne and Grafton and was charged with exploring a wide range of strategic options for the Company, including the possibility of maintaining the status quo. (2AC ¶50). The Study Team retained [redacted] as its financial advisor. (2AC ¶ 50). Volgenau made clear to the Board that his personal criteria for any strategic alternative included the preservation of SRA's "name, values and culture" and "honesty and service" -- concepts

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[12] Confidential Company information was provided to Providence despite the Study Team's determination to pursue a strategy other than a going private transaction. (2AC ¶¶51-52).

that are potentially not consistent with maximizing value for all stockholders. (2AC ¶57; Morse Aff. Ex. C. at 21).

[redacted]

As a result of [redacted] presentation, the Study Team determined to pursue an acquisition of [redacted] (2AC ¶52). Despite the Study Team's determination to pursue this route, Volgenau continued to meet with Providence regarding a going private transaction. (2AC ¶52). Not only did Volgenau continue his dialog with Providence outside the purview of the Study Team, but he kept Providence (a potential competing bidder for [redacted] advised about the status of SRA's bid for [redacted] (2AC ¶52; Morse Aff. Ex. C at 19). [redacted]

[redacted]

D. The Special Committee is Formed in Response to Volgenau's Invitation for Providence to Meet with the Board, but the Process is Corrupted by Volgenau's Interests

After losing the auction [redacted], Volgenau and senior management continued to meet with Providence and Volgenau finally invited Providence to make a presentation to the full Board of SRA on October 27, 2010. (2AC ¶53; Morse Aff. Ex. C at 19).

Providence made its presentation knowing Volgenau's goal of preserving SRA's "name, values and culture." (2AC ¶¶2, 49). Despite its long access to SRA management and confidential Company information, Providence gave a preliminary indication of interest of acquiring SRA for $28 per share. (Morse Aff. Ex. C at 19). In view of the obvious conflicts (which had not been present since his initial meeting with [redacted]) for Volgenau, as SRA's controlling shareholder, in going private discussions, the Board formed a Special Committee. (2AC ¶54).

The Special Committee, consisting of Defendants Klein (chairman), Gilburne, Grafton, Barter and Ellis retained Houlihan Lokey as its financial advisor and permitted Providence to continue its due diligence work. (2AC ¶54). That led to a low-ball $27.25 per share offer from Providence to Klein on December 29, 2010. (Morse Aff. Ex. C at 20). When that low-ball offer was met with a chilly response, Providence attempted to side-step the Special Committee by telling Volgenau it would raise its offer to $28.50. (Morse Aff. Ex. C at 21). That tactic failed, leading the Special Committee to broaden its process to include multiple private equity firms and a single strategic bidder which had expressed its interest in December 2010. (2AC ¶57). No additional strategic bidders were permitted to join the process in the first instance because of Volgenau's opposition. (2AC ¶57). As the auction process unfolded, the Special Committee had to seek Volgenau's permission to expand the field of strategic bidders. (2AC ¶60). A small number of strategic bidders were eventually permitted into the process, but only after Volgenau vetted them and approved their participation. (2AC ¶¶60, 62-63).

As the process approached its end stages, Houlihan Lokey arranged, but did not participate in, meetings between the strategic bidders and Volgenau. (2AC ¶63). Instead, Houlihan Lokey permitted Volgenau to conduct these meetings on his own and relied upon Volgenau to provide debriefings later. (2AC ¶¶63, 98). Volgenau conveyed to these potential strategic bidders the importance to him of preserving "name, values and culture" at SRA, impairing SRA's potential synergy value to strategic buyers in the process. (*See* Ex. B, hereto). Shortly after these meetings, the strategic bidders dropped from the process, leaving Providence and another bidder, both financial buyers as the only bidders remaining. (2AC ¶63).

As the final two bidders entered an end-game, both had negotiated a substantial roll-over equity commitment from Volgenau. (2AC ¶66). In order to increase its bid, Providence demanded concessions from Volgenau in the form of a promissory note. (2AC ¶68). Despite Volgenau's concessions leading to higher bids from Providence and [redacted] the Special Committee and Houlihan Lokey never attempted to engage the bidders and Volgenau in further negotiations to extract greater value for shareholders. (2AC ¶¶68-70).

