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Case Number 264,2015

IN THE

Supreme Court of the State of Delaware

WALTER E. RYAN, JR.,

Plaintiff Below-Appellant,

v.

NAREN GURSAHANEY, THOMAS COLLIGAN, TIMOTHY DONAHUE, ROBERT DUTKOWSKY, BRUCE GORDON, BRIDGETTE HELLER, KATHLEEN HYLE, DINESH PALIWAL, KEITH MEISTER, and CORVEX MANAGEMENT LP,

Defendants Below-Appellees,

and

THE ADT CORPORATION, a Delaware Corporation,

Nominal Defendant Below-Appellee.

No. 264, 2015

COURT BELOW:
COURT OF CHANCERY OF THE STATE OF DELAWARE
C.A. NO. 9992-VCP

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NATURE OF THE PROCEEDINGS

Plaintiff is a stockholder of ADT Corporation ("ADT" or the "Company") who appeals the grant of a Rule 23.1 dismissal of his derivative lawsuit. Plaintiff's verified amended complaint (the "Complaint") challenges the ADT Board of Directors' actions in response to removal threats by Keith Meister, a well-known activist investor with a history of removing board members. Meister threatened removal of the ADT Board if they did not acquiesce to his demands to (i) make radical changes to its leverage to institute stock buybacks; (ii) appoint him to the ADT Board; and (iii) provide him with an individualized exit plan at inflated prices.

Plaintiff's Complaint, supported with ADT's internal documents received from a Section 220 books and records request, satisfies the requirements for excusing demand. The Complaint details two extensive campaigns undertaken by Meister and his hedge fund, Corvex Management LP ("Corvex"), that threatened the ADT Board with removal if they did not acquiesce to Meister's demands.

The *first* of these threatened removal campaigns began when Meister took immediate advantage of ADT's neophyte Board (the majority of which had little or no prior experience with ADT or public company board service) just after ADT spun-off from Tyco International ("Tyco") in September 2012. A0025-26 at ¶¶19-

20. By October 2012, Meister accumulated a 5% stake in ADT, worth over $400 million, making him ADT's largest investor. A0027-28 at ¶¶22-23.

In November 2012, Meister threatened to remove the ADT Board if they refused to jettison their self-described "disciplined" approach to capital allocation and instead aggressively leverage the Company's balance sheet to repurchase its shares, and appoint him to their board. The ADT Board and management had publicly stated their intent to follow a disciplined capital allocation plan that kept debt relatively low (at 1.5x EBITDA), maintained a "solid investment grade rating," and utilized available cash flow to grow its business through product development and acquisitions. A0026-29 at ¶¶21-22, 24-27. Rather than defend their growth model, the ADT Board, faced with Meister's threats, substantially implemented his demands on November 26, 2012, in less than ten days, announcing a plan to increase leverage to 2.0x EBITDA and repurchase $2 billion of ADT's shares over three years (ADT later agreed to yet more aggressive leveraging and share repurchases to facilitate Meister's exit once he again threatened removal when he became aware that ADT's shares were headed for a substantial fall). A0030-31, 0060-68 at ¶¶29-30, 68-85.

In addition to coercing the substantial financial re-engineering, Meister threatened the Board's removal if he was not appointed a director to oversee the process. The ADT Board assessed Meister's willingness and ability to seek their

removal, if his demand for a board seat was not accepted. A0033-43 at ¶¶37-41. Directors received presentations at a December 13, 2012 board meeting warning about the history of Meister's willingness and ability to launch successful activist campaigns and agitate for change. A0033-42 at ¶¶38-40. Meister was identified as the most willing and most influential of all ADT stockholders to challenge the ADT Board, and that Meister possessed the ability to work alongside other investors to effectuate change, and that 19 of the top 20 investors in ADT were *at least* 50% likely to align with Corvex and other hedge fund investors holding ADT stock (which were characterized as "more willing to support an activist strategy" and "experience[d] leading activist campaigns"). A0039-42 at ¶40. Combined, those investors held over 53% of ADT's shares outstanding, more than enough votes to unseat the Board. *Id.*

Directors were also warned about actions available to Meister if he was not appointed to its Board, including "launch[ing a] proxy contest" and "initiat[ing a] vote withhold/against campaign to attack one or more incumbent" directors. A0039-42 at ¶40. With insiders owning only 1.5% of ADT's shares, the Board had little ammunition to block Meister's challenges. These options were presented as likely actions if Meister's demand was not met. Indeed, according to minutes, the ADT Board's Chairman, Bruce Gordon, stated to the other directors at ADT's December 13, 2012 meeting "that if Mr. Meister is not asked to join the Board then

Corvex Management will *likely* make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT at ADT's 2013 annual meeting." A0033 at ¶37 (emphasis added).

In response to Meister's "likely" actions to unseat the ADT Board if they did not acquiesce, the ADT Board took steps of obvious entrenchment. They entered into a one-year standstill agreement (from December 19, 2012 through December 5, 2013), that appointed Meister to the board and Audit Committee, but required Meister to vote in favor of the Company's slate of directors and limit his purchases of ADT shares to no more than 15,666,021. A0043-44 at ¶42. As a result, the ADT Board was able to retain their relatively new board positions and earn over $200,000 in fees and stock awards. *Id.*

The *second* entrenchment campaign began shortly after Meister determined from his insider access to ADT's financials that the Company was struggling. Meister invested in ADT because he thought it could grow revenue, margins and cash flow, and had little competition in the security industry. By March 2013, Meister became aware from ADT Board presentations and meetings that competition in the industry was negatively affecting ADT's growth prospects. A0046-47 at ¶47. Recognizing the negative impact on his sizeable investment, Meister sought a quick, but profitable, exit. To do so, Meister made a series of threatening demands on the Board in order to pump up ADT's stock price and

thereafter buyback his stock. These actions included accelerating the Company's already existing share repurchase program with additional borrowings, increasing dividends, and issuing a special dividend to further support the public appearance that the Company was strong. A0060-68 at ¶¶68-85.

