EFiled: Nov 19 2018 04:08PM EST
Filing ID 62682739
Case Number 392,2018

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

PublicVersion Dated November 19, 2018

APPELLANT'S REPLY BRIEF

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Dated: November 2, 2018

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PRELIMINARY STATEMENT

Defendants cannot rewrite the Complaint[1] or escape reasonable inferences in Plaintiff's favor at this stage. The Complaint, Proxy, and 220 Production collectively show that months before the Special Committee's formation, EnCap and Earthstone management were engaged in economic bargaining. The parties were "negotiating," exchanged at least one "offer," completed substantial due diligence, furnished indicative valuations, and agreed on an "action plan" to complete the Transaction all well before the *MFW* conditions were even purportedly proposed. EnCap thus failed to "embrace the procedural approach most favorable to minority investors," by not conditioning "the merger on *MFW*'s dual requirements in the beginning stages of the process that led to the merger." *Flood v. Synutra Int'l, Inc.*, 2018 WL 4869248, at *6 (Del. Oct. 9, 2018).

Defendants also cannot pretend that the Special Committee acted with due care or that Company stockholders were adequately informed. The Committee knew Lodzinski was substantively negotiating with EnCap, yet waited months before attempting to take an oversight role. Even then, the Committee ignored its advisors and continued deferring to Lodzinski. Later, the Board omitted from the

[1] Terms not otherwise defined herein have the same meanings as in Appellant's Opening Brief ("OB").

Proxy material facts memorialized in meeting minutes regarding Stephens's financial analysis and EnCap's motives for selling Bold.

Defendants' alternative grounds for affirmance also fail. EnCap used Earthstone to offload an asset that no other market participant would buy, and for a price no other market participant would pay. The Transaction was a substantively unfair merger engineered by Earthstone's controlling stockholder through an equally unfair process. EnCap held a majority of Earthstone's equity for a majority of the Transaction process, and the Company's public disclosures continued to describe EnCap as a "controlling stockholder" even after EnCap (barely and briefly) dipped below 50% ownership.

Under Delaware law, Defendants may not evade entire fairness review. This Court should reverse the trial court's decision below.

ARGUMENT

I. THE TRANSACTION DID NOT SATISFY *MFW*'S *AB INITIO* REQUIREMENT

A. *Synutra* Mandates Reversal

As this Court recently confirmed, *MFW* does not apply where the "plaintiff has pled facts that support a reasonable inference that the two procedural protections were not put in place early and before substantive economic negotiation took place." *Synutra*, 2018 WL 4869248, at *8. Here, the well-pled facts establish eight months of Transaction process, including economic bargaining, prior to when the *MFW* protections were purportedly implemented. During this period:

- Lodzinski informed the Board that he "***intend[ed] to make [an] offer***" to acquire the controller's company (A73);
- Lodzinski extended his "offer" to acquire Bold by ***proposing an equity valuation of Bold of approximately $305 million*** (A76-77);
- Earthstone increased its acquisition offer by ***revising its equity valuation of Bold to $335 million*** (*Id.*);
- Earthstone shared with the controller its "***corporate model of Earthstone and Bold as well as a model of Earthstone's net asset valuation***" (A77-78);
- Earthstone management met with the controller's company and its financial advisor to "***discuss[] Bold's assets***" and proposed "***a suggested action plan***" (A78);

- Earthstone management met at EnCap's offices to discuss "***the equity market's likely receptivity to a combination of Earthstone and Bold***" (A71, A79); and

- Earthstone management met with EnCap and its counsel at EnCap's offices to "***develop a preliminary timeline*** to complete a possible transaction, ***identify the participants and their counsel***, and ***assign responsibilities to complete the proposed transaction***" (A79-80, A86).

Plaintiff alleges that all of this occurred before the August 19 Letter, without any Board involvement or oversight, and before anyone at Earthstone, EnCap, or Bold had discussed forming a special committee or seeking minority stockholder approval.

Further, eighteen days before Defendants claim *MFW* protections were imposed, Lodzinski reported that he was "***negotiating***" with Bold, as the Special Committee had expressly permitted him to do. A87-88, A1050. On August 10, 2016, nine days before the August 19 Letter and while the Committee and its advisors were still "getting up to speed," Earthstone management presented the full Earthstone board with an "***assumed $333.0mm purchase price for Bold***," indicating that price negotiations had occurred. A88, A1082.