On April 1, 2011, SRA announced the Merger Agreement, pursuant to was effected by Providence and Volgenau at the bargain price $31.25 per share. (2AC ¶71). In connection with the Buyout, Volgenau rolled-over a substantial portion of his equity interest in SRA into ownership of the newly private SRA in partnership with Providence to control a significant portion 22.9% of SRA. (2AC ¶72; Morse Aff. Ex. C. at 46-47). DiPentima also received the opportunity to roll-over SRA stock that he owns for the

purpose of co-investing with Providence in post-Buyout SRA. (2AC ¶72).

E. The Terms of the Buyout Explicitly Violate the Certificate's Equal Treatment Provision

All class A shares were converted into consideration of $31.25 per share in the Buyout. Volgenau's shares were, in part, treated differently, resulting in a *prima facie* violation of the Certificate's equal treatment requirement. Under the Merger Agreement and Equity Rollover Commitment Letter, dated March 31, 2011, between Ernst Volgenau, as trustee of the Ernst Volgenau Revocable Trust, and Sterling Holdco (the "Rollover Letter"), $150 million worth of class B shares were converted into equity interests in post-merger SRA and a promissory note issued to Volgenau. (2AC ¶76). That is not an "equal per share payment" as required by the Certificate. The rollover is a required condition precedent for the Buyout pursuant to section 8.7 of the Merger Agreement and will allow Volgenau to enjoy SRA's continuing growth prospects. (2AC ¶77). Along with that disparate consideration Volgenau was also promised extensive governance rights in post-merger SRA, including to remain as SRA's chairman, compensation as chairman, one of three board seats, information rights, preemptive rights and registration rights. (Morse Aff. Ex. C. at 67). All of these were aspects of Volgenau's consideration that differed from what public shareholders received. The aspects of Volgenau's Buyout compensation have different value than $31.25 cash, which shall be a subject for trial. Tellingly, Defendants concede the Certificate was violated saying that they *could* have proposed it to be amended in connection with the Buyout vote. (*See* SRA Defendants' Opening Brief ("Def. Br.") at 10). Of course, Defendants did not do it that way.

IV. ARGUMENT

A. Standard of Review

In its evaluation of the SRA Defendants' Motion under Rule 12(c), the Court must accept as true all Plaintiff's well-pleaded factual allegations and draw all reasonable inferences in favor of Plaintiff.[13] Pleadings are to be construed as to do substantial justice.[14] For the purpose of this motion the most essential facts of the Court must accept from Plaintiff's well-pleaded allegations are:

- Volgenau is SRA's controlling stockholder (2AC ¶¶42-44, 47);
- Volgenau was permitted to manipulate the SRA sale process by steering the Board away from any potential strategic buyers and toward preferred, financial buyers (2AC ¶¶57-63);
- The Certificate creates a requirement that merger considerations be equal on a per share basis as between Class A shareholders and Class B shareholders (2AC ¶45);
- Volgenau did not receive equal per share consideration in the Buyout but rather received a package of consideration including cash, the ability to roll over part of his investment into a 22.9% ownership of SRA as a going concern, and substantial corporate governance rights, including remaining SRA's chairman, continuing compensation in that position, one of three

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13 *TIFD III-X, LLC v. Fruehauf Prod. Co., L.L.C.*, 880 A.2d 854 (Del. Ch. 2004).

14 Ch. Ct. R. 8(f).

positions on the post-Buyout SRA Board, information rights, preemptive rights and registration rights. (2AC ¶72; Morse Aff. Ex. C at 46-47, 67).

B. The SRA Defendants' Motion Mischaracterizes Plaintiff's Claims

1. Overview of Plaintiff's Claims

The 2AC states claims against Defendants in four counts. Count I states a claim of breach of fiduciary duties of care and loyalty against all individual Defendants – the Board of SRA – for approving an unfair Buyout, priced at $31.25 per share, and transferring value of SRA to Volgenau and others. Count II states a claim for breaches of fiduciary duties of loyalty and care and entire fairness specific to Defendants Volgenau and Sloane as officers and directors of the Company. Volgenau exercised his control of the Company to feed confidential Company information to Providence without Board knowledge or approval and further used his control to corrupt the sale process employed by the Special Committee and to extract premium value for his shares to which he was not entitled. Sloane, as CEO, disloyally provided information to Providence without Board knowledge or approval in furtherance of Volgenau's interest. Count III states a claim against the Providence Defendants and the Merger Subs for aiding and abetting the breaches of fiduciary duties and entire fairness articulated by Counts I and II.