Although the Board implemented his demands, neither Meister nor ADT's Board publicly revealed Meister's intended abandonment of his ADT investment or exit from the Board until *after* his hedge fund pocketed a $60 million profit in November 2013, in a private deal. A0067-68 at ¶83. This private deal entrenched the ADT Board through a six-year extension of the standstill agreement, which when publicly announced, led to a significant decline in ADT's share price. A0068-69 at ¶¶85, 87. Meister's profitable exit could only be facilitated by the ADT Board's authorization of a further increase in ADT's borrowing capacity to pay for Meister's shares.

In granting dismissal, the Court of Chancery erred, *first*, by applying the wrong legal standard for evaluating demand futility allegations involving entrenchment. Specifically, in determining whether the "actual threat" element of the entrenchment standard was sufficiently alleged, the lower court solely considered allegations albeit, not all; and some without drawing reasonable inferences regarding the steps Meister actually took to remove the board and ignored the particular allegations involving the ADT Board's belief that Meister's

pedigree as an activist and his threats to remove the Board from their positions were serious. At the pleadings stage, as here, it should be enough to plead with particularity that a board believed it was actually threatened with removal and took entrenchment steps in response. This Court's decisions do not foreclose such allegations as sufficient for purposes of demand futility. Indeed, to uphold entrenchment theories only where plaintiff alleges the taking of "concrete" removal steps would allow, like the lower court did here, situations where the board *admitted* that they were actually threatened and responded with entrenchment acts to evade judicial review. It would also encourage boards to quickly entrench and acquiesce to demands before actual steps are taken; a goverance practice that clearly should not be supported.

Second, the Court of Chancery failed to properly credit or ignored Plaintiff's numerous allegations demonstrating that the ADT Board was confronted several times with the likelihood (and actually believed) Meister would seek to remove them if they did not acquiesce to his demands, and also failed to draw reasonable inferences in Plaintiff's favor from the nature, timing and magnitude of the events that indicate that the Board's actions were entrenchment motivated.

For each of these reasons, the judgment of the Court of Chancery should be reversed.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred by employing a legal standard that rejects as insufficient for demand futility purposes particular allegations that board members believed an actual threat of removal existed and requires Plaintiff to allege concrete steps taken by the threatening party to effectuate removal.

2. The Court of Chancery also erred by recasting allegations, ignoring others, not appropriately crediting allegations it identified, and failing to draw reasonable inferences in Plaintiff's favor from the allegations that demonstrate that the nature, timing and magnitude of a series of entrenchment events surrounding the ADT Board's acquiescence of Meister's demands were primarily for entrenchment purposes. For instance, the lower court:

(a) recast particular allegations definitively demonstrating that the Board perceived an actual threat (by restating the Board's statement in November 2012 that Meister would "likely" remove them, and Meister's statement in September 2013 that he "would" remove them, to something he just "might" do); (Op. 7, 18);

(b) ignored Meister's pedigree as an activist investor with a history of removing boards and the radical changes ADT agreed to implement that significantly overleveraged ADT to keep the share price inflated so Meister could sell his shares in a private sale at a sizeable profit (during which ADT suffered credit rating declines); and

(c) failed to recognize that the timing of these and other events strongly support entrenchment motive, including ADT's increased and accelerated leveraging, buybacks and issuing special and increased dividends (in July through November 2013), just weeks and days prior to ADT's repurchase of Meister's shares in November 2013, after it had reiterated just months prior (in May 2013) that it would not make such changes and their disruptive impact.

STATEMENT OF FACTS

In late September 2012, ADT was spun-off from Tyco. A0025 at ¶19. The ADT Defendants[1] comprise the initial board of directors who had little experience with ADT or its business, though they were richly compensated (over $200,000 each) for serving on its Board. A0025-26 at ¶20.[2]

A. ADT's Initial Capital Allocation Plan Emphasized A Strong Balance Sheet for Purposes of Growth

In an announcement of the planned spinoff, Tyco described ADT as "appropriately capitalized to fund future growth opportunities," with "[s]trong balance sheets and investment grade credit ratings," which ADT's newly appointed board and management embraced and expected to continue. A0026-27 at ¶21. They described ADT's then existing capital structure and liquidity as "strong," and its 1.5x net debt to EBITDA ratio as a "solid investment grade rating." *Id.*

B. Meister Targeted ADT As An Activist Investment With A Vulnerable Board And Exerted Pressure For Massive Stock Buyback

1. Activist Background Of Keith Meister And His Fund, Corvex

Meister is the founder, managing director, and principal partner of Corvex. A0022 at ¶13. Meister was a former executive in Carl Icahn's investment

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1 The term "ADT Defendants" includes all defendants other than Meister and Corvex.

