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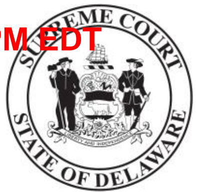

IN THE SUPREME COURT OF THE STATE OF DELAWARE

NICHOLAS OLENIK, Individually and on Behalf of All Others Similarly Situated, Plaintiff Below Appellant, v. FRANK A. LODZINSKI, RAY SINGLETON, DOUGLAS E. SWANSON, BRAD THIELEMANN, ROBERT L. ZORICH, JAY F. JOLIAT, ZACHARY G. URBAN, ENCAP INVESTMENTS L.P., BOLD ENERGY III LLC, BOLD ENERGY HOLDINGS, LLC and OAK VALLEY RESOURCES, LLC, Defendants Below Appellees, and EARTHSTONE ENERGY, INC., a Delaware corporation, Nominal Defendant Below, Appellee.	No. 392, 2018 Court below: Court of Chancery of the State of Delaware C.A. No. 2017-0414-JRS

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NATURE OF PROCEEDINGS

The Court of Chancery correctly applied Delaware law in dismissing this stockholder suit challenging the fairness of an all-stock "Up-C" business combination between Earthstone Energy, Inc. ("Earthstone" or the "Company") and Bold Energy III LLC ("Bold").[1] Bold was a portfolio company of EnCap Investments, L.P. ("EnCap"), which also indirectly owned a 41.1% interest in Earthstone at the time of Earthstone's initial offer letter to Bold. (A60-61.)

Although this case could have been readily dismissed based on EnCap's lack of a controlling interest in Earthstone or the absence of facts pled showing that the transaction was unfair, Vice Chancellor Slights did not need to reach those arguments because the negotiations were conditioned on the formation of a Special Committee and approval by the holders of a majority of Earthstone's unaffiliated stock. In *Kahn v. M&F Worldwide Corp.* ("*MFW*"), this Court applied the business judgment standard of review to a controlling-stockholder transaction where the alleged controller "conditioned its offer upon the [target's board] agreeing, *ab initio*, to . . . approval [of the transaction] by a Special Committee and by a majority of the minority stockholders." 88 A.3d 635, 646 (Del. 2014). More recently, this Court clarified in *Flood v. Synutra International, Inc.* that the

[1] This brief is submitted on behalf of Earthstone, Bold, and individual defendants Frank A. Lodzinski ("Lodzinski") and Ray Singleton ("Singleton") (the "Earthstone Defendants").

business judgment rule applies if the *MFW* conditions are announced "before there has been any economic horse trading," even if the parties engaged in discussions before the first offer letter was submitted. -- A.3d --, 2018 WL 4869248, at *1 (Del. Oct. 9, 2018).

In a thoroughly-reasoned 70-page opinion ("Op."), Vice Chancellor Slights correctly applied *MFW*, observing that Earthstone's initial offer letter to Bold "announced and made clear from the outset – at the start of negotiations on the proposal – that any transaction between Earthstone and Bold would be conditioned on" both of the *MFW* requirements. (Op. at 44-45.) While noting that the parties had engaged in "discussions" prior to the offer, Vice Chancellor Slights recognized "the important distinction between 'discussions' about the possibility of a deal and 'negotiations' of a proposed transaction after the 'discussions' lead to a definitive proposal." (Op. at 46.) This distinction mirrors the distinction between preliminary discussions and substantive "horse trading" recognized in *Synutra*. The allegations of Plaintiff Nicholas Olenik ("Plaintiff") do not show "horse trading" before the offer letter that set out the *MFW* conditions.

Unable to dispute the contents of the initial offer letter, Plaintiff raises a host of meritless arguments that Vice Chancellor Slights properly rejected. Plaintiff contends that business judgment review should not apply because: (i) the parties engaged in discussions before the initial offer letter; (ii) the offer letter came from

the Special Committee rather than the alleged controller, and the *MFW* conditions were supposedly not accepted by the alleged controller; (iii) the trial court should not have considered the offer letter on a motion to dismiss even though the letter was prominently cited and described in Plaintiff's Verified Amended Stockholder Class Action and Derivative Complaint (the "Complaint"); (iv) the Complaint sufficiently alleged that the Special Committee did not exercise the appropriate degree of care; and (v) the overwhelming approval of the transaction by Earthstone's unaffiliated stockholders should be disregarded due to purported disclosure deficiencies.

The trial court correctly dispatched these arguments. Merely sharing valuation-related materials during preliminary discussions is a far cry from the substantive "horse trading" contemplated by *Synutra*. Instead, as Vice Chancellor Slights recounts in detail, the "horse trading" occurred ***after*** the *MFW*-compliant initial offer letter, which "was followed by more than two months of negotiations between the Special Committee and Bold that included several attacks, parries and remises before a final deal was struck." (Op. at 46.)

The fact that the conditions were spelled out in a letter from the Special Committee rather than from Bold likewise makes no difference. The onus is on Plaintiff to plead facts supporting a reasonable inference that the negotiations were not conditioned on the *MFW* protections. *See Synutra*, 2018 WL 4869248, at *8

(dismissal appropriate where "plaintiff has pled no facts supporting a reasonable inference that [the controller] did not condition the merger on *MFW*'s dual procedural protections before any economic negotiations took place"). There is no allegation that EnCap or Bold contested or pushed back in any way against the application of the *MFW* conditions at any time during the negotiations.

There is also no merit to Plaintiff's argument that the initial offer letter (the "August 19 Offer") could not be considered on a motion to dismiss. (OB at 31-33.)[2] As the Vice Chancellor observed (Op. at 44 n.200), Plaintiff relied on the August 19 Offer in the Complaint. (A91-92; Compl. ¶¶ 118-19.) The offer letter was incorporated by reference and subject to judicial notice. *See Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 818 (Del. 2013).

Plaintiff's conclusory assertions that the Special Committee did not take appropriate care (OB at 34-39) are also unsupported by any factual allegations. *Synutra* undermines Plaintiff's arguments that the Special Committee did not adequately inform itself, did not obtain a sufficient price or otherwise did not discharge its duty of care. *See Synutra*, 2018 WL 4869248, at *10-11. Vice Chancellor Slights also correctly rejected Plaintiff's arguments regarding the committee's purported lack of independence. (Op. at 47-52.) Plaintiff's disclosure allegations related to the definitive proxy statement filed by Earthstone on April 7,

[2] Citations to "OB" are to Appellant's Opening Brief.

2017 (the "Proxy") (OB at 40-49) are equally meritless. (Op. at 60-67.)

The Court should thus affirm Vice Chancellor Slights' straightforward application of Delaware law. The Court may also affirm dismissal based on the grounds that the trial court did not reach, including the fact that EnCap did not actually control Earthstone and that Plaintiff's makeweight allegations of unfairness would be insufficient even under an entire fairness standard.

SUMMARY OF ARGUMENT[3]

1. Denied. The trial court correctly applied *MFW* and took the same approach that this Court later endorsed in *Synutra*.

First, contrary to Plaintiff's assertion, the trial court's treatment of the *ab initio* requirement is not "at odds with *MFW*." The August 19 Offer undisputedly contained the *MFW* conditions and is the first offer letter between the parties. *Synutra* forecloses Plaintiff's argument that the pre-August 19 discussions between Earthstone and Bold equate to "negotiations," as there is no allegation that either side changed its position on any issue before the August 19 Offer (whereas Plaintiff concedes there was considerable negotiating ***afte***r the August 19 Offer).