Count IV, which is the only count challenged by the Motion, has two parts. The first is that the distribution of merger consideration in the Buyout violates the Certificate's equal consideration entitlement and is thus invalid because it is the voidable product of a breach of the contract created by the Certificate between the Company and its shareholders. That breach was caused by the SRA Board's because the Buyout was

structured in a way that offended the Certificate. The second aspect of Count IV is that in approving the Buyout in violation of the Certificate's equal consideration guarantee, the SRA directors have breached their fiduciary duties of loyalty and care to SRA's public stockholders by favoring Volgenau in the distribution of Buyout consideration, by ignoring their known fiduciary and contractual duties and by being grossly negligent regarding the requirements of the Certificate. That conduct further renders the Buyout voidable. The second aspect of Count IV is not addressed by the SRA Defendants' Motion despite their effort to dismiss all of Count IV. Instead their Motion appears entirely to focus on Plaintiff's characterization of the Merger as "invalid." Their reading, that Count IV arises under the *ultra vires* doctrine, is mistaken.

2. Count IV of the 2AC States Claims Arising Out of the SRA Defendants' Breach of the Certificate and Breach of Fiduciary Duties

The Certificate provides a contractual right to SRA shareholders (and a corresponding obligation for directors) to treat shareholders in a particular manner in a merger: "[u]pon the merger or consolidation of the Corporation (whether or not the Corporation is the surviving entity), holders of common stock will be entitled to receive equal per share payments or distributions..." In effect, the Certificate creates an entitlement beyond common law entire fairness, which governs all self-dealing transactions benefiting a controller and requires the price and process be entirely fair to public shareholders. Under SRA's Certificate entitlement, entire fairness of merger consideration (which is also not present in the Buyout process or price) is insufficient, the

shareholders must also be treated to "equal per-share payments or distributions." The Certificate's equality requirement has been disregarded by the SRA Defendants here.

Plaintiff submits that all SRA Defendants are susceptible to proof that their conduct breached the entitlement created by the Certificate and also offends their fiduciary duties, including the duty of loyalty, not merely the duty of care.[15] Volgenau has expressly benefitted personally from the disparate treatment of shareholders in the Buyout including his obtaining ongoing ownership and governance rights in SRA. The supposedly independent directors likewise face liability for duty of loyalty breaches. Although not personally interested in the distribution of merger consideration, they have approved a consideration package for Volgenau that both violates the entire fairness doctrine and also violates the express provision of the Certificate requiring equal treatment in mergers and did so as part of a process dominated by Volgenau's interests.[16] By elevating Volgenau's rights above other shareholders and by eviscerating the rights of SRA shareholders in the process, the SRA Defendants have violated their duty of loyalty.

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[15] The SRA Defendants also breached their duty of care. It was an act of gross negligence to ignore the Certificate's terms in approving the Buyout. *See In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 750 (Del. Ch. 2005) (Gross negligence, in the context of corporate fiduciaries, is a "reckless indifference to or a deliberate disregard," of one's duties as a fiduciary.).

[16] *Cinerama v. Technicolor*, 663 A.2d 1156, 1168 (Del. 1994), *quoting Cinerama v. Technicolor*, 663 A.2d 1134, 1153 (Del. Ch. 1994) (The "material interest of 'one or more directors less than a majority of those voting' would rebut the application of the business judgment rule if the plaintiff proved that 'the interested director controls or dominates'" the board's process.); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) ("the duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a ... controlling shareholder and not shared by the stockholders generally.").

Moreover, the SRA Board members acted in bad faith by failing to act in accordance with their known duties under the Certificate and for demonstrating a conscious disregard for their duties.[17]

The SRA Defendants attempt to parse the meaning of "equal" in this context (Def. Br. at 10 n.4), but they cannot credibly argue that the factual allegations here are anything other than that the merger consideration as between Volgenau and public stockholders is not equal. (*See* 2AC at ¶¶2, 72, 76, 77; Morse Aff. Ex. C. at 46-47, 67). As such, the issue before the Court is not whether the shareholders have received equal consideration -- they did not.[18] The issue is also not whether the director Defendants complied with the Certificate provision -- they did not. Rather the success or failure of the SRA Defendants' Motion depends on their pigeonholing that claim as arising under the doctrine of *ultra vires*. Contrary to Defendants' position, the Buyout is invalid because it is a voidable act as a result of the directors' violation of the Certificate's guarantee of equal treatment and their fiduciary obligation to ensure stockholder rights, including

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17 *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006).