2 Only two of the ADT Defendants had prior experience with Tyco; Naren Gursahaney and Bruce Gordon. A0026 at ¶20. Gursahaney became ADT's CEO and previously served as President of Tyco Security Solutions. A0018 at ¶5. Gursahaney's total compensation from ADT/Tyco in 2013 and 2012 was $7,170,763 and $4,949,818, respectively. *Id.* Gordon became the ADT Board's Chairman and previously was Tyco's lead director. A0020, 0025-26 at ¶¶9, 20. Gordon received fees and stock awards of $365,023 from ADT in 2013. A0020 at ¶9.

companies, A0027-28 at ¶23, and engaged in activist investing targeting vulnerable public companies to force corporate changes -- often through proxy fights and forced stock repurchases -- for profit. A0033-37 at ¶38. Meister manages Corvex with a view to inducing lucrative outcomes from financial engineering.[3] Since inception, Corvex has engaged in several activist campaigns that threatened and/or removed board members who did not acquiesce to its demands.[4]

While activism may address performance gaps by entrenched management and boards, activist campaigns such as the one launched by Meister against ADT, benefitted the activist and the ADT Defendants at the expense of the Company and its stockholders. Jeffrey Ubben, founder of the $14 billion activist hedge fund firm, ValueAct Capital, stated in April 2014 that "Companies might want to push back more because there is some bad behavior going on" and identified Meister's

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[3] *See* Rob Copeland, *Fund Manager's Combative Style Pays Off*, THE WALL STREET JOURNAL, Oct. 27, 2014, http://online.wsj.com/articles/hedge-fund-managers-combative-style-pays-off-1414356003 (A0155-159).

[4] *See, e.g.*, Karlee Weinmann, *CommonWealth Ousts Entire Board, Sealing Win For Activists*, LAW 360, Mar. 15, 2014, http://www.law360.com/articles/521559 (noting "CommonWealth REIT officially folded to a long-running activist campaign" led by a pair of hedge funds, including Corvex, by "oust[ing] its entire board of trustees") (A0160-61); David Welch and Serena Saitto, *Hedge Funds Find That Activism Pays*, BLOOMBERG BUSINESSWEEK, Jan. 17, 2013, http://www.businessweek.com/printer/articles/91808 ("Onetime Carl Icahn protégé Keith Meister, 39, engineered a quick sale of Ralcorp Holdings (RAH), ... turn[ing] a quick $90 million profit on its $189 million investment ... in a matter of months.") (A0162-63); *see also* Lisa Brown, *BRIEF: Ralcorp names Meister to board*, ST. LOUIS POST-DISPATCH, Oct. 3, 2012, http://www.stltoday.com/business/local/ralcorp-names-meister-to-board/article_4781c2a2-0d9f-11e2-90b2-001a4bcf6878.html (noting that Ralcorp expanded its board from 9 to 10 directors to include Meister, effective immediately, in exchange for Corvex agreeing to vote its 5.3% stake in support of the board's director nominees and to not present proposals for consideration) (A0164).

investment in ADT as an example of "*destructive activism*" where the "company's worse off in acceding to his demands."[5] A0165-66.

2. Meister's Stock Buyback Plan Depended On Market Expansion And Low Competition

Meister significantly increased his investment in ADT in September and October 2012, at prices ranging from $36 to $39 per share, making it Corvex's largest investment. A0027 at ¶22. Prior to disclosing its sizable investment in ADT shares, Meister made a presentation at a conference in which Meister identified specific ways for ADT to create value for its investors. A0028 at ¶24. His first value investment thesis -- *i.e.*, that ADT's stock price did not reflect its growth potential and minimal competitive pressure -- was the foundation for Meister's second thesis -- that unlocking ADT's value could be achieved by incurring debt to repurchase approximately 30% of ADT's stock at what Meister perceived as "attractive prices." A0029 at ¶25. Under this second thesis, Meister targeted a 3.0x debt/EBITDA ratio for ADT, which would require ADT taking on an additional $2.5 billion in debt. *Id.* Meister argued that incurring massive debt at an estimated cost of 3% to repurchase ADT stock with an internal rate of return of 14% to 21%, would yield ADT stockholders significant returns of 11% to 18%. *Id.* As with his revenue and margin growth estimates, Meister's purported internal

[5] *See* Lawrence Delevingne, *Hedge Honcho: Activists killing 'golden goose,'* CNBC, Apr. 30, 2014, http://www.cnbc.com/id/101626635# (A0165-166).

rate of return estimates for ADT were based on Meister's first investment thesis being correct, that ADT would have significant positive future growth and no meaningful competition. *Id.*

Meister estimated that a stock buyback would result in ADT's share price increasing from approximately $44 per share to $60-$80 per share. A0029 at ¶¶26-27.

C. ADT Defendants Acquiesced In Substantial Part To Meister's Stock Buyback Demand

ADT's management and only certain board members met with Meister on November 17, 2012, during which Meister sought appointment to the ADT Board to oversee implementation of his activist stock buyback plan. A0029-30 at ¶28.

ADT's entire board held a telephonic meeting, just over a week later, to discuss Meister's demands. A0030 at ¶29. A day later, the ADT Board acquiesced to Meister's stock buyback demand and announced that it would approve an extensive share repurchase program, authorizing a debt/EBITDA target of 2.0x (1.0x short of Meister's plan) in order to repurchase $2.0 billion of its common stock over a three-year period. A0030-31 at ¶30. Moody's, dropping its outlook on ADT from stable to negative, attributed the "genesis for [the] buyback" to the "activist shareholder" Meister, and presciently stated its "concern … that the board has not met all of the activist's demands and it's going to face continued pressure." A0032 at ¶35.

D. Meister Pressured The ADT Board To Appoint Him As A Director And To Its Audit Committee By Threatening A Proxy Contest

Meanwhile, Meister increased his pressure to be added to the Board, threatening a proxy contest. A0033 at ¶37. The ADT Defendants took Meister's threat seriously enough to seek input from Mackenzie Partners, Goldman Sachs, Credit Suisse and Lazard Freres, as well as legal counsel, each of whom made presentations at the December 13 Board meeting. *Id.* In its presentation, Credit Suisse focused on the fact that Corvex had initiated four activist campaigns -- ADT, Ralcorp, Correction Corp. and Above Net -- and had already exited investments in Correction Corp. and Above Net with profits. A0033-37 at ¶38. ADT was not only Corvex's largest current holding in dollar amount, but the only company where Corvex was then in activist mode (Ralcorp had already acquiesced and appointed Meister to the board). *Id.* Twice, Credit Suisse highlighted that Corvex had threatened a proxy fight when Above Net did not fully implement its demands, but withdrew his challenges after Above Net succumbed to Corvex's demands and agreed to sell itself. *Id.*

Both Credit Suisse and Lazard Freres presented to the Board what Meister could do in advance of the first Annual Meeting of ADT stockholders (to be held in 2013) and the ADT Board's options. The Lazard Freres presentation recognized that even with the passage of the December 7, 2012 director nomination deadline, Meister had the ability to "initiate a vote withhold/against campaign to attack one

or more incumbent [ADT directors]." A0037-38 at ¶39. Credit Suisse also outlined the experience of key Corvex management with prior notable activist campaigns. A0033-37 at ¶38.