Second, the trial court did not misapply the pleading burden with respect to the pre-August 19 discussions. As stated above, Plaintiff did not plead any facts showing that the preliminary discussions morphed into actual "horse trading" over material financial terms. Overturning Vice Chancellor Slights' careful application of the Rule 12 pleading standards would mark a sudden and unwarranted U-Turn from this Court's approach in *Synutra*.

Third, for similar reasons, the trial court did not err in holding the August 19 Offer sufficient to satisfy *MFW*. It is Plaintiff's burden to plead facts supporting a reasonable inference that EnCap did not condition the merger on *MFW*'s dual

[3] The Earthstone Defendants incorporate the arguments in the EnCap and Oak Valley Appellees' Answering Brief.

procedural protections. There is simply no allegation that EnCap refused to accept the *MFW* conditions or that either party wavered even slightly about the conditions' applicability at any point during the negotiations.

Fourth, Plaintiff's assertion that the August 19 Offer cannot be considered at the pleading stage is groundless given that Plaintiff cited and relied on this document in the Complaint.

2. Denied. The allegations in the Complaint come nowhere close to demonstrating "gross negligence." Indeed, the Special Committee obtained an excellent deal for Earthstone's stockholders – a fact confirmed by the substantial stock price increase when the deal was announced, the overwhelming approval of the transaction by Earthstone's unaffiliated stockholders and Vice Chancellor Slights' meticulous description of what the Special Committee did and the terms it achieved.

3. Denied. The Proxy disclosed all material facts. It fully disclosed the respective cash positions of both companies, putting to rest Plaintiff's claim that Bold's purported liquidity needs were omitted. Plaintiff's assertions that the financial advisor's initial contribution analysis did not support the proposed ownership split is likewise of no moment. This was a combination between a company with mature, revenue-producing oil and gas properties (Earthstone) and a company with mostly undeveloped properties (Bold). It was thus self-evident that

a revenue contribution analysis focusing on the early years would not accurately reflect the respective valuations of the entities, as most revenue in the early years would naturally come from the already-producing properties. The primary objective of the transaction was for Earthstone's highly capable management team to take the reins on developing Bold's properties, so that those properties would come online as the mature properties began to peter out. There was no material omission.

4. Alternatively, this Court should affirm the Court of Chancery's dismissal of the Complaint based on Plaintiff's insufficient allegations that EnCap controlled Earthstone or Lodzinski, the absence of factual allegations supporting a non-exculpated claim against Lodzinski or Singleton, and the absence of factual allegations showing substantive unfairness in the transaction.

STATEMENT OF FACTS[4]

A. History and Formation of Earthstone

Earthstone's CEO, President, and Chairman, Frank A. Lodzinski, has spent more than 30 years building successful oil and gas companies and delivering significant returns to investors when those companies are sold. In 1984, Lodzinski formed Energy Resource Associates, Inc., which acquired management and controlling interests in oil and gas limited partnerships, joint ventures, and producing properties. (A350.) After building the company and exchanging certain partnerships for common shares of Hampton Resources Corporation ("Hampton") and becoming president of that entity, Hampton was sold to Bellwether Exploration Co. in 1995, delivering substantial returns to Energy Resource Associates' original investors.[5] Lodzinski replicated this success with three subsequent companies: Texoil, Inc. (1997; acquired by Ocean Energy in 2001); AROC, Inc. (2001; monetized in 2003); and Southern Bay (2004; merged into GeoResources in 2007; sold to Halcon Resources in 2012). (A350.) Each

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[4] The Court may consider the Proxy "to establish what was disclosed to stockholders and other facts that are not subject to reasonable dispute." *In re Books-A-Million, Inc. Stockholders Litig.*, 2016 WL 5874974, at *1 (Del. Ch. Oct. 10, 2016), *aff'd*, 2017 WL 2290066 (Del. May 22, 2017).

[5] *See id.*; A55; Compl. ¶ 43 n.5 (Lodzinski "Scorecards for Success" Presentation at 6). The "Scorecards" presentation was previously accessible at the website listed in footnote 5 of the Complaint and is now accessible at https://www.ipaa.org/wp-content/uploads/2017/01/OakValley_Lodzinkski_ Frank.pdf.

company delivered substantial returns to its original investors when it was sold. (*See* page 6 of "Scorecards" presentation referenced in footnote 5.)

In December 2012, Lodzinski organized a new company called Oak Valley Resources, LLC ("Oak Valley") for the purpose of acquiring and managing oil and gas properties. (A289.) Oak Valley merged with Earthstone in December 2014. (*Id.*) The combined company (which took on the Earthstone name) had significant producing oil and gas assets (primarily in South Texas's highly productive Eagle Ford shale play and in North Dakota's Williston Basin). (A253.)

Oak Valley's largest investor was EnCap, which owned approximately 57.3% of the membership interests in Oak Valley and had the right to appoint three members of Oak Valley's five-member Board of Managers. (A254, A354.) Defendants Douglas E. Swanson, Jr. and Robert L. Zorich and non-Defendant Bryan T. Stahl served as EnCap-appointed directors of Oak Valley. (A57; Compl. ¶ 46.) Lodzinski and Robert Anderson served as the two non-EnCap managers on the Oak Valley Board of Managers. (*Id.*) Lodzinski also owned an approximate 28.4% interest in an entity that owned a 2.6% membership interest in Oak Valley. (A354, A367-68.) There is no allegation that he received any compensation from Oak Valley from December 2014 forward (and, indeed, he did not).

Following the merger of Oak Valley and Earthstone, Lodzinski became Chairman, President, and CEO of Earthstone and, along with the management

team, began to implement Earthstone's strategy of exploring attractive opportunities for acquiring new acreage. (A289.) Earthstone's management team has thereafter maintained a regular, ongoing dialogue with investment bankers, institutional investors, private equity firms, and potential joint venture parties to look for potential acquisition opportunities and to discuss more generally overall industry conditions. (*Id.*)

Before the transaction with Bold, the Earthstone Board of Directors (the "Board") consisted of Lodzinski, Ray Singleton (who served as Executive Vice President of Earthstone's Northern Region until his retirement in June 2018), Swanson, Zorich, Brad Thielemann, Jay F. Joliat, Zachary G. Urban, and Philip D. Kramer.[6] (A50-52; Compl. ¶¶ 26–32.) At the time of the negotiations with Bold, only three of the seven Earthstone directors (Swanson, Zorich and Thielemann) were employees or principals of EnCap. (A51.)