This is not one of the "close cases" envisioned in *Synutra*. 2018 WL 4869248, at *8. There, the controller engaged ***the board*** and agreed to *MFW* protections "at the germination stage of the Special Committee process, when it

[wa]s selecting its advisors, establishing its method of proceeding, beginning its due diligence" and before "substantive economic negotiations" had occurred. *Id*. at *7. Here, the controller engaged with conflicted ***management*—**not the board—and commenced "substantive economic negotiations" long before "the germination stage of the Special Committee process[.]" *Id*. The Committee did not select advisors—or even form, for that matter—before price negotiations began. Nor did the Committee take charge of due diligence, or even determine the Company's "method of proceeding." *Id*. Earthstone management did, led by conflicted Lodzinski.

Thus, no "ordinary person would conclude that [EnCap] had conditioned the merger on *MFW*'s dual requirements in the beginning stages of the process that led to the merger." *Id*. at *6. The trial court simply failed to "apply appropriate pleading stage principles and refuse to dismiss the case." *Id*. at *8.

B. Defendants Are Not Entitled to the Unreasonable Inference that No "Economic Bargaining" Occurred Before August 19

Defendants argue that nothing "suggests economic bargaining" occurred before the August 19 Letter, which Defendants characterize as the "first offer." EnCap and Oak Valley Appellees' Answering Brief ("EnCap Br.") 16. According to Defendants, even though EnCap and Earthstone communicated concerning

"valuations of Bold, corporate models, asset valuations, the asset and divestiture market, an action plan for a 'possible transaction,' and the equity market's receptivity to a transaction" before the Special Committee was even formed, those discussions purportedly "contained no offers or counteroffers." EnCap Br. 16-17. This is patently false, and Defendants' position rests on a series of unreasonable inferences to which Defendants are not entitled. *See Brehm v. Eisner*, 746 A.2d 244, 255 (Del. 2000) (only "Plaintiffs are entitled to all reasonable factual inferences").

Four months before the August 19 Letter, in April 2016, Lodzinski told the Board he "intend[ed] to make [an] offer" to acquire Bold. A73. Thus, for this Court to find that no "economic bargaining" occurred and "no offers or counteroffers" were made before August 19, the Court must infer that: (i) Lodzinski failed to follow through on his statement to the Board in April; (ii) Lodzinski instead waited nearly half-a-year "to make [an] offer"; (iii) the $305 million indicative valuation furnished to EnCap on May 11 was ***not*** the "offer" Lodzinski told the Board the "intend[ed] to make"; (iv) the materially higher, $335 million valuation proposal furnished on May 18 also was not an offer (or counteroffer); and (v) the May 18 valuation increased by $30 million not through any "economic bargaining," but

because Earthstone management independently determined to pay more. Each inference lacks credibility.

Apparently recognizing Earthstone's decision to increase its valuation in May 2016 as evidence of bargaining or negotiation, Defendants argue that Plaintiff "never alleges that EnCap or Bold rejected the $305 million 'valuation,' asked for a higher valuation, or proposed their own valuation," and ask the Court to conclude that EnCap merely "'indicated it would review Earthstone's valuations with [Bold's financial advisor].'" EnCap Br. 17 (quoting A77). In other words, Defendants seek the additional unreasonable inference that EnCap—which was anxious to sell Bold, did not want to continue funding Bold, and could not locate a buyer—never substantively responded to either of Earthstone's May 2016 valuation proposals, and instead sat idle until receiving the August 19 Letter. This is absurd, particularly given that EnCap and Earthstone management remained continually engaged throughout the rest of May, all of June and July, and up through the August 19 Letter. A77-91.

Incredibly, Defendants argue that all "***negotiations*** were conditioned on the formation of a Special Committee and approval by the holders of a majority of Earthstone's unaffiliated stock." *See, e.g.,* Earthstone Appellees' Answering Brief ("Earthstone Br.") 1 (emphasis added). Plaintiff expressly alleges "***negotiations***"

before August 19, when Defendants claim *MFW* conditions were put in place. *See, e.g.,* A60, A76, A80, A84-A85, A87. Those allegations came from the Company's own documents, including an ***August 1, 2016*** letter from Lodzinski reporting that he was "***negotiating***" with EnCap and Bold (A1050), and an August 10, 2016 board presentation prepared by management reflecting an "***assumed $333 million purchase price***" for Bold (A1082).