All of the presentations to the Board recognized that even though Corvex only owned 5% of ADT, other stockholders, particularly other hedge funds, were likely allies of Meister in any challenge to the ADT Board. A0039-42 at ¶40. Credit Suisse's analysis concluded that 19 of ADT's top 20 stockholders, representing 41.4% of outstanding shares, and other hedge funds, representing another 11.9% (for a total of over 53%), were at least 50% or more likely to challenge the Board and align themselves with a Corvex-led proxy contest. *Id.* Thus, among the Board's considerations of Meister's request to be appointed to the Board, as evidenced in the December 13, 2012 Board minutes, were "the likely consequences of [Meister] winning or losing [a proxy] contest." A0042 at ¶41. Followed by the ADT Board Chairman's statement during the same meeting that "if Mr. Meister is not asked to join the Board then Corvex Management will likely make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT at ADT's 2013 annual meeting of shareholders." A0033 at ¶37.

A day later, the ADT Board met again. A0043 at ¶41. Rather than defend ADT's new management and Board members at its first annual meeting in the Spring, and to secure their continued place in office, the ADT Defendants,

authorized ADT to negotiate a standstill agreement with Meister (the "Standstill Agreement"). A0043-44 at ¶42. Through the Standstill Agreement, Meister was appointed to the ADT Board, which required ADT to increase the size of its Board from eight to nine members, and in turn Meister agreed to vote in favor of ADT's slate of directors and limit his purchases to no more than 15,666,021 shares for a period of approximately one year. *Id.* The Standstill Agreement was effective until either Meister left the ADT Board or December 5, 2013. *Id.*

E. Meister Pressed The Board For Every Financial Engineering Option To Elevate The Stock Price And Buyout Corvex's Shares After Learning That ADT Was Facing Stagnant Future Growth

Materials presented to the ADT Board on March 13, 2013 show that ADT's prior public forecasts of strong growth in revenue, EBITDA margins, and cash flow would not materialize. A0046-47 at ¶47. The Board was informed that increased competition from direct and indirect threats, including "new formidable entrants launching in the space," were causing recurring revenue to soften and costs to increase, which in turn was causing EBITDA margins to fall. *Id.* (projecting EBITDA margins for the next quarter to fall below the critical 50% level). *Id.*

ADT's financial challenges, primarily from increased competition, continued thereafter, despite ADT's continued public affirmations of strong growth and positive guidance. A0050-55 at ¶¶52-60. ADT's bleak internal forecasts

undermined Meister's plan to incur additional debt to repurchase a large bulk of ADT shares to create return on capital. A0060 at ¶68. As a result, Meister pressed the ADT Defendants to keep ADT's share price pumped up until he could dump his shares, again explicitly threatening action against the Board if his demands were not met. A0061 at ¶69.

In line with Meister's demands, on July 31, 2013, ADT announced that it intended to now target a new larger leverage ratio of 3.0x debt to EBITDA, the ratio Meister set for ADT in his October 2012 presentation, but at odds with what they promised analysts just two months earlier. A0053, 58 at ¶¶54, 66. In late August, Meister continued to exert pressure on the ADT Board to prop up ADT's share price with even more aggressive leveraged stock repurchases. Meister submitted proposals to accelerate the time for hitting the increased 3.0x leverage target and threatened the Board with a Dell-like public leveraged buy-out plan[6] and a competing slate of directors at the 2014 Annual Meeting if the Board did not acquiesce. A0061 at ¶69. Meister's ultimatums were presented to the ADT Board as a condition to Meister's exit from the Board. *Id.* Adding to Meister's pressure against the Board was the impending expiration of the Standstill Agreement on

[6] In early 2013, Icahn threatened a proxy fight and years of litigation if Dell did not meet his demands of paying a special dividend and convening a special meeting in connection with founder Michael Dell's bid to take the company private.

December 5, which would then allow Meister to launch a full attack on the Board. A0060-61 at ¶68.

In materials provided to the ADT Board on or before September 9, 2013, consultants from Centerview Partners advised the Board of Meister's latest ultimatums, including the adoption of Meister's accelerated leveraged stock buyback and his interest in having his shares repurchased at a certain price. If these demands were not adopted, Centerview told the Board Meister "would" present an alternative capital allocation framework (a "Public LBO") and run a competing slate of directors to be voted on at the annual meeting. A0061 at ¶69.

Succumbing to Meister's threats, the ADT Board continued to support the market price of ADT stock with a variety of financial engineering tools, including a special dividend and additional stock repurchases. A0063 at ¶74. On September 23, ADT announced a special dividend of $0.125 per share payable on November 20, 2013. *Id.* The next day, on September 24, ADT announced that it would issue $1 billion in debt. ADT took further steps to support the price of its stock. On November 20, ADT announced that it would increase its next quarterly dividend by 60%. A0065 at ¶79. That same day, ADT announced that it would increase the Company's repurchase authorization from $2.0 billion to $3.0 billion. A0065-66 at ¶¶80-81. The market responded favorably, but ultimately misinterpreted the

Company's actions as a sign of positive growth rather than its true primary purpose of benefitting Meister and entrenching the Board. A0064 at ¶¶76-77.