18 "It is the very nature of equity to look beyond form to the substance of an arrangement. Equity will not permit one to evade the law by dressing what is prohibited in substance in the form of that which is permissible. So too, equity will not permit a fiduciary to deprive his beneficiaries of their entitlement to seek redress for fiduciary misconduct by structuring a transaction so as to obscure that entitlement." *Gatz v. Ponsold*, 925 A.2d 1265, 1280-81 (Del. 2007). "[T]hat difference in form, which is the product of transactional creativity, should not affect how the law views the substance of what truly occurred." *Id.* at 1281.

those arising under the Certificate, are protected without favoring Volgenau over other stockholders.[19]

Although the Buyout is not void *ab initio* as a result of the *ultra vires* doctrine, the breach of the Certificate and the corresponding violation of the directors' fiduciary duties renders the Buyout "voidable at the discretion of the Court."[20] In these circumstances, the Plaintiffs will not be limited to a single damages approach.[21] Where, for example, the Merger involves improper self-dealing the Court has power to fashion an appropriate award consisting of "equitable and monetary relief as may be appropriate, including rescissory damages."[22] Plaintiff, and the SRA shareholders should not have their claims

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[19] Plaintiff submits that a distinction exists between the breach of the Certificate and the disloyal favoring of Volgenau's interests in the process. However, at this stage of proceedings, the Court need not determine whether Count IV's fiduciary duty claim (that the directors favored Volgenau with disproportionate merger consideration) is subsumed by Count IV's contract claim (that the Certificate's equal treatment provision was violated). *See In re Delphi Financial Group Shareholder Litigation*, 2012 Del. Ch. LEXIS 45, *60-61 (Mar. 6, 2012) (attached as Exhibit C, hereto) (holding, in the preliminary injunction context, that no decision was necessary at that stage as to whether there were concurrent contractual and fiduciary duty claims in a circumstance where a merger was structured to avoid a charter prohibition against disparate allocation of merger consideration.).

[20] *Arnold v. Society for Savings Bancorp, Inc.*, 1995 Del. Ch. Lexis 86, *8-*9 (June 15, 1995) (attached as Exhibit D, hereto) *citing Weinberger v. UOP*, 457 A.2d 701, 714 (Del. 1983); *see also Adams v. Calvarese Farms Maint. Corp.*, 2010 Del. Ch. LEXIS 199, *53 (Sept. 17, 2010) (attached as Exhibit E, hereto) (holding that assessments levied by a homeowners association without the member approval required by a provision of the governing contract was invalid and voidable). The SRA Defendants' conduct vis-à-vis the Certificate's equal treatment provision also ties directly into Counts I and II. Their gross negligence, bad faith and disloyalty in favoring Volgenau and ignoring the Certificate are symptomatic of an unfair process corrupted by Volgenau's self interest.

[21] *Weinberger*, 457 A.2d at 714.

[22] *Id.*

or potential remedies curtailed by the SRA Defendants' misreading of Count IV. For example, under Count IV, Plaintiff may be entitled -- in addition to the difference between $31.25 and fair value -- to rescission of some or all of Volgenau's equity stake, disgorgement to shareholders of improper benefits obtained as a result of Volgenau's roll-over, or damages in the form of difference in fair value between Volgenau's Buyout consideration and public stockholders' consideration.

3. Count IV of the 2AC Does Not Arise Under the Doctrine of *Ultra Vires*

The SRA Defendants' Motion must be denied because it is brought under the mistaken premise that Count IV seeks to have the Buyout declared an *ultra vires* (void) corporate act.[23] That is not the nature of Count IV. As discussed above, Count IV is a claim aimed at the SRA Board members for their breach of fiduciary duty and contractual violation of certain entitlements and obligation created by the Certificate. That conduct renders the Buyout voidable and, thus, invalid.