Defendants simply fail to overcome the reasonable, pleading-stage inference that EnCap and Earthstone engaged in economic bargaining prior to August 19.

C. Defendants Tacitly Admit That Nothing in the Record Establishes When EnCap Accepted the *MFW* Conditions

"[W]hat is critical for the application of the business judgment rule is that the ***controller accept*** that no transaction goes forward without special committee and disinterested stockholder approval[.]" *Synutra*, 2018 WL 4869248, at *1 (emphasis added). Defendants implicitly recognize that nothing in the record establishes when EnCap ***accepted*** the *MFW* conditions, and that the conditions were merely ***proposed*** by the Special Committee on August 19. Defendants argue that Plaintiff must plead that EnCap "contested" or "refused to abide" by the *MFW* conditions. Earthstone Br. 25. Wrong.

Plaintiff was required to plead facts sufficient "'to call into question'" EnCap's up-front acceptance of *MFW* protections. *Synutra*, 2018 WL 869248, at *8 (citation omitted). Plaintiff met that burden easily by accurately pleading that EnCap did not accept the August 19 proposal, and that the Proxy lacks any reference to the *MFW* conditions. A295.

Defendants note that the *MFW* conditions "were included in the final deal terms," but those terms merely reflect EnCap's ***eventual*** agreement to the conditions, not ***when*** that agreement occurred. Earthstone Br. 25. Defendants' argument that "none of the various counter-proposals and communications from Bold are alleged to contain any pushback" against the *MFW* conditions also fails. Earthstone Br. 25; EnCap Br. 20. Those "counter-proposals and communications" are not in the record—and Plaintiff does not have them—because Earthstone omitted them from its Section 220 Production and Defendants chose not to submit them to the trial court. Defendants' decisions to withhold those documents speak for themselves and actually strengthen the inference that EnCap did not immediately accept the proposed terms in the August 19 Letter. If those documents established EnCap's agreement, Defendants would have attached them to their motions to dismiss. Indeed, Defendants' justification for submitting the August 19 Letter was that the Complaint referenced it, yet the Complaint *also* references (to

the extent described in the Proxy) the "counter-proposals and communications" upon which Defendants now seek to rely. A91-A98. Thus, "it is more reasonable to infer that exculpatory documents would be provided than to believe the opposite: that such documents existed and yet were inexplicably withheld." *See In re Tyson Foods, Inc. S'holder Litig.*, 919 A.2d 563, 578 (Del. Ch. 2007).

Further, the Proxy's silence as to any up-front agreement speaks volumes. If Defendants "ha[d] described their adherence to the [*MFW* elements] 'in a public way suitable for judicial notice, such as board resolutions and a proxy statement,'" they could conceivably be entitled to a rebuttable inference that EnCap accepted the *MFW* conditions.[2] Simply put, if the *MFW* conditions were actually accepted, imposed and complied with *ab initio*, the Proxy would have said so.

Finally, Defendants' argument that Plaintiff failed to allege that the *MFW* conditions were "dangled" in exchange for a price concession is baseless. Earthstone. Br. 24-25. Plaintiff need not plead "dangling" of the *MFW* conditions, but rather that the conditions were not imposed *ab initio*, making it *possible* they could be used to secure Transaction approval "as a substitution for a bare-knuckled

[2] *In re Books-A-Million Inc. S'holder Litig.*, 2016 WL 5874974, at *8 (Del. Ch. Oct. 10, 2016) (quoting *Swomley v. Schlecht*, 2014 WL 4470947, at *20 (Del. Ch. Aug. 27, 2014)), *aff'd*, 164 A.3d 56 (Del. 2017).

contest over price[.]"[3] If plaintiffs were required to establish that the *MFW* conditions were "dangled" then ***that*** would be the requirement, not "*ab initio*." Here, the *MFW* conditions were ***proposed*** after bargaining not overseen by the Board, and while the Committee's advisors were racing to "get up to speed." A87-88.

In any event, a potential "dangle" is not the only scenario the *ab initio* requirement is meant to prevent. The most reasonable inference here is that the Special Committee offered the conditions as a feeble attempt to *cleanse* a transaction process that had been underway for months. But *MFW* is not a "cleansing" mechanism or an optional "reset" for a board committee. Moreover, that the Contribution Agreement—which marked the end of the Transaction process—is the only document referencing an agreement to a majority-of-the-minority condition, suggests that a "dangle" may have occurred.