F. ADT Defendants Entrenched Themselves Further By Repurchasing Corvex's Shares At A Fixed Price In Exchange For Meister's Withdrawal From The ADT Board And An Extension To The Standstill Agreement

As part of its buyback program, ADT had entered into two separate agreements with two large ADT stockholders to repurchase their shares. The first on January 30, 2013, with Credit Suisse to repurchase $600 million of ADT common shares at a volume-weighted share price calculated over six months, A0044-45 at ¶¶43-44,[7] and the second on November 20, 2013, with JP Morgan, to repurchase approximately $400 million of its common stock, at a volume-weighted share price set over a period of four months in the future. A0066 at ¶80.

In Meister's case, however, ADT announced, on November 25, 2013, that the Board reached an agreement to repurchase over 10 million of Corvex's ADT shares in a private transaction at a set price of $44.01 per share, the previous day's closing price, in exchange for Meister leaving the Board. A0067-68 at ¶83. ADT's repurchase of these shares was valued at over $450 million. A0016-17, A0069 at ¶¶3, 86. This amount would have exceeded ADT's authority under its

[7] Since corporations engage in stock repurchases when they perceive that their stock is undervalued, the announcement of such buybacks have been shown to result in a positive abnormal return of around 3%. To minimize the abnormal returns and impact of purchases by companies on the market for their shares, the SEC advises companies to make such large buybacks subject to restrictions relating to volume, price and timing. *See* 17 CFR 240.10b-18 (SEC Rule 10b-18 for stock repurchases).

repurchase program had it not been for the November 20, 2013 increase in authority from $2 billion to $3 billion the Board authorized just five days earlier. A0070 at ¶89.

Foreseeably, Meister's and Corvex's sudden exit from ADT caused ADT's price to drop significantly from $44.01 to $38.80 on December 13, 2013. A0069-70 at ¶88. Analysts and investors questioned why Meister would leave when just one year earlier he was touting ADT's bright prospects and arguing its stock was worth "$61 to $83" per share. A0068 at ¶84.

Just over two months later, ADT's results for its quarter ended December 31, 2013, badly missed the Company's guidance and analysts' consensus estimates, and revealed to the public finally a far-worse-than-forecasted financial condition and diminished future prospects. A0071-72 at ¶¶91-92. ADT's share price took another large hit on these revelations, declining to $31.40 per share. A0072 at ¶94. While numerous ADT investors incurred substantial losses on these steep price drops, Meister had profited by more than $60 million on Corvex's private deal with the ADT Defendants. A0072-73 at ¶95.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN APPLYING A STANDARD FOR DETERMINING BOARD ENTRENCHMENT THAT REJECTS AS LEGALLY IRRELEVANT ALLEGATIONS THAT THE BOARD BELIEVED AN ACTUAL THREAT OF REMOVAL EXISTED.

A. Question Presented

Did the Court of Chancery err in creating an overly narrow legal standard that rejects specific allegations that the ADT Board believed that their board positions were actually threatened by Meister and, instead, requires allegations that Meister took affirmative steps aimed at removing the Board? *See* Op. at 18-19.

B. Scope Of Review

The ruling below is reviewed by this Court *de novo*. *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000) ("our review of decisions of the Court of Chancery applying Rule 23.1 is *de novo* and plenary. We apply the law to the allegations of the Complaint as does the Court of Chancery. Our review is not a deferential review that requires us to find an abuse of discretion.").

C. Merits Of The Argument

Under *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) and its progeny, a derivative plaintiff need not make a demand on a corporation's board of directors if the plaintiff can plead particularized factual allegations demonstrating that the director defendants' primary motivation for the challenged conduct was entrenchment. *Grobow v. Perot*, 539 A.2d 180, 188 (Del. 1988) (citing *Unocal*

Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)). Entrenchment is sufficiently plead with allegations "tending to show that the ... directors' positions were actually threatened" and that the board's response "was motivated and reasonably related to the directors' retention of their positions on the Board." *Id.* The Court of Chancery failed to appropriately apply these standards.

The Court of Chancery required that the Complaint allege an actual "struggle for corporate control" whereby the activist "actually took action aimed at removing one or more of the Director Defendants." Op. at 18-19. This agitator-centered focus caused the Court to wrongfully reject as conclusory Plaintiff's well pled allegations that the ADT Board actually perceived a threat to their positions and responded with entrenchment acts. Op. at 15, 18. The Court's holding creates a legal standard that deems any focus on the board's belief of an actual threat to their removal as too speculative to raise a reasonable doubt of director disinterestedness.

Particular allegations that the board perceived an actual threat of removal are certainly stronger than any allegations of steps taken by an activist to remove the board, which may or *may not* have caused the board to perceive that they were in any danger of losing their board seats. The Delaware Courts have held that a board's belief of an actual threat and its assessment of its vulnerability is important and should be considered in any entrenchment analysis. *See Greenwald v.*

Batterson, 1999 Del. Ch. LEXIS 158, at *15 (Del. Ch. July 26, 1999) (Lamb, V.C.) ("the mere allegation that directors have taken action to entrench themselves, without an allegation that the *directors believed* themselves vulnerable to removal from office, will not excuse demand.") (emphasis added). This Court has likewise supported a standard that credits particular allegations of a board's belief and allows for further inquiry. *See Kahn ex rel. DeKalb Genetics Corp. v. Roberts*, 679 A.2d 460, 465 (Del. 1996) ("where the board perceives a threat, its response will not be upheld merely because the response serves 'any rational business purpose'"). The Court of Chancery's holding here creates a rigid rule that imprudently encourages quick entrenchment actions by boards faced with likely challenges to their positions. Under that rule, valid derivative claims are dismissed where, like here, the board quickly took defensive, entrenchment acts that saved the agitator from having to take action in furtherance of his threat.