In furtherance of its strategy, Earthstone acquired Lynden Energy Corp. ("Lynden Corp.") in May 2016. (A290.) The Lynden acquisition provided Earthstone with a non-operated working interest presence in the highly prolific Midland Basin, which is part of the Permian Basin in Texas. (*Id.*) Earthstone continued to seek new opportunities for the purpose of creating significant

[6] Plaintiff's original complaint named Kramer as a defendant even though Kramer did not join the Board until October 12, 2016. Plaintiff later dismissed Kramer from the suit with prejudice (A14), which is unsurprising given that the claims against Kramer lacked merit.

operated working interest holdings in this area. (*Id.*)

B. Earthstone's Initial Interest in Bold

Earthstone's management team actively explored other potential acquisition targets in the Midland Basin. On June 25, 2015, Earthstone met with Wells Fargo Securities LLC ("Wells") to discuss potential targets. (*Id.*) At Lodzinski's direction, Wells compiled a target list of entities or assets owned directly or indirectly by private equity firms. (*Id.*) One of the targets identified by Wells was Bold, an EnCap portfolio company formed in March 2013 that had an operated position in approximately 20,900 net acres in the Midland Basin as of December 2016. (*Id.*) Most of this net acreage was undeveloped. (A67-68; Compl. ¶ 67.) Bold had retained Tudor Pickering & Holt ("TPH") in mid-2015 to run a process to explore a potential sale of Bold's assets. (A290; A68; Compl. ¶ 68.) After being informed by Wells that TPH was seeking bids for Bold's assets, Lodzinski and Earthstone management reviewed an executive summary prepared by TPH to evaluate whether the opportunity made sense for Earthstone. (A290.) Ultimately, however, Earthstone elected not to make a bid at that time. (*Id.*)

In November 2015, after learning that a sale of Bold did not occur, Lodzinski initiated discussions with EnCap and raised the idea of possibly acquiring Bold or another EnCap portfolio company. (*Id.*; A68-69; Compl. ¶ 69.) On November 12, 2015, EnCap provided Earthstone with a presentation that TPH

had used to market Bold to potential buyers earlier in the year. (A290; A69-70; Compl. ¶ 72.) Earthstone also signed a confidentiality agreement with EnCap and then obtained additional information about Bold, including access to the TPH data room established during the earlier TPH process. (A290-92; A70; Compl. ¶ 73.) Earthstone management also met with a petroleum engineering firm, W.D. Von Gonten & Co., to discuss geological characteristics of the Midland Basin formations where Bold's acreage was located. (A292; A70; Compl. ¶ 74.) Earthstone also met separately with three investment banking firms in December 2015 and January 2016 to obtain their views regarding Bold's assets. (A292; A70; Compl. ¶ 74.) All three expressed the view that the Bold assets were an attractive opportunity. (A292; A71; Compl. ¶ 75.) None of these firms, nor W.D. Von Gonten & Co., received any compensation for their input regarding the potential transaction. (A292.)

In January 2016, following a downturn in oil prices and deterioration in the capital markets for that industry, Earthstone's management team met with EnCap and decided that discussions with Bold should be postponed. (*Id.*; A71; Compl. ¶ 76.)

In late April 2016, Earthstone re-engaged with EnCap to discuss updated thoughts on the value of Bold in light of recent improvement in energy prices and a recent uptick in Permian Basin acquisition activity. (A292; A72-73; Compl. ¶ 79.)

Lodzinski provided a status report letter to Earthstone's Board on April 27 that updated the directors on several initiatives and potential transactions, including Bold, with the notation "updating analysis and intend to make offer."[7] EnCap indicated on May 2 that it would begin to build an independent valuation model of Earthstone and Bold for its internal use in evaluating a possible combination. (A292.) On May 11, Earthstone's management team provided EnCap with a presentation indicating an equity valuation of Bold of approximately $305 million in shares of Earthstone common stock and illustrations showing the pro forma impact on Earthstone of a potential combination. (A292; A76; Compl. ¶ 86.) After further internal evaluation, Earthstone provided updated materials to EnCap indicating a $335 million equity valuation, which included additional acreage recently acquired by Bold that was not included in Earthstone's earlier $305 million valuation. (A292; A77; Compl. ¶ 88.)

In June 2016, separate and apart from the potential Bold transaction, Earthstone conducted a registered stock offering that raised net proceeds of $47.1 million. (A664.) The offering reduced Oak Valley's ownership interest in

[7] A734-741; *see also* A292; A72-73; Compl. ¶ 79 (discussing status report letter and May 2 Board meeting). Plaintiff repeatedly complains that Lodzinski had supposedly kept the Earthstone Board "in the dark" about a possible Bold transaction since November (*e.g.*, A72-73; Compl. ¶ 79), but it is undisputed that the potential discussions were on hold for three of those six months due to the energy industry downturn. In addition, the only specific earlier development that the Proxy states was not disclosed to the Board was the November 19, 2015 confidentiality agreement between Earthstone and EnCap. (A290.)

Earthstone from approximately 52% to approximately 41.1%. (A59-60; Compl. ¶¶ 51, 53.) Plaintiff does not and cannot allege that Earthstone and Bold exchanged offers or counteroffers, entered into any agreements (except for a confidentiality agreement), or agreed upon *any* terms of a potential transaction (including structure, conditions precedent, etc.) prior to Oak Valley's ownership interest falling below 50% in June 2016. Indeed, as Plaintiff admits, the discussions prior to that point were sufficiently tentative that only a brief update ("updating analysis and intend to make offer") by management to the Board was needed. (A73; Compl. ¶ 80.) In other words, the preliminary discussions about a potential deal—which had already been put on hold once—had not yet graduated to the point at which the formation of a special committee and the start of negotiations was warranted.

C. Formation of the Special Committee

Following a series of additional communications among Earthstone, EnCap, and TPH during June and early July 2016, which involved discussions concerning Bold's assets, operations, and development plans and timelines for a potential combination, Earthstone held an internal conference call to discuss the formation of a special committee consisting of defendants Joliat and Urban. (A293; A78-82 Compl. ¶¶ 90–99.) At the time the Special Committee was formed, no offers or counteroffers had been exchanged between Earthstone and Bold with respect to a

possible combination. (A293.) The Special Committee retained Richards, Layton & Finger, P.A. ("RLF") as its legal counsel after interviewing two other firms and engaged Stephens, Inc. ("Stephens") as its financial advisor after considering five other investment banking firms. (A293-94; A82, A87-88; Compl ¶¶ 99, 110.) On July 29, the Earthstone Board adopted a resolution authorizing the Special Committee and giving it the full authority to determine whether an offer should be made (and, if so, the terms and conditions of such offer), negotiate any potential transaction, hire its own advisors and counsel, and terminate negotiations. (A293-94; A83; Compl. ¶ 101.) No offers were made before the committee was formed.

D. The Offers and Counteroffers

Over the next three weeks, the Special Committee and its advisors conducted extensive diligence and investigation on whether to make an offer for Bold. (A294-95.) On August 19, the Special Committee authorized Lodzinski to make an offer that would combine the two companies in an all-stock transaction valuing Bold at $325 million, with the number of Earthstone shares to be issued calculated by dividing $325 million less an assumed $25 million of net financial obligations by the greater of (i) Earthstone's weighted average stock price over a 20-day period, or (ii) $10.50 per share. (A295; A91; Compl. ¶ 118.) This offer would result in former unitholders of Bold owning approximately 55% of the combined company on a fully diluted basis. (A295.) With the Special

Committee's authorization, Lodzinski presented this offer to Bold on August 19, 2016. (A91; Compl. ¶ 118.) The offer—the first made by or exchanged between the parties—was explicitly conditioned on Special Committee approval and majority-of-the-minority approval of the potential transaction. (A748.) On August 31, Bold responded with a counteroffer that would provide former unitholders of Bold with 62.5% of the combined company on a fully diluted basis. (A295; A292-93; Compl. ¶¶ 120–21.) The counteroffer included additional acreage that Bold was negotiating to acquire, which would be contributed to the combined company. (A295-96.)