D. Earthstone Rejected Plaintiff's Request for the August 19 Letter

Finally, Plaintiff must address Defendants' continued gamesmanship concerning the 220 Production, which omitted the August 19 Letter. Defendants now deny that the August 19 Letter "fell within the scope of Plaintiff's Section 220

[3] *Synutra*, 2018 WL 4869248, at *7.

demand."[4] False. The August 19 Letter was responsive to Requests 2 and 5 in the demand. *See* A826-27. Moreover, Plaintiff's good faith "compromise" regarding the scope of the 220 Production—following the Company's outright rejection of Plaintiff's demand—does not excuse Earthstone's attempt to curate the record.

Defendants also accuse Plaintiff of "referenc[ing] certain documents outside the complaint and at the same time prevent[ing] the court from considering those documents' actual terms." EnCap Br. 22-23. The Complaint references the August 19 Letter ***as the Proxy describes it***. The Complaint does not quote or paraphrase the contents of the August 19 Letter, which Plaintiff never saw until Defendants attached it to their motions. Plaintiff's amended Complaint neither revised the allegations concerning nor relied upon the August 19 Letter. Rather, the two complaints contain ***exactly the same allegations*** regarding the August 19 Letter, which derive solely from the Proxy's cursory description of it. *Compare* A91 *with* A1002.

[4] Earthstone Br. 26.

II. THE COMMITTEE FAILED TO ACT WITH DUE CARE

Skirting Plaintiff's care allegations, Defendants focus on generalized facts such as the number of Committee meetings and the Committee's retention of advisors. *See* EnCap Br. 25; Earthstone Br. 28. But "a finding that the process checked certain boxes," does not establish that the Committee met its duty of care.[5] *Synutra*, 2018 WL 4869248, at *12 (the *MFW* inquiry "is a qualitative inquiry as to how the committee actually functioned"); *see also, e.g.*, *H&N Mgmt. Grp., Inc. v. Couch*, 2017 WL 3500245, at *7 (Del. Ch. Aug. 1, 2017) (care breach sufficiently pled despite committee's numerous meetings, retention of advisors, and fairness opinion).

Plaintiff alleges a reasonably conceivable care breach by the Committee, including that the Committee: (i) sat idly for months after learning of Lodzinski's negotiations with EnCap/Bold, (ii) allowed Lodzinski to continue negotiating with EnCap despite his conflict, and (iii) failed to remove Lodzinski from the Transaction process. OB 7, 34-39. Defendants do not dispute these facts.

[5] Nor does the movement in Earthstone's stock price "in the months after the announcement" excuse the severe process failures. *See* EnCap Br. 25. Defendants' lone citation on this issue supports no such proposition, and merely notes that the subject company's stock increased after announcement of the transaction. *Id.* (citing *C&J Energy Servs., Inc. v. City of Miami Gen. Emps.*, 107 A.3d 1049, 1063 (Del. 2014)).

Nor do Defendants dispute that when the Committee was established, Lodzinski had: (i) already informed the Board that he "intend[ed] to make [an] offer" for Bold (A73), (ii) proposed to EnCap a $305 million to $335 million valuation range for Bold (A76-77), and (iii) created a "timeline" and "action plan" with EnCap "to complete the proposed transaction" (A78-80, A85-87). Defendants do not dispute that the Committee permitted Lodzinski to continue leading negotiations for Earthstone and to directly communicate with the Committee's financial advisor. Earthstone Br. 16-18; EnCap Br. 28-29.

Rather, Defendants respond to these allegations by mischaracterizing Lodzinski as conflict-free (EnCap Br. 26-28; Earthstone Br. 28-29), even though the Committee itself had determined that "***any directors affiliated with EnCap*** would be kept out of the flow of information." A85 (emphasis added). The Committee never walled-off Lodzinski despite his self-proclaimed "long-standing" and ***ongoing*** business dealings with EnCap, and the fiduciary duty he owed to EnCap subsidiary Oak Valley. A54-57, A59-62, A122-24; *see also infra* at Section IV(A). When the Committee deferred to Lodzinski, even allowing him to speak directly with Stephens, they breached their duty of care by ***knowingly*** allowing a conflicted person to dominate the process.