As demonstrated below, the lower court erred in dismissing this action because Plaintiff sufficiently alleged an actual threat and the directors believed themselves to be vulnerable.

II. THE COURT OF CHANCERY ERRED IN NOT EXCUSING DEMAND UNDER RULE 23.1 BECAUSE PLAINTIFF SUFFICIENTLY ALLEGED OBJECTIVE FACTS THAT THE ADT BOARD'S RESPONSE TO MEISTER'S DEMANDS TO (1) RADICALLY CHANGE ITS CAPITAL ALLOCATION PLAN; (2) APPOINT HIM TO THE BOARD IN RETURN FOR A STANDSTILL AGREEMENT; (3) ACCELERATE THE DESTRUCTIVE FINANCIAL ENGINEERING TO BOOST THE ADT STOCK PRICE SOLELY FOR HIS EXIT; AND (4) SUBSEQUENTLY BUY HIM OUT AT AN INFLATED PRICE USING THE COMPANY'S ASSETS, WAS PRIMARILY ENTRENCHMENT MOTIVATED

A. Question Presented

Did the Court of Chancery err in concluding that Plaintiff failed to sufficiently allege that the ADT Board's response to Meister's demands to (1) radically change its capital allocation plan; (2) appoint him to the Board in return for a standstill agreement; (3) accelerate the destructive financial engineering to boost the ADT stock price solely for his exit; and (4) subsequently buy him out at an inflated price using the Company's assets (rather than subject his sale to the immediate market drop suffered by all other stockholders), was primarily entrenchment motivated? *See* A0123-135 (issue preserved below).

B. Scope Of Review

The ruling below is reviewed by this Court *de novo*. *See supra* at I.B.

C. Merits Of The Argument

In determining the sufficiency of Plaintiff's pleadings, the Complaint's allegations must be "taken as true" and all reasonable inferences that flow from the particularized facts must be construed in a light most favorable to the Plaintiff.

Brehm, 746 A.2d at 255. Further, in considering the sufficiency of Plaintiff's allegations of demand futility, the allegations of the entire Complaint are relevant, and are not just limited to the section labeled "demand futility." Plaintiff is not required to plead evidence; nor is proof of success on the merits required at this stage of the litigation. *Id.* In short, a determination of demand futility is to be based on the totality of the circumstances. *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993).

1. The Court Of Chancery Erred in Concluding That The ADT Board's First Entrenchment Acts Were Insufficiently Pled

In reaching its conclusion that Defendants were entitled to dismissal, the lower court improperly recast some of Plaintiff's particularized allegations and ignored others, rather than accept all allegations as true, as it was required to do. The lower court also failed to recognize the nature, timing and magnitude of the first entrenchment events – those surrounding the ADT Board's adoption of an ill-fated capital allocation plan and appointment of Meister to the Board in exchange for the December 2012 Standstill Agreement – and failed to draw several reasonable inferences in Plaintiff's favor.

As an initial matter, the lower court ignored the significance of Meister's role as an activist investor and hedge fund manager, that ADT comprised his largest investment and the only investment where he was engaging in activism, and

that Meister was ADT's largest stockholder up against a relatively new Board. A0025-28, 0033-34, 0039-40 at ¶¶20, 22-23, 38, 40. By ignoring these allegations, the lower court failed to recognize the context in which the ADT Board percieved Meister's demands. When activist investors, like Meister, acquire a relatively large stake in a company and focus their activism solely on that company's board, the activist investor's demands are typically made (and perceived to be made) with the intent to remove the board if the investor's demands are not accepted. Meister, as a protégé of Carl Icahn, one of the most prolific activist stockholders, had a long history of seeking board member removal when his demands were not accepted. A0033-37 at ¶38; *see also* A0104-06, 0156-164. Unlike the lower court, this Court gives weight to such allegations. *See Unocal*, 493 A.2d at 956 (in evaluating the reasonableness of the board's response, the court recognized that "the threat was posed by a corporate raider with a national reputation as a 'greenmailer'"). The lower court erred by recognizing Meister as an activist who "could or might become aggressive and run a proxy contest or other activist campaign," Op. at 15, but giving no weight to those allegations.

The lower court also ignored the ADT Board's dramatic change to its capital allocation plan from a "disciplined" approach to one that analysts deemed imprudent and that put the Company at risk of receiving a below investment grade credit rating (which it later did receive). A0026-27 at ¶21; *see Chrysogelos v.*

London, 1992 Del. Ch. LEXIS 61, at *25-26 (Del. Ch. Mar. 25, 1992) (identifying numerous Court of Chancery cases holding that "economically questionable" transactions "suppl[y] added reason to doubt that ... the transactions were motivated purely by business (as opposed to control-related) considerations."). The timing of this change is also significant in that it occurred less than 10 days after Meister, who had no management experience in ADT's industry or inside access to ADT's financial records, made his demands on the ADT Board. A0029-30 at ¶¶28-30;[8] *Chrysogelos*, at *27 ("These measures, which the directors began to take immediately ... and concluded within the short space of six months, strongly suggests a control retaining motive"). The lower court failed to draw the reasonable inference that the ADT Board acquiesced to Meister's financial re-engineering plan, which sacrificed long-term growth for a quick share price appreciation, to avoid a threat to their positions.