On September 6, 2016, following additional discussion with Stephens and RLF, the Special Committee authorized Lodzinski to prepare a counteroffer that "would issue approximately 60% of Earthstone's common stock on a pro forma basis in exchange for Bold." (A296; A93; Compl. ¶ 121.) Lodzinski then presented the counteroffer to Bold on September 8. (A296.) The minutes of the September 6 Special Committee meeting indicate that Stephens advised that "the Company should try to end up at approximately 40%" and that "[t]he members of the Committee . . . advised that they would like the ownership split to be 40% or more for the Company." (A751; A93; Compl. ¶ 121.) On September 9, however, Bold reiterated that it wanted 62.5% of the combined company, thereby rejecting Earthstone's 60% offer. (A296; A94; Compl. ¶ 123.)

On September 12, Lodzinski advised Bold's president that, subject to Special Committee approval, Earthstone might be able to increase its proposal slightly from 34.593 million shares of Earthstone common stock to 35.5 million shares due to rapid appreciation in the value of Permian Basin assets as reflected by comparative transactions. (A296; A94; Compl. ¶ 123.) Lodzinski then stated that he would refer the substance of the discussion to the Special Committee and seek its further direction regarding same. (A296.)

On September 13, a Stephens representative advised the Special Committee that Stephens was presently comfortable from a fairness analysis perspective with an ownership percentage of "approximately 40%." (A753; A95-96; Compl. ¶ 125.) The Special Committee advised Lodzinski that they would "like to keep the Company's ownership percentage at approximately 40%." (A96; Compl. ¶ 125.)

On September 19, after there was no further movement, Lodzinski obtained approval from the Special Committee to increase Earthstone's offer to 36 million shares, which would give Bold's former unitholders 61% of the combined company. (A296; A96; Compl. ¶ 127.) The Special Committee also authorized Lodzinski to offer another 500,000 shares if necessary, which would increase Bold's stake to 61.3%. (A296-97.)

E. Final Deal Terms

Following extensive negotiations, the parties reached an agreement by which Earthstone would issue 36,070,828 shares of Class B Common Stock to Bold Holdings and 150,000 shares of Class A Common Stock to Bold management, which resulted in an ownership split of 61.1% for Bold and 38.9% for Earthstone. (A296-99, A301; A99; Compl. ¶ 131.) Earthstone thus achieved a more favorable split for its stockholders than what the Special Committee had authorized on September 23.

F. Favorable Market Reaction

The market reaction to the transaction was highly favorable. On November 8, 2016, the day the transaction was announced, Earthstone's stock rose 28.8%. (B3.) The vote in favor of the combination was overwhelming: the holders of more than 99% of non-affiliated stock who voted at the meeting, and more than 70% of the holders of all non-affiliated stock, voted to approve the transaction. (B88 (showing 8,936,936 non-affiliated shares voting in favor of the transaction, with only 18,619 voting against and 4,731 abstentions).)

G. Plaintiff's Section 220 Demand

On January 16, 2017, Plaintiff's counsel served their Section 220 demand letter. (A823.) Earthstone completed its production of documents in response to the Section 220 demand on February 10, 2017. (B80.) Plaintiff thereafter made no follow-up requests and engaged in no further communications with Earthstone

before filing suit in June. Plaintiff also raised no objections to the April 7, 2017 Proxy and simply allowed the transaction to close on May 9 without voicing any further concerns, let alone seeking an injunction.

H. Defendants' Motions to Dismiss and Plaintiff's Amended Complaint

Plaintiff filed the Complaint (which amended his prior complaint after Defendants moved to dismiss the prior version) on October 13, 2017. After full briefing and oral argument, Vice Chancellor Slights granted Defendants' motions to dismiss, holding that the *MFW* conditions were satisfied and that the allegations failed to take the Bold transaction outside the business judgment rule. (Op. at 41.)

ARGUMENT

I. The Court of Chancery Correctly Dismissed This Case Under *MFW*

A. Question Presented

Whether the court below correctly applied the business judgment rule to the Earthstone-Bold transaction on the grounds that the parties' negotiations were conditioned on the formation of a special committee and approval by a majority of Earthstone's unaffiliated stockholders.

B. Scope of Review

The application of legal principles in ruling on a motion to dismiss is subject to *de novo* review. *See Mar-Land Indus. Contractors, Inc. v. Caribbean Petroleum Refining, L.P.*, 777 A.2d 774, 777 (Del. 2001).

C. Merits of Argument

The trial court concluded that the August 19 Offer included both of the *MFW* conditions and that the parties' negotiations were conditioned on the *MFW* requirements from the inception. While recognizing that the parties engaged in on-again, off-again discussions about a potential transaction during the year before the August 19 Offer, the trial court held that these discussions did not rise to the level of "negotiations." (Op. at 46.) This Court subsequently endorsed a similar approach to the *MFW* factors in *Synutra*, which similarly distinguished between preliminary discussions and the characteristic "economic horse trading" that occurs after an offer has been made. 2018 WL 4869248, at *1.

Plaintiff asserts that the pre-August discussions should be construed as "negotiations" because the parties had meetings and shared valuation-related information. (OB at 24-48.) What is missing, however, is any allegation that the parties engaged in "economic horse trading" before the August 19 Offer. As in *Synutra*, the trial court left open the possibility that a future lawsuit could survive dismissal if the record supported an inference that the parties "negotiate[d] the material terms of a transaction before submitting a formal offer, and then claim[ed] *ab initio* status by sweeping those terms, along with the *MFW* conditions, into its first (and final) formal proposal. . . ." (Op. at 44 n.199.) The trial court, however, explained in meticulous detail why the allegations here fall well short of the mark.

1. The August 19 Offer Was the "Outset" of Negotiations

Although the Complaint alleges there were discussions, presentations, exchanges of information, conversations, valuations/pitches, and planning prior to the August 19 Offer (A68-71, A73, A76-79; Compl. ¶¶ 69, 72, 74, 81, 86, 88-92), it does not allege any prior offers or negotiations. There is no allegation that either side changed its position on any material issue in connection with any of these preliminary communications. *See Synutra*, 2018 WL 4869248, at *3 (focusing on start of "economic negotiations" or "price negotiations"). By contrast, the August 19 Offer "was followed by more than two months of negotiations between the Special Committee and Bold that included several attacks, parries and remises

before a final deal was struck." (Op. at 46.) Plaintiff concedes that "[b]y November 7, 2016" – long after the August 19 Offer – "Earthstone and Bold had reached agreement on a structure for the proposed transaction." (A99; Compl. ¶ 131.) Thus, as Plaintiff appears to recognize, there was not even an agreement on a potential structure for the proposed transaction, let alone on the price, until long after the *MFW* die was cast. The allegations simply do not support a reasonable inference that the parties negotiated material deal terms before the August 19 Offer and instead support precisely the opposite: that the terms were negotiated ***after*** the August 19 Offer.