Defendants cite various inapposite cases to defend the Committee's conduct. *See* EnCap Br. 29-30; Earthstone Br. 29. None involved a conflicted CEO who engaged in ***months*** of substantive dealings with a controller to whom he was beholden, much less without the board's knowledge or approval. Nor does any of Defendants' authority concern a committee that permitted a clearly conflicted individual to represent the Company in negotiations.[6]

In *In re Jefferies Group, Inc. Shareholders Litigation*, the Court of Chancery found a care breach sufficiently alleged where conflicted directors engaged substantively with the transaction counterparty, then a later-formed committee permitted those same conflicted directors to represent the Company in remaining negotiations. C.A. No. 8059-CS (Del. Ch. Nov. 4, 2013) (TRANSCRIPT); *see also McPadden v. Sidhu*, 964 A.2d 1262, 1270-71 (Del. Ch. 2008) ("tasking [a conflicted manager] with the sale process" was a care breach).

[6] *See, e.g.*, *In re Alloy*, *Inc. S'holder Litig.*, 2011 WL 4863716, at *11 (Del. Ch. Oct. 13, 2011) (allegedly conflicted directors merely participated in "due diligence meetings"); *In re NYMEX S'holder Litig.*, 2009 WL 3206051, at *7 (Del. Ch. Sept. 30, 2009) (because "the Board was clearly independent, there was no requirement to involve an independent committee in negotiations"); *Hamilton P'rs, L.P. v. Highland Capital Mgmt., L.P.*, 2014 WL 1813340, at *16 (Del. Ch. May 7, 2014) (CEO did not "dominate[] or control[] the Special Committee" by virtue of being "involved" in "two of their proposals" to the counterparty).

Tellingly, the Earthstone Defendants altogether ignore *Jefferies* and the other cases upon which Plaintiff relies, and the EnCap Defendants discuss *Jefferies* in a single sentence that fails to distinguish it. EnCap Br. 31. None of Defendants' other authority explains how the Committee's abdication of the process to a conflicted CEO does not create a pleading-stage inference of a care violation. EnCap Br. 31-32 & n.6.

Defendants' additional arguments are equally meritless. Their attempt to dismiss months of Lodzinski's dealings with EnCap as mere "preliminary discussions"[7] fails for the reasons set forth above in Sections I.A & I.B. Defendants also fail to refute the valid pleading-stage argument that Lodzinski's imposition of a valuation range hampered the Committee's effectiveness.

Lodzinski's pre-Special Committee negotiations with EnCap cannot be excused by the Committee's subsequent deference in allowing Lodzinski to submit a $325 million offer to acquire Bold (*i.e.*, squarely within the $305–$335 million range he unilaterally established with EnCap) (A91-92). Nor does it help Defendants that weeks after Lodzinski submitted that offer, Stephens—having previously determined through its initial contribution analysis that the Transaction was unfair—used financial information ***provided by Lodzinski*** and his team to

[7] EnCap Br. 30, 31.

calculate a valuation range "comparable" to the one Lodzinski had established. EnCap Br. 31. To the contrary, those facts underscore both the detrimental impact of Lodzinski's pre-engineering of the Transaction, and the Committee's failure to achieve a fair process or price.

III. EARTHSTONE STOCKHOLDERS WERE NOT FULLY-INFORMED

A. The Revision of Stephens's Contribution Analysis Was Material

Defendants do not and cannot dispute the critical undisclosed facts that: (i) Stephens's initial contribution analysis "d[id] not support the currently proposed [Transaction]"; (ii) the analysis was revised ***because*** it indicated the Transaction was unfair; and (iii) the Committee directed Stephens to revise the analysis despite Stephens's express caution that ***the specific revision*** ordered by the Committee "could provide less meaningful results." OB 8 & 18 (quoting A88-90, A103-06, A112-13).[8] These are not immaterial "specific details of the analysis" or mere "disagreements with the substance of Stephens's analysis" as Defendants claim. EnCap Br. 36-37. They are material facts—made clear in Board minutes but omitted from the Proxy—that raise a clear inference of manipulation and misrepresentation of Stephens's analysis.