Additionally, the lower court glossed over the significant allegations surrounding the ADT Board's assessment of Meister's willingness and ability to successfully challenge them if they did not add him to the Board. The Board and its advisors specifically contemplated the likelihood that Meister would launch a successful proxy contest. They considered that Meister had done so successfully in

[8] Also a significant timing issue is that Meister met only with certain ADT Board members initially and the full board had only one day to deliberate. A0029-30, at ¶¶ 28-29.

the past, that he was the largest and most influential ADT stockholder, and that he would likely have the support of a clear majority of the ADT stockholders, over 53% (including 19 of the 20 top investors and other hedge funds who typically align with activist campaigns).[9] A0033-37, 0039-42 at ¶¶38, 40. Specific allegations of alignment of a majority block of shares is supportive of Plaintiff's claim. *See Blasius Ind., Inc. v. Atlas Corp.*, 564 A.2d 651, 663 (Del. Ch. 1988) (recognizing that a majority of stockholders could "employ the mechanisms provided by the corporation law ... to advance [a] view" different than the "board['s] view"); *Nycal Corp. v. Angelicchio*, 1993 Del. Ch. LEXIS 226, at *9 (Del. Ch. Aug. 31, 1993) ("I assume that the plaintiffs, representing a majority of shareholders, had the power to remove the board"). The lower court improperly watered-down these particular allegations in stating that "Corvex held only 5% of ADT's stock" and "there are no allegations that other hedge funds that held a significant amount of ADT stock were coordinating with Corvex or otherwise following its lead." Op. at 18-19.

The lower court's facile assessment is further undercut by the ADT Board's advisor's presentation of likely action Meister would take to threaten the Board's positions, including launching a proxy contest and initiating a vote

[9] It was reasonable for the Board to conclude that Meister would procure the support of his fellow activists in return for his support of their campaigns.

withhold/against campaign. A0037-39 at ¶39. These removal mechanisms would not have been contemplated by ADT advisors and the Board had there been no likelihood of Meister obtaining a stockholder majority. Indeed, the ADT Board's advisors' presentations indicated that Meister posed a credible threat of removing the Board and could obtain a majority of stockholder votes in a removal campaign. *Compare Greenwald*, at *17 (Lamb, V.C.) (rejecting entrenchment allegations because "[t]here is nothing in the complaint to suggest either that the defendants contemplated such a transaction at the time they approved the Financing Agreement or that the board had a history of such transactions.").

Moreover, on one of the most critical allegations in Plaintiff's Complaint -- *i.e.*, the Chairman of the Board's admission to the entire Board "that if Mr. Meister is not asked to join the Board then Corvex Management will *likely* make a stockholder proposal to elect Mr. Meister and possibly others as directors of ADT" (A0033 at ¶37) -- the lower court improperly recast the allegation as something "Corvex and Meister *might*" do, Op. at 18 (emphasis in original), rather than "*likely*" do as alleged and actually stated by a Defendant. The lower court erred by diluting the significance of this important admission, made shortly after ADT's advisors presented to the Board Meister's credible threats.

Nor was the Court of Chancery correct in analogizing this case to the situation in *Grobow*. Op. at 16-18. In *Grobow*, the defendant, H. Ross Perot, was

not, as Meister is here, an activist investor with a history of and willingness to remove board members if demands were not met. Nor was Perot perceived by the GM board or its advisors as desirous of, let alone threatening, the launch of a board challenge. Instead, Perot held less than 1% of GM's shares, with no indication that he was aligned with or could likely align with a majority of other GM stockholders. Perot had merely publicly criticized the board's actions. *Grobow*, 539 A.2d at 188 (noting plaintiffs merely argued that such criticism "*could* cause the directors embarrassment sufficient to lead to their removal from office," but that it was "too speculative" to support plaintiff's entrenchment theory). Moreover, in *Grobow*, a Special Review Committee was established, chaired by an outside director, that evaluated the agreement to repurchase Perot's shares and unanimously recommended that GM's board approve its terms. *Id.* at 184. In contrast, the ADT Board did not establish a special committee to evaluate Meister's demands and Plaintiff specifically alleged that the ADT Board and their advisors believed that Meister posed an actual threat to the Board's positions.[10]

Finally, the Court of Chancery erred by finding that Plaintiff failed to allege that entrenchment was the primary purpose for the ADT Board's actions. Op. at

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[10] The Court of Chancery's reliance on *Kahn*, is equally misplaced. Op. at 16 n.33. *Kahn* was decided at summary judgment, not, as here, on the pleadings. 679 A.2d at 464. Nor was an activist investor involved or particular allegations that the board admittedly believed that an actual threat existed. Instead, the dismissal in *Kahn* turned on the plaintiff's conflicting arguments that the directors both perceived a threat and that the directors could not establish a legally cognizable threat to corporate policy. *Id.* at 465-66.

19-21. Although allegations of an extraordinary or excessive financial benefit may be one way to establish motive -- as the lower court suggests -- motive can also be satisfied at the pleading stage from the particular allegations surrounding the actual threat and the appropriateness of the board's response. *See Chrysogelos*, at *27-28 & n.12 (inferring "a control-retaining motive" from "the nature and timing of [the] defensive measures" and assessing facts "arguably probative of the directors' motivation"). Here, it is reasonable to infer that the ADT Board's primary motive for caving to Meister's demands was entrenchment because (1) they recognized Meister as the most willing and influential ADT stockholder with a likely majority following, who successfully removed boards in the past (A0033-42 at ¶¶37-40); (2) their agreement to appoint him to the Board was dependent on Meister entering into the initial standstill agreement (A0042-44 at ¶¶41-42); (3) their actions came shortly in time after Meister's demands (*id.*); and (4) their constitution as a board was less than a month old, yet they ditched their disciplined capital allocation plan, adopted just after going public, for Meister's plan, which was met with credit rating downgrades. A0025-27, 0031-32 at ¶¶20-21, 33-35.