The trial court's opinion was a straightforward application of Delaware law and foreshadowed this Court's approach in *Synutra*. Delaware courts have consistently held that dismissal is proper when the *MFW* conditions are contained in the first offer. *See MFW*, 88 A.3d at 640 (*MFW* requirements were satisfied where first letter proposal sent included the conditions); *see also In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, 2017 WL 3568089, at *18 (Del. Ch. Aug. 18, 2017) (explaining that where the controller is on both sides, the MFW conditions can be included in the initial offer); *In re Books-A-Million, Inc. S'holders Litig.*, 2016 WL 5874974, at *8 (Del Ch. Oct. 10, 2016) (*MFW* requirements were satisfied where proposal contained the conditions when first offer had been terminated); *In re EZcorp, Inc. Consulting Agreement Deriv. Litig.*,

2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016). Not only were the *MFW* conditions expressly enumerated in the opening offer, but the Special Committee was already formed before the August 19 Offer and made that offer itself and made or directed all subsequent proposals on behalf of Earthstone.

Synutra made clear that reality should trump formalism in assessing whether the *MFW* conditions were imposed early enough. *See Synutra*, 2018 WL 4869248, at *6 (rejecting "cramped" reading of *ab initio* requirement); *id.* at *7 (emphasizing the "essential element of *MFW*" is that *MFW* conditions "cannot be dangled in front of the Special Committee, when negotiations to obtain a better price from the controller have commenced, as a substitution for a bare-knuckled contest over price"). This Court observed that this approach "may give rise to close cases," but stressed that "the Court of Chancery can be trusted to apply appropriate pleading stage principles" to resolve cases involving different factual permutations. *Id.* at *8.

Nothing in the record even hints that the *MFW* conditions were "dangled in front of the Special Committee" to extract concessions on price or on any other material (or, indeed, immaterial) issue. The Special Committee made the first offer and controlled the months of negotiations that followed. While Plaintiff complains that the MFW conditions were not listed in the Proxy's description of the August 19 Offer (OB at 7, 30), this does not support Plaintiff's proposed inference given

that the August 19 Offer speaks for itself and plainly contains the *MFW* conditions.

2. Plaintiff Pleads No Facts Showing That EnCap Contested the *MFW* Conditions.

The fact that the August 19 Offer came from the Special Committee rather than EnCap does not strengthen Plaintiff's case. Indeed, it weakens it, given that the Special Committee was already calling the shots when the August 19 Offer was made. As *Synutra* made clear, it is Plaintiff who must plead "facts supporting a reasonable inference that [the controller] did not condition the merger on *MFW*'s dual procedural protections before any economic negotiations took place." 2018 WL 4869248, at *8. Plaintiff does not plead that the August 19 Offer lacks the *MFW* conditions or that EnCap refused to abide by them (or even hinted that it would not follow them). None of the various counter-proposals and communications from Bold are alleged to contain any pushback whatsoever against the Special Committee's insistence in the August 19 Offer that the *MFW* conditions apply. It is also undisputed that both *MFW* conditions were included in the final deal terms.

3. The August 19 Offer Was Fair Game on a Motion to Dismiss.

The trial court properly considered the August 19 Offer in deciding the motions to dismiss because Plaintiff explicitly references and relies upon it in the Complaint. (A91-92; Compl.¶ 118 ("On August 19, 2016, the Special Committee

authorized Lodzinski to send an offer letter to Bold. Lodzinski proceeded to submit an offer letter to Bold proposing a transaction whereby Earthstone would combine with Bold in an all-stock transaction valuing Bold at $325 million . . . .").) Plaintiff cannot partially summarize the August 19 Offer's contents in the Complaint, but protest the trial court's consideration of the *MFW* conditions contained in that same document. (*See* Op. at 44 n.200; *Winshall*, 76 A.3d at 818 ("[A] plaintiff may not reference certain documents outside the complaint and at the same time prevent the court from considering those documents' actual terms.") (internal citation and quotations omitted).) The paragraph discussing the August 19 Offer does not reference the Proxy; it references only the letter. (Op. at 44 n.200; A91-92; Compl. ¶ 118.)

Plaintiff is wrong in claiming that the trial court could not consider the August 19 Offer because it was not produced in response to his Section 220 demand. The record submitted by Plaintiff on this appeal does not show that the August 19 Offer fell within the scope of Plaintiff's Section 220 demand.[8] Plaintiff

[8] After sending the Section 220 request, Plaintiff's counsel made a "compromise proposal" on January 30, 2017 for Earthstone to "produce board and board committee (including the Special Committee) minutes, presentations (*e.g.*, banker books and any other distributed materials), and resolutions regarding the Bold transaction." (B75.) Plaintiff's compromise request thus did not include offer letters, nor did Plaintiff ever make a follow-up request for the offer letters in the months that elapsed after Earthstone's production even though the letters were described in the Proxy (which makes Plaintiff's assertion that Earthstone strategically "withheld" the letters (OB at 19, 30) to avoid follow-up requests even

has possessed the August 19 Offer since August 11, 2017, two months before Plaintiff filed the operative Complaint on October 13, 2017. Regardless, as Vice Chancellor Slights correctly concluded, there is no rule of law that prohibits the trial court from considering documents referenced in the pleadings just because such documents are not produced in response to a Section 220 request. (Op. at 44 n.200 (citing cases).) Although Plaintiff cites *In re Tyson Foods, Inc.* (OB at 33), that opinion does not address the admissibility of documents on a motion to dismiss or hold that documents otherwise properly considered on a motion to dismiss should be excluded unless produced in response to a Section 220 demand. 919 A.2d 563, 577-78 (Del. Ch. 2007).

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more implausible). *See IRA Trust FBO Bobbie Ahmed v. Crane*, 2017 WL 7053964, at *21 n.161 (Del. Ch. Dec. 11, 2017).

II. The Special Committee Members Were Sufficiently Independent and Did Not Act with Gross Negligence

A. Question Presented

Whether the trial court correctly concluded that the Complaint lacked sufficient allegations demonstrating that the Special Committee failed to act with the requisite degree of care.

B. Scope of Review

The application of legal principles in ruling on a motion to dismiss is subject to *de novo* review. *See Mar-Land Indus.*, 777 A.2d at 777.

C. Merits of Argument

The trial court also correctly dispatched Plaintiff's arguments regarding the Special Committee's conduct. Plaintiff alleges nothing approaching the "gross negligence" required to impeach director behavior in a suit where the *MFW* conditions were successfully imposed from the beginning. *See Synutra*, 2018 WL 4869248, at *10-11. As detailed in the trial court's opinion, the Special Committee conducted numerous meetings, engaged appropriate outside advisors, made multiple counter-proposals over several months and arrived at a deal that the market celebrated with an immediate stock price surge. (*See* Op. at 52-59.)

Plaintiff's argument that the Special Committee breached its duty of care by allowing Lodzinski to participate in the negotiations is equally meritless. As the trial court correctly concluded, the fact that Lodzinski participated in the

discussions "can hardly be reviewed as remarkable" given his "proven track record and expertise in the oil and gas industry." (Op. at 57.) Delaware courts have reached similar conclusions in past cases. *See, e.g., In re Alloy, Inc.*, 2011 WL 4863716 at *11 (Del. Ch. Oct. 13, 2011) (rejecting a challenge to the independence of a special committee because "one would expect a thorough evaluation of [the company] to involve those two insiders because … they had the best knowledge and experience regarding the Company and its business and strategy"); *In re NYMEX S'holder Litig.*, 2009 WL 3206051, at *7 (Del. Ch. Sept. 30, 2009) ("It is well within the business judgment of the Board [or Special Committee] to determine how merger negotiations will be conducted, and to delegate the task of negotiating to the Chairman and the Chief Executive Officer."); *see also Hamilton Partners, L.P. v. Highland Capital Management, L.P.*, 2014 WL 1813340, at *3, *16–17 (Del. Ch. May 7, 2014) (rejecting similar challenge where complaint did not adequately allege that CEO "dominated or controlled the Special Committee").