Mischaracterizing Plaintiff's argument as an assertion that the Board failed to disclose Stephens's ***initial*** contribution analysis, Defendants note that the Board did disclose the initial contribution analysis as part of the revised analysis. *See* Earthstone Br. 33; EnCap Br. 36. But what Plaintiff actually alleges is that "the

[8] The EnCap Defendants' assertion that these facts merely represent "plaintiff's characterization of the facts" ignores that they are taken nearly verbatim from the minutes of the Committee's August 16, 2016 meeting. EnCap Br. 34 (internal quotations omitted).

mere disclosure of the revised analysis itself, including the 2019 projections and their impact, is no substitute for disclosure of the material facts" regarding the reason for and consequence of revising the analysis, and that "disclosing the revised analysis and 2019 projections without also disclosing those omitted facts constitutes a quintessentially improper partial disclosure under Delaware law." OB 44-45 (citing *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996)). Defendants sidestep these arguments, and do not even attempt to address *Zirn's* discussion of misleading partial disclosures.

Defendants also invite the Court to disregard the contribution analysis altogether given the Proxy's assertion that Stephens "did not regard the relative contribution metrics as meaningful" due to the "difference in development stages" between the two companies. Earthstone Br. 33; *see also* EnCap Br. 35. That self-serving language contradicts the undisputed facts alleged, including that: (i) Stephens clearly deemed a contribution analysis necessary or, at minimum, relevant to evaluate the fairness of the Transaction; (ii) Stephens's initial contribution analysis—based on the projections ***Stephens*** deemed appropriate—indicated that the Transaction was unfair[9]; and (iii) the Committee included the

[9] The EnCap Defendants suggest it would have been absurd ***not*** to include the 2019 projections given "the real benefit of the Transaction to Earthstone—the deal thesis

contribution analysis in the Proxy, and was sufficiently concerned about the initial results that it directed Stephens to revise the analysis despite knowing that the specific change[10] could create "less meaningful results." *See, e.g.*, A88-90, A103-06, A112-13.

These undisputed facts establish that the contribution analysis was sufficiently relevant to be material, obligating the Board to disclose the full truth about the revision and its impact on the validity of the analysis. Counterfactual self-serving language within a Proxy cannot rebut that inference at the pleading stage. If anything, the Board's self-serving attempt to discredit the contribution analysis ***amplified*** the Board's disclosure failure by encouraging stockholders to disregard the very contribution analysis that initially revealed the unfairness of the Transaction.

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from the outset of the process," EnCap Br. 35 (emphasis added), but do not and cannot explain why, then, Stephens (i) chose to ***omit*** those 2019 projections, (ii) warned the Committee of the threat posed by those projections to analytical validity, and (iii) only included those projections after the Committee ordered them to.

[10] Omitting certain words from their selected quotation, the EnCap Defendants mischaracterize Stephens's warning about the threat posed by the 2019 projections to analytical validity as an entirely generic and "unremarkable" statement about projections generally, EnCap Br. 35, when in fact the warning explained Stephens's specific rationale for excluding the 2019 projections from its analysis.

The Court should likewise reject Defendants' complaints that a contribution analysis favors a mature, well-capitalized company (like Earthstone) over a relatively new, cash-strapped company in need of financial support (like Bold). Earthstone Br. 32-33; EnCap Br. 35. Given the "contribution" structure of the Transaction, the comparative financial conditions of Earthstone and Bold were material considerations, and Stephens's focus on that contrast lends its contribution analysis ***more*** analytical and persuasive force, not less. Given the vast divergence in Earthstone and Bold's respective maturity and risk profiles, discovery might reveal that individuals who evaluated and/or negotiated the Transaction viewed the contribution analysis as the ***most*** probative analytical metric.

B. EnCap's Motivation for the Transaction Was Material

Defendants concede the Board's awareness by July 22, 2016 that Bold was undergoing a liquidity crisis and that "EnCap ha[d] reached its total capital commitment" in Bold. The Board was also aware that EnCap "d[id] not think that the current management of Bold could take the Company public" and that EnCap was "looking to sell Bold." A84; A743. EnCap's desire to exit its Bold investment and lack of options other than a sale to Earthstone motivated EnCap to engage in a transaction and thus provided Earthstone significant negotiation leverage, a material consideration in evaluating the fairness of the Transaction. OB 46-49.