2. The Court of Chancery Erred In Concluding That The ADT Board's Second Entrenchment Acts Were Insufficiently Pled

The lower court failed to credit Plaintiff's allegations surrounding the nature, timing and magnitude of the transactions leading to ADT's repurchase of Meister's

shares and his exit from its board (*i.e.*, the second entrenchment acts). Specifically, the lower court ignored the allegations that by March 2013 Meister no longer believed ADT would reach $60-$80/share and sought a profitable exit. A0046-47 at ¶47. To facilitate that exit, he demanded that the ADT Board implement even more aggressive capital allocation changes (resulting in additional credit downgrades) and threatened the ADT Board with a public LBO or running a competing slate of directors if they did not meet his accelerated capital allocation timeframe. A0060-61 at ¶¶68-69. Rather than fully credit Plaintiff's allegation that Meister "*would*" present … a Public LBO … and run a competing slate of directors to be voted on at" the upcoming annual meeting if his accelerated "leverage timeframe [was] not adopted," A0061 at ¶69 (emphasis added), the lower court recast the allegation as something Meister "*might* present." Op. at 7 (emphasis added). Plaintiff's allegation is a direct quote from materials presented to the ADT Board and, thus, is definitive and not open to interpretation, and must be accepted as true. *See Cal. Pub. Emples. Ret. Sys. v. Coulter*, 2002 Del. Ch. LEXIS 144, at *38 (Del. Ch. Dec. 18, 2002) ("I decline to rule on construction of the [directors' plan] on a motion to dismiss."). The lower court erred in diluting the import of this significant allegation, especially given it occurs just before Meister obtained a buyout of Corvex's ADT shares at a large profit without any price protections that the Company obtained in similar repurchases completed

during the same time period. In exchange to agreeing to Meister's demands, the ADT Board received a six-year extention to the Standstill Agreement with Meister.

The only reasonable inference to draw from these allegations is that the Board perceived Meister presented a credible threat to their Board seats and that they acquiesced to *all* of Meister's demands for his exit because they were motivated primarily by entrenchment. No other motive has been offered, nor can a more compelling reasonable inference be drawn from these allegations. The lower court erred in failing to draw that reasonable inference. Normally, when a Board takes defensive maneuvers in response to a threat, they do so to avoid the agitator's demands. *See Unocal*, 493 A.2d at 955-56; *Chrysogelos*, at *27-28 (finding significant no allegations "indicating that the repurchase ... was part of any preexisting business plan" and that "its timing [and] magnitude ... suggest that the transaction was driven by other than purely business-related concerns").

3. The Chancery Court Erred By Not Evaluating All Allegations Together

The lower court was required to assess as a whole all of the allegations surrounding Meister's destructive activism and determine if collectively they provide a reasonable inference that the ADT Board's defensive responses were entrenchment motivated. *See Chrysogelos*, at *26 ("None of these circumstances, if considered individually and in isolation from the rest, would be sufficient to create a reasonable doubt as to the propriety of the directors' motives. However,

when viewed as a whole, they do create such a reasonable doubt..."); *Coulter*, at *29-30 (finding allegations "[t]aken together" were sufficient "to doubt" director "disinterestedness").

Here, Meister's second removal campaign was a continuation of the first -- involving the ADT Board's acquiescence to Meister's capital allocation demands and an extension of the same Standstill Agreement, albeit for more years, and ending with Meister's profitable exit -- and, thus, they must be assessed together. Over the one-year period during which Meister threatened to remove the ADT Board, it succumbed to Meister's "manipulation of [ADT's] corporate machinery" on several occasions, involving buying back shares, increasing dividends, issuing a special dividend and accelerating timetables -- substantially all of which required ADT taking on additional debt leading to ADT's credit rating downgrades and for which the ADT Defendants had to formally authorize increases to existing plans in order to effectuate Meister's gainful exit. *See Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984) (allegations detailing "the manipulation of corporate machinery" for the primary purpose of entrenchment is sufficient for excusing demand). Separately, the allegations here are very compelling, but when evaluated as a whole, no reasonable conclusion can be drawn other than that entrenchment was the primary motive of the ADT Board each time it responded to Meister by using

Company assets to ensure their continuation in office.[11] *See Louisiana Mun. Police Employees Ret. Sys. v. Berman*, LA CV 14-01670 (C.D. Cal. Sept. 16, 2014) (applying Delaware law and excusing demand under *Aronson* where standstill agreement was entered in exchange for support of the incumbent board and a defensive stock repurchase plan financed by debt); *see also Samuel M. Feinberg Testamentary Trust v. Carter*, 652 F. Supp. 1066 (S.D.N.Y. 1987) (demand excused where directors were acting out of self-interest when repurchasing shares of B.F. Goodrich from Carl Icahn); *Lewis v. Curtis*, 671 F.2d 779 (3d Cir. 1982) (demand excused where directors bought back Icahn's shares after he threatened proxy fight).

* * *

Dismissal here was inappropriate because the objective facts of the Complaint display the very essence of entrenchment motivation: the ADT Defendants' acceding to Meister's demands in each instance, which rendered the Company worse off -- vastly overleveraging it, then using the Company's assets to buyout Meister at an over $60 million premium, saving him from a loss from the immediate market drop. As the gatekeepers for a company and its governance, directors must put the company's interest ahead of their own.

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[11] Although the Chancery Court did not reach Defendants' Rule 12(b)(6) arguments, Op. at 2, 25, if this Court "find[s] the entrenchment allegations to be adequate under the more stringent Rule 23.1 test, *a fortiori*, it is also sufficient under Rule 12(b)(6)." *Chrysogelos*, at *21.

CONCLUSION

For all the foregoing reasons, the Court of Chancery's Rule 23.1 dismissal should be reversed and the case remanded for further proceedings.

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