Plaintiff's complaint about Lodzinski's involvement separately fails because the allegations do not show that EnCap controlled him. As set forth on pages 39-40 *infra*, Lodzinski drew no salary or other compensation from his service on Oak Valley's Board, and there are no allegations showing that he was beholden to or controlled by EnCap. The trial court correctly concluded that allowing Lodzinski to participate in the negotiations was a valid exercise of business judgment.

Plaintiff appears to have abandoned his other arguments about the committee members' purported lack of independence that were asserted below. This is unsurprising because those arguments were meritless. As in the trial court, Plaintiff "does not meaningfully argue" on appeal that the Special Committee was not fully empowered to select its own advisors or to reject a proposed transaction. (Op. at 51.) Plaintiff asserted below that Urban and Joliat lacked independence because they were appointed to the Earthstone Board by EnCap, but it is clear under Delaware law that "a director's nomination or election [to the board] by an interested party" is not enough in itself to rebut independence. Op. at 48-49; *In re EZcorp*, 2016 WL 301245, at *40.

The fact that Urban and Joliat held noncontrolling minority interests in Oak Valley – another argument asserted below but apparently abandoned on appeal – is similarly unavailing, as Oak Valley's only asset was Earthstone stock. Owning a minority interest in Oak Valley is thus not materially different from holding a minority equity interest in Earthstone, and in any event, there are no assertions showing how these Oak Valley interests were material to Urban and Joliat or how these directors have any material financial ties to EnCap. *See* Op. at 49-50; *MFW*, 88 A.3d at 650 (mere financial ties between directors and interested party not disqualifying absent additional facts showing how directors' impartiality is curtailed or how alleged ties are material to the directors).

That Urban was CEO of an entity that previously invested with other Lodzinski-led companies – another argument raised in the trial court but apparently abandoned here – likewise does nothing to impeach Urban's independence. Prior business and social relationships are not disqualifying under settled Delaware law. *See Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1051 (Del. 2004); *MFW*, 88 A.3d at 649. There are no allegations showing how any of the committee members are beholden to EnCap. (*See* Op. at 51.)

In sum, Plaintiff offers no basis for disturbing the trial court's well-founded conclusions regarding the Special Committee's conduct and independence.

III. The Trial Court Correctly Rejected Plaintiff's Disclosure Claims

A. Question Presented

Whether the trial court correctly concluded that the overwhelming vote by Earthstone's unaffiliated stockholders in favor of the Bold transaction was fully informed and free of material omissions.

B. Scope of Review

The application of legal principles in ruling on a motion to dismiss is subject to *de novo* review. *See Mar-Land Indus.*, 777 A.2d at 777.

C. Merits of Argument

Plaintiff claims Vice Chancellor Slights erred in holding that the Proxy did not omit material information. In Plaintiff's view, the Proxy was required to disclose that: (i) Stephens' initial contribution analysis supposedly did not support the Transaction and that Stephens was allegedly directed to revise the analysis in a way that would "provide less meaningful results"; and (ii) EnCap was motivated to effectuate the transaction because it did not want to provide more liquidity for Bold and wanted to take advantage of Earthstone's favorable cash situation. (OB at 8, 18, 40.)

These arguments are groundless. As Plaintiff conceded below, the legacy Earthstone entity was a "mature oil and gas company with strong cash flows" from producing wells, whereas Bold's assets consisted primarily of undeveloped acreage with a limited number of producing wells. (A41, A104; Compl. ¶¶ 3, 140.) It is

thus self-evident that a revenue contribution analysis based on the first few years of revenue contributed by each party to the combined entity would disproportionately favor legacy Earthstone, given that Earthstone was receiving revenue from its mature producing properties while most of Bold's properties were not yet producing. Moreover, the only difference between the final contribution analysis disclosed on page 66 of the Proxy and the earlier one (which Plaintiff apparently says should also have been disclosed) is that the final version includes projections for 2019 in addition to the projections for 2017-18 (which are listed year-by-year in the Proxy). (A311.) Investors can thus see that the contribution analysis favors Earthstone in the early years and Bold in the later year, just as one would expect. An investor who believed the 2017 and 2018 comparisons were more meaningful than the 2019 comparison could give more emphasis to the early-year analysis. There is no allegation that any numbers in the disclosed version of the contribution analysis (or, for that matter, anywhere in the Proxy) were doctored or manipulated in any way that would make them materially inaccurate. The Proxy also disclosed the fact that Stephens "did not regard the relative contribution metrics as meaningful" given the "difference in development stages" between the two companies. (A311.)

The trial court thus correctly rejected Plaintiff's allegations about the contribution analysis. (Op. at 61-64.) The Complaint is bereft of any allegation

showing how the Proxy omitted anything about the contribution analysis that would significantly alter the total mix of information available from the Proxy. This case bears no resemblance to *In re Orchard Enters., Inc. S'holder Litig.* (OB at 43), as there is no allegation that the financial advisor did anything other than to include 2019 projections in a contribution analysis that provided line-item information for each year and which was described in the Proxy as not providing a meaningful comparison given the differing development stages. 88 A.3d 1, 21 (Del. Ch. 2014).

Plaintiff's arguments about Bold's supposed hunger for cash (OB at 1, 10-11, 46-49) are likewise unavailing. The Proxy undisputedly disclosed the respective cash positions and revenues of each company. (*See* A262-63, A358.) Disclosure allegations cannot be based on "opinions or possibilities, legal theories or plaintiff's characterization of the facts." *Seibert v. Harper & Ros, Publishers, Inc.*, 1984 WL 21874, at *6 (Del. Ch. Dec. 5, 1984) (declining to find a disclosure violation based on plaintiff's allegation that a company's stock buy-back plan "served no proper purpose"); *see also Brody v. Zaucha*, 697 A.2d 749, 754 (Del. 1997) (holding that a director had "no duty...to adopt his opponents' current explanation of why he was removed"). To the extent EnCap preferred to combine Bold with a mature cash-flowing entity (or to sell Bold as it tried to do in 2015) rather than to continue funding Bold's development costs out of pocket, such a

motive is obvious from the disclosures. (After all, if EnCap preferred to keep funding Bold as a stand-alone entity, it presumably would not be interested in a combination.) Plaintiff offers not even the thinnest of gruel for its disclosure claims.

Plaintiff's citations (OB at 46-47) are inapposite. In *Sherwood*, the court temporarily enjoined a stockholder vote so that the plaintiff director who had been recently removed from the defendant company's director slate could conduct a proxy contest. *Sherwood v. Ngon*, 2011 WL 6355209, at *15 (Del. Ch. Dec. 20, 2011). Moreover, in *Eisenberg*, the court determined a company's offering materials for its self-tender offer were inadequate after the company "conceded" at oral argument that the stated reason for the offer in the materials was inaccurate. *Eisenberg v. Chicago Milwaukee Corp.*, 537 A.2d 1051, 1059 (Del. Ch. 1987).

The trial court thus correctly rejected Plaintiff's disclosure claims. (Op. at 60-63, 66-67.)