Defendants again sidestep Plaintiff's argument and attack a strawman instead. Defendants argue that "[t]he Proxy [] contains voluminous information concerning Bold's liquidity issues" such as revenue and expense information (EnCap Br. 38), and that "[t]he Proxy undisputedly disclosed the respective cash positions and revenues of each company[.]" Earthstone Br. 7. Plaintiff's argument, however, is not that Bold's "cash position" was not disclosed, but rather that Bold's liquidity crisis ***motivated EnCap to sell***. *See* OB 47-48.

Defendants almost entirely avoid the materiality of Bold's motivations, and cite two inapposite cases. *See* EnCap Br. 38. *Seibert* stands for an irrelevant proposition that parties need not disclose "alleged improper motives."[11] Plaintiff has not alleged an improper motive, but instead that EnCap's desire to unload Bold was material. *McMillan* stands for the general principle that "every detail of negotiations" need not be disclosed.[12] Defendants tellingly do not address *Morrison v. Berry*, 191 A.3d 268 (Del. 2018) or *Appel v. Berkman*, 180 A.3d 1055 (Del. 2018), both of which establish the materiality of a party's motivations in certain circumstances. *See* OB 8, 47.

[11] *Seibert v. Harper Row, Publ'rs, Inc.*, 1984 WL 21874, at *6 (Del. Ch. Dec. 5, 1984).

[12] *McMillan v. Intercargo Corp.*, 1999 WL 288128, at *9 n.27 (Del. Ch. May 3, 1999).

For their part, the Earthstone Defendants argue that EnCap's desire to stop funding and to sell Bold "is obvious from the disclosures." Earthstone Br. 34-35. Otherwise, they argue, EnCap "would not be interested in a combination." *Id.* That breathless assertion falsely assumes that every strategic investor that supports a sale does so because the investor "has reached its total capital commitment" and "does not think that the current management [] could take the Company public," and therefore is actively "looking to sell." A743. That is simply false, and the Court should reject Defendants' imposition on stockholders of the burden of gleaning the nuanced motivations underlying complex multi-party transactions. *See, e.g.*, *Appel*, 180 A.3d at 1064 ("[P]roxy statements are not intended to be mysteries to be solved by their audience.").

The Court rejected essentially the same argument in *Appel*, holding that "stockholders should not be expected to speculate about facts any reasonable board advisor or director would find to be of importance." *Id.* at 1063-64. As in *Appel*, proof that this disclosure "could have been made succinctly is demonstrated by the minutes…which used terse words to convey the important information." *Id.* at 1063; *see also* A743 (July 22, 2016 Committee minutes stating "EnCap has reached its total capital commitment and EnCap does not think that the current management of Bold could take the Company public."). Indeed, the Board omitted

the material information regarding EnCap's motivation for the Transaction from the Proxy despite devoting a full paragraph to the July 22, 2016 meeting minutes. A294.

IV. DEFENDANTS' ALTERNATIVE GROUNDS FOR AFFIRMANCE ARE MERITLESS

A. EnCap Controlled Earthstone

Defendants argue that EnCap was not Earthstone's controller. Because their arguments essentially repeat their arguments below, Plaintiff respectfully refers the Court to the parties' comprehensive briefing below. A140-232; B92-226; B232-277.

In short, however, control is clear here. The well-pled facts establish that EnCap, "as a practical matter," was "no differently situated than if [it] had majority voting control" of Earthstone throughout the Transaction process. *Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304, 307 n.8 (Del. 2015) (citation and internal quotations omitted).

First, EnCap possessed majority voting control of Earthstone until mid-June 2016, or approximately ***seven months*** into the Transaction process. A58, A60-61. Thus, Defendants cannot dispute that EnCap commenced the Transaction process and engaged with Earthstone's CEO for months without Board knowledge while "occup[ying] a uniquely advantageous position for extracting differential benefits from the corporation at the expense of minority stockholders." *In re EZ Corp. Inc. Consulting Agreement Deriv. Litig.*, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016) (citing Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law*

and Some of the New Challenges We (and Europe) Face, 30 Del. J. Corp. L. 673, 678 (2005)).

Second, even after EnCap's voting power dipped to approximately 41%, Earthstone's SEC filings continued to identify EnCap as "***a controlling stockholder.***" A61-62 (emphasis added).[13] EnCap's substantial holdings, coupled with the Company's "outright admission that [EnCap] was the corporation's 'controlling stockholder'" is "persuasive evidence" of control. *In re Rouse Props., Inc.*, 2018 WL 1226015, at *19 (Del. Ch. Mar. 9, 2018) (citing *In re Zhongpin Inc. S'holders Litig.*, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014)); *see id.* at *7-8; *In re Loral Space & Commc'ns Consol. Litig.*, 2008 WL 4293781, at *21 (Del. Ch. Sept. 19, 2008) (36% stockholder was controller where company had "consistently and publicly maintained" that the stockholder controlled the company).