Count IV, and the 2AC, never characterizes the Buyout as *ultra vires*. That concept was raised, for the first time, by the SRA Defendants' Motion. Indeed, Plaintiff agrees that SRA, the corporation, had the power to enter into a merger transaction and the obtained proper approvals of that merger transaction pursuant to 8 *Del. C.* §251. The

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[23] For the purposes of this Motion, Plaintiffs allegations that Certificate was violated to benefit of Volgenau must be accepted as true. The SRA Defendants' argument requires an admission on their part that they caused SRA to commit an *ultra vires* act. If successful with their strawman argument that the Buyout cannot, under §124's standing limitations, be declared void *ab initio*, the necessary admission would all but prevent any meritorious defense to Plaintiff's fiduciary duty and entire fairness claims. Presumably the SRA Defendants do not wish to make such a concession, so the logic of their Motion falls apart.

individuals on the SRA Board, however, breached contractual and fiduciary duties to SRA shareholders in structuring the Buyout in a way that provided Volgenau with unequal consideration. Defendants' assertion that, pursuant to 8 *Del C.* §124(1), Plaintiff does not have standing to assert Count IV (Def. Br. at 9-10) is unavailing, because 8 *Del C.* §124(1) explicitly applies only to claims relating to "the doing of any act ... by or to the corporation." Here Count IV seeks relief against the SRA Board members of what the shareholders are entitled to based on the improper actions of the SRA Board. Plaintiff does not seek injunctive or monetary relief from the Company under Count IV.

A review of the history of §124 is illustrative as to why there is a disconnect between SRA Defendants' argument and their reality of the Count IV in this case. The purpose of §124, when adopted in 1967, was to avoid the then-rampant problem of corporations, and those contracting with corporations, using *ultra vires* arguments to evade contractual obligations.[24] This resulted in lengthy corporate charters featuring "page after page of boiler-plate corporate powers in the 'purpose' sections of their certificates of incorporations."[25] Most corporate charters, including SRA's Certificate at Article Third now use the "standardized statement of corporate purpose authorized by present Section 102(a)(3) in lieu of the former boiler-plate."[26] That the history of §124

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24 1 David A. Drexler, et.al., *Delaware Corporation Law and Practice*, §11.05 (Matthew Bender 2011) at 11-10.

25 *Id.*

26 *Id.* at 11-11.

arises from issues concerning a corporation's power to act suggests that claims like Count IV do not fall within the genre of actions §124 sought to prevent.

The distinctions historically drawn between void and voidable acts is also illustrative as to why Count IV arises under a theory of breach of contract and fiduciary duty (*i.e.*, voidable acts) and not the doctrine of *ultra vires* (*i.e.*, void acts). Void acts, including *ultra vires*, waste and fraud are the sort of conduct for which "it would be a shocking, if not theoretically impossible, thing for stockholders to be able to sanction the directors in committing illegal acts or acts beyond the authority of the corporation."[27] In contrast voidable acts are those the corporation could have accomplished had it done so "in the appropriate manner."[28] Under that reasoning, the director Defendants' violation of the Certificate constitutes a voidable act. Defendants could have complied with the equal payment provision in the Buyout or they could have attempted to seek amendment of the Certificate.[29] They did neither, rendering the Buyout invalid as a voidable act by Defendants.

Moreover, the exceptions to §124 demonstrate why Count IV of the 2AC are not governed by §124. First, as discussed above §124(1) is inapplicable to Count IV because

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27 *Harbor Finance Partners v. Huizenga*, 751 A.2d 879, 896 (Del. Ch. 1999).

28 *Id.*

29 The SRA Defendants even acknowledge that they could have sought an amendment of the Certificate in order to pursue the Buyout including disparate payments to Volgenau. (Def. Br. at 10). Because they could have done it the right way, their *ultra vires* theory fails. The SRA Defendants presumptuously suggest they would have won that vote, but that is unknowable. Because there was no amendment to the Certificate, Defendant had no legally authorized basis to ignore the entitlements created by the Certificate, giving rise to Plaintiff's claim.

Count IV challenges the improper conduct of the directors -- not the Company itself. Second, Defendants assert under §124(2) that "Plaintiff could only pursue its suit against the former SRA directors that the Merger violated Section 124 of the SRA charter *only* in a *derivative* capacity." (Def. Br. at 11-12). However, whether a claim is direct or derivative "turn[s] solely on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?"[30] Defendants are correct that Plaintiff has not pled any of its claims as derivative claims, but under *Tooley*, Plaintiff could never have properly pled Count IV as derivative. Count IV seeks relief from which damages and any other equitable relief would flow to the SRA shareholders, rather than to SRA itself, and under *Tooley*, such claim is direct (not derivative) in nature and thus could never fit within the purview of §124. Thus, §124 is simply inapplicable to Count IV.

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30 *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).

V. CONCLUSION

For the foregoing reasons, Plaintiff respectfully submits the SRA Defendants' Motion for Judgment on the Pleadings as to Count IV of the 2AC should be denied.

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