IV. The Dismissal Should Be Affirmed on the Alternate Grounds Not Reached by the Trial Court

A. Question Presented

Whether the dismissal can be affirmed on the alternate grounds that EnCap did not control Earthstone, that the directors are protected from liability under the exculpatory provisions and that the Complaint does not adequately allege unfairness. (*See* B96, B124-136 (presentation of no-control argument below), B136-142 (presentation of no-non-exculpated claim argument below), B146-152 (presentation of no-unfairness argument below).)

B. Scope of Review

This Court may affirm a judgment based "on any issue that was fairly presented to the Court of Chancery, even if that issue was not addressed by that court," and, accordingly, "may affirm the judgment of the Court of Chancery on the basis of a different rationale." *Cent. Laborers Pension Fund v. News Corp.*, 45 A.3d 139, 141 (Del. 2012); *see also* Del. Supr. Ct. R. 8.

C. Merits of Argument

Because it dismissed under *MFW*, the trial court did not reach the other grounds for dismissal that Defendants asserted below. These grounds included the absence of factual allegations establishing that EnCap controlled Earthstone or Lodzinski, the absence of factual allegations supporting a non-exculpated claim against Lodzinski or Singleton and the absence of factual allegations showing

substantive unfairness in the transaction.

1. EnCap Did Not Control Earthstone

The Court could affirm without reaching the *MFW* conditions because EnCap did not control Earthstone and thus did not stand on both sides of the transaction, thereby eliminating any basis for applying entire fairness review. A stockholder is deemed to be a controller when it (1) owns more than 50% of a corporation's voting power, or (2) "exercises control over the business affairs of the corporation." *In re Crimson Exploration Inc. S'holder Litig.*, 2014 WL 5449419, at *10 (Del. Ch. Oct. 24, 2014) (citation omitted).

The first test is not met because EnCap undisputedly held a minority interest at the time of the August 19 Offer. Although EnCap did hold a majority stake during some of the pre-August 19 discussions, EnCap's indirect interest was diluted to 41.1% through an equity raise that occurred before the August 19 Offer, and there is no case law that would support finding EnCap to be a controller based solely on its prior ownership level. *See In re PNB Holding Co. S'holder Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006); *see also In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 664 (Del. Ch. 2013) (rejecting argument that a minority stockholder was a "dominating controller...because [it] had previously owned the entire company"); *Odyssey Partners, L.P. v. Fleming Cos., Inc.*, 735 A.2d 386, 408 (Del. Ch. 1999) ("The fact that [a director] was a former . .

. officer and [board] designee [of a majority stockholder] is not, alone, a sufficient basis for a finding that he was controlled by [the majority stockholder]"); *In re CompuCom Sys., Inc. S'holders Litig.*, 2005 WL 2481325, at *8 (Del. Ch. Sept. 29, 2005) (finding fact that directors "served as directors and executives in companies in which Safeguard *formerly* held an equity interest" insufficient to disqualify them from Special Committee) (emphasis in original).

The bright-line "majority rule" test appropriately focuses on whether EnCap controls the company at the time of the negotiations, such that the management team would have to answer to a controlling stockholder if a deal is not consummated. Because there is no "more than 50%" stockholder waiting at the end of the tunnel if a deal is not consummated, there is no basis for treating EnCap as a controller under the bright-line test, and doing so would only foster needless uncertainty in the law. *See generally In re Walt Disney Co.*, 2004 WL 2050138, at *4 (Del. Ch. Sept. 10, 2004) (following "bright-line rule whereby officers and directors become fiduciaries only when they are officially installed," because a contrary result would "lead to significant uncertainty").

The second test is not met because there are no allegations that EnCap directed Earthstone's management to pursue the transaction. Courts are reluctant to find actual control absent facts showing that the purported controller "actually control[led] the board's decisions about the challenged transaction." *In re*

Crimson, 2014 WL 5449419, at *12; *see, e.g.*, *In re PNB*, 2006 WL 2403999, at *9 (emphasizing the exceedingly high bar to establish "actual control" absent majority ownership, and noting that even stockholders "with very potent clout have been deemed . . . to fall short of the mark"); *In re Sea Land Corp. S'holders Litig.*, 1987 WL 11283, at *4–5 (Del. Ch. May 22, 1987) (reasoning that "the *potential* ability to exercise control is not equivalent to the actual *exercise* of that ability").

There are no allegations showing that Earthstone's three EnCap-affiliated directors (Swanson, Thielemann, and Zorich)—who constituted a minority of Earthstone's Board—exercised control over Lodzinski or Singleton, let alone took any steps to pressure Earthstone management to pursue a transaction with Bold. *Compare In re Sea Land*, 1987 WL 11283, at *5 (declining to find control where there was "no allegation [that the alleged controller] actually took any steps to exert leverage to pressure [the company] to accede to a transaction"), *with Kahn v. Lynch Commc'n Sys.*, 638 A.2d 1112, 1114 (Del. 1994) (finding control where 43.3% stockholder told management that "'[y]ou have to do what we tell you'").

There is likewise no allegation that Lodzinski's or Singleton's[9] job security or compensation was affected based on their willingness to transact with Bold. *See*

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[9] Singleton was an officer and director of Earthstone prior to its combination with Oak Valley in 2014. (A50-51; Compl. ¶ 27.) Plaintiff's conclusory allegation (A124; Compl ¶ 184) that Singleton is somehow "beholden" to EnCap is thus even more tenuous.

Wayne Cty. Emps.' Ret. Sys. v. Corti, 2009 WL 2219260, at *11 (Del. Ch. July 24, 2009), *aff'd*, 996 A.2d 795 (Del. 2010) (rejecting interestedness claim where threats to individual defendant's employment were not pled). Nor is there any allegation that Lodzinski received ***any*** compensation from Oak Valley when he was an officer of Earthstone (he did not), let alone an allegation showing that he was beholden to Earthstone merely by virtue of his unpaid Oak Valley Board service in the years after the Earthstone-Oak Valley combination.[10] All Oak Valley did was hold shares in Earthstone. There is no allegation that Oak Valley exercised any control over the management or operations of Earthstone.

The fact that Lodzinski owned a minority equity interest in Oak Valley similarly fails to show interestedness or control. *See Zimmerman ex rel. Priceline.com, Inc. v. Braddock*, 2002 WL 31926608, at *9 (Del. Ch. Dec. 20, 2002) ("Moreover, a director's holdings in a given company do not *ipso facto* cast into doubt that director's ability to act independently of an allegedly dominating director and/or shareholder of that company. If anything, '[t]he only reasonable inference that . . . can [be] draw[n] . . . is that [the stockholder-director in question] is an economically rational individual whose priority is to protect the value of his . . . shares'") (quoting *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d

[10] Indeed, Lodzinski is not alleged to have received any salary or other compensation for his service at Oak Valley following Oak Valley's 2014 merger with Earthstone (and indeed received no such salary or compensation from Oak Valley).

342, 356-57 (Del. Ch. 1998), *rev'd on other grounds sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)). Because Oak Valley simply held stock in Earthstone, Lodzinski's ownership in Oak Valley represented an indirect interest in Earthstone and Lodzinski's interests were thus fully aligned with Earthstone's stockholders.

Plaintiff's conclusory claim that Lodzinski is dependent on EnCap for future financing (A123; Compl. ¶ 183) likewise fails to show that Lodzinski or Singleton was beholden to EnCap. *See Zimmerman ex rel. Priceline.com, Inc. v. Braddock*, 2002 WL 31926608, at *7–8 (Del. Ch. Dec. 20, 2002).