Third, the dip in EnCap's voting power did not change its control of the process, as demonstrated by the fact that the Earthstone Board continued to hold its

[13] Defendants' attempt to avoid Earthstone's public statements by asserting several unreasonable interpretations fail. EnCap Br. 43. Earthstone's public filing clearly states (i) a ***fact***, *i.e.*, that Earthstone is a "company with a controlling stockholder"; and (ii) that stockholders may "perceive" a "disadvantage" from that same ***fact***. Additionally, Defendants' argument that Earthstone's disclosure that it "ceased to be a 'controlled company'" is somehow probative of a lack of control lacks merit because that is a reference to the NYSE MKT listing rules which, unlike Delaware law, find control ***only*** if the stockholder owns more than 50% of the company's outstanding stock. *Id.*; A182-83.

meetings ***at EnCap's offices***. *See In re eBay, Inc., S'holders Litig.*, 2004 WL 253521, at *3 (Del. Ch. Jan. 23, 2004) (finding that a slight decrease in stock ownership during the time defendants were alleged to breach their fiduciary duties was "insufficient" to detract from the company's prior acknowledgement that "defendants control the company and the election of directors.").

Earthstone's Board and management composition also remained unchanged, and Plaintiff's allegations are "sufficient, under the low 'reasonable conceivability standard of Rule 12(b)(6), to infer that a majority of the Board was not independent or disinterested."[14] Defendants Swanson, Thielemann and Zorich—all EnCap officers—remained on the eight-member Board throughout the Transaction process.

So did Lodzinski, whose self-described "long-relationship" and history of significant business deals with EnCap[15] "establish[es] an obligation or debt (a sense of 'owingness') upon which a reasonable doubt as to [Lodzinski's] loyalty to [the] corporation may be premised." *In re Ply Gem Indus., Inc. S'holders Litig.*, 2001 WL 1192206, at *1 (Del. Ch. Oct. 3, 2001). Lodzinski also owed duties to EnCap in his capacity as an officer and director of EnCap-controlled Oak Valley.

[14] *Calesa Assocs., L.P. v. Am. Capital, Ltd.*, 2016 WL 770251, at *10-11 (Del. Ch. Feb. 29, 2016).

[15] A49, 54-55, 57; OB 9, 36.

A49, 54-55; OB 36. Finally, Plaintiff alleges that Lodzinski was negotiating for continued employment directly with EnCap before the Transaction's material terms were finalized.[16] *See Jefferies*, at 63-64.

B. The Transaction Was Unfair

Defendants also cannot credibly contend that Plaintiff's allegations of unfairness fail to meet the "minimal" pleading standards "governing the motion to dismiss stage of a proceeding in Delaware." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011).

The Complaint alleges—based on the 220 Production—that Bold was out of cash, that EnCap lacked confidence in Bold's management team, and that the Special Committee's advisor's initial take on the Transaction was that a 60/40 split favoring Bold was unfair. Further, Plaintiff alleges that prior to the Transaction, Bold ***had been unsuccessfully shopped to the market*** and that Earthstone had stepped in as lifeline. "In economics, the value of something is what it will fetch in the market," and "[m]arket prices are typically viewed [as] superior" because "the market price should distill the collective judgment of the many[.]" *DFC Glob. Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346, 368-69 (Del. 2017). Here, Bold had no willing buyer and thus the reasonable, pleading-stage inference is that the

[16] A82-83, A98; OB 17.

"collective judgment" of the market was either that Bold was undesirable or that the price EnCap wanted was too high.

Collectively, these allegations more than plead "'some facts that tend to show that the transaction was not fair.'" *Calma v. Templeton*, 114 A.3d 563, 589 (Del. Ch. 2015) (citation omitted).

CONCLUSION

The trial court's Order granting motions to dismiss, dated July 20, 2018, should be REVERSED.

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Dated: November 2, 2018

PublicVersion Dated
November 19, 2018

CERTIFICATE OF SERVICE

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