Plaintiff has thus alleged no facts showing that EnCap was a controller or that Lodzinski or Singleton were beholden to EnCap. As set forth above, Plaintiff has not pled a viable omissions claim and does not dispute that the transaction received majority approval. The Court can thus affirm the dismissal without reaching whether *MFW*'s *ab initio* requirement was met (though it plainly was). *See Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 312–14 (Del. 2015) ("[W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves.").

2. Plaintiff Did Not Plead a Non-Exculpated Claim Against Lodzinski or Singleton

The Court can also affirm dismissal of the claims against Lodzinski and Singleton because no valid non-exculpated claim was pled. Because Earthstone's Certificate of Incorporation contains a valid exculpation provision under 8 *Del. C.* § 102(b)(7), Plaintiff must plead allegations showing disloyalty or bad faith. *In re Cornerstone Therapeutics Inc. Stockholder Litig.*, 115 A.3d 1173, 1179–80 (Del. 2015). For the reasons set forth above, Lodzinski and Singleton had no disabling conflicts of interest, were not beholden to EnCap and did not act in bad faith.

3. The Allegations Do Not Show Substantive Unfairness

Even if the entire fairness standard applied (and it most assuredly does not), Plaintiff must still plead facts showing that the deal terms are substantively and materially unfair to survive dismissal. *E.g.*, *Capella Holdings, Inc. v. Anderson*, 2015 WL 4238080, at *5–6 (Del. Ch. July 8, 2015) ("Without well-pleaded allegations about the unfairness of the transaction, Anderson fails to plead his entire fairness case against the Director Defendants, as well as against Capella"; "Even when entire fairness scrutiny would otherwise seem to apply, a plaintiff must first 'make factual allegations in its complaint that, if proved, would establish that the challenged transactions are not entirely fair' to state a claim"); *Ravenswood Inv. Co. v. Winmill*, 2011 WL 2176478, at *4 (Del. Ch. May 31, 2011) (dismissing claims where defendants had the burden to prove entire fairness

but plaintiff "has not alleged facts suggesting unfairness"); *Monroe Cty. Emps.' Retire. Sys. v. Carlson*, 2010 WL 2376890, at *2 (Del. Ch. June 7, 2010) (dismissing claim where defendants had the burden to prove entire fairness but plaintiff failed to "make factual allegations about the transaction in the complaint that demonstrate the absence of fairness"); *see also Anderson v. GTCR LLC*, 2016 WL 5723657, at *6–7 (D. Del. Sept. 29, 2016) (dismissing claims for failing to allege unfair price).

Plaintiff has wholly failed to make "factual allegations in its complaint that, if proved, would establish that the challenged transaction[] [is] not entirely fair." *Monroe*, 2010 WL 2376890, at *2. Plaintiff's unfairness claim rests on the following bare allegations: (i) a statement by the Special Committee earlier in the negotiations that it "would like to keep the Company's ownership percentage at approximately 40%," which Plaintiff claims is materially higher than the 38.9% ownership that was ultimately achieved (A95-96, 115-16; Compl. ¶¶ 125, 162); (ii) the financial advisor's "contribution analysis"—which was only one of four valuation methodologies it used in preparing the fairness opinion, and *does* support fairness—should not have included projected EBITDA for 2019 (A113; Compl. ¶ 155-56); (iii) EnCap supposedly did not want to invest more money in Bold and purportedly viewed Earthstone as a cash "bailout" for Bold (A47, 67-68; Compl. ¶¶ 18, 65–68); (iv) the transaction did not adequately reflect the tax benefits for

EnCap (A48; Compl. ¶ 19); and (v) the Special Committee should have negotiated a "collar" or "walk-away" right that would allow Earthstone stockholders to obtain a higher percentage of the combined entity (or allow Earthstone to exit the transaction) if Earthstone's shares rose after the transaction was announced (A107; Compl. ¶ 144.)

None of these allegations supports an inference of unfairness. Of course, 38.9% is "approximately 40%," and a statement that an acquiring party "would like" to make a lower offer at an earlier period in the negotiations hardly shows that the price ultimately agreed upon was unfair. If such allegations were sufficient, a plaintiff could allege unfairness in every transaction where the acquiring company offers a lower purchase price during earlier rounds of negotiation—i.e., ***in virtually every case***. It is undisputed that the Special Committee fully endorsed the final deal terms. Earthstone's unaffiliated stockholders unsurprisingly reached the same conclusion by a 99%-1% margin among voted shares: that the transaction was fair and in their best interests.

For the reasons stated above, the contribution analysis likewise does not show unfairness. Again, this was a combination between a company with mature producing assets and a company with primarily undeveloped non-producing assets that would not contribute revenue in the short term. Plaintiff also does not

challenge the validity of the financial advisor's 2019 projections—or indeed ***any*** estimates and assumptions used with respect to Bold's undeveloped acreage.

Plaintiff's "bailout," "tax benefit," and "collar" allegations (A47, A67-68, A48, A107) are similarly conclusory and fail to show that the deal terms were unfair. There is no allegation suggesting that the companies' cash positions were not adequately considered in the financial adviser's analysis, which assumed that EnCap would put no additional funds into the entity. There is likewise no allegation showing how the merger consideration for Earthstone was rendered unfair because of the tax consequences other than conclusory assertions that Earthstone stockholders should have received a greater share of the combined company.[11] At most, the "cash" and "tax benefit" arguments speak to EnCap's motives to enter the transaction and do not establish that the actual deal terms are unfair. Merely alleging that one party receives a benefit does not show that the transaction is unfair to the other party. Plaintiff also alleges no facts showing why not including a collar[12] was unfair, a claim that cannot survive dismissal any more

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[11] Plaintiff does not and cannot identify any adverse tax consequences to Bold or EnCap that would have occurred if Bold did not combine with Earthstone.

[12] Plaintiff's "no collar" argument (A107; Compl. ¶ 107) shows the depths Plaintiff must scour to attempt to find any evidence of unfairness. It is, of course, a good thing for Earthstone's stockholders that the price of Earthstone stock rose when the deal was announced, which reflects the market's view that the transaction adds significant value for stockholders and hardly shows unfairness. The fact that Plaintiff attempts to turn this positive development into yet another meritless

than a conclusory allegation that the stockholders should have received a higher price or some other benefit (which can be alleged in any case).

In sum, the most remarkable feature of this case may well be the sheer weakness of the "unfairness" allegations. There is no allegation that the underlying oil and gas properties were worth more than what Earthstone thought or were otherwise incorrectly valued. Again, "[e]ven when entire fairness scrutiny would otherwise seem to apply, a plaintiff must first 'make factual allegations in its complaint that, if proved, would establish that the challenged transactions are not entirely fair' to state a claim." *Capella Holdings*, 2015 WL 4238080, at *5–6. Plaintiff's conclusory "unfairness" allegations scrape the bottom of the pleading barrel and are insufficient even if entire fairness governed this transaction.

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criticism (by claiming that the directors were obligated to "protect" Earthstone from this desirable outcome) (A107) confirms why this is an exemplar case for dismissal on the pleadings.

CONCLUSION

The Earthstone Defendants respectfully request that the Court affirm the trial court's judgment.

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