A.2d 1334, 1345 (1987), where the directors exacted from Consolidated Gold Fields, in connection with transactions by which it acquired 49.7% ownership of Newmont Mining, a standstill agreement limiting Gold Fields to 40% Board representation and restricting additional purchases of Newmont stock.

In response, defendants may point out:

- There is no presumption that control inheres in any block of stock less than a majority of the voting shares. *Kahn v. Lynch Communications Systems, Inc.*, Del. Supr., 638 A.2d 1110, 1113-1114 (1994), *citing Citron v. Fairchild Camera & Instrument Corp.*, Del. Supr., 569 A.2d 53, 70 (1989). The fact that Priak is entitled to designate three directors does not assure that in a proxy contest Priak would defeat any attempt by the holders of the other 74.6% of the outstanding shares to elect the remaining directors, a majority of the Board. *See Unitrin*, 651 A.2d at 1382-1383 (finding a proxy contest viable despite ownership of 28% of outstanding stock by a group of directors, and a poison pill restricting dissident stock accumulations to 14.9%).
- One cannot presume that the other directors of the surviving corporation would be dominated and controlled by Priak, by virtue of a distant family relationship, employment as a corporate officer, or retention by the corporation as a service provider; indeed, such domination and control will not be presumed even where there is a stockholder having absolute majority voting power. *See, e.g.*, *Williams v. Geier*, Del. Supr., __ A.2d __, No. 380, 1994, slip op. at 26 n.22 (Jan. 23, 1996); *Aronson*, 473 A.2d at 816-817. Domination and control of a director can only be established by specific proof that the director's independent judgment was, in the specific case at issue, subverted to serve the personal conflicting interests of the person asserted to have dominated the director. *See Kahn v. Lynch Communication Systems*, 638 A.2d at 1113-114; *Rales v. Blasband*, Del. Supr., 634 A.2d 927, 936 (1993); Aronson *v. Lewis*, 473 A.2d at 816, *citing Kaplan v. Centex, Inc.*, Del. Ch., 284 A.2d 119, 123 (1971).
- The absence of any present limitation on Priak's ability to acquire additional voting shares does not disable an

> independent board of directors from taking action in the future to prevent an acquisition of control by Priak. If the board of directors were to perceive the risk of such an acquisition by Priak, it would have ample means at hand to blunt that threat (for example, by adopting a stockholder rights plan, or "poison pill.") *See, e.g.*, *Revlon*, 506 A.2d at 180-181; *Stahl v. Apple Bancorp, Inc.*, Del. Ch., C.A. No. 11510, Allen, C., slip op. at 19 (Aug. 9, 1990) (recognizing that poison pill could validly be adopted to preclude 40% stockholder from depriving other stockholders of opportunity to sell company at a better price than offered by the 40% stockholder).

In all events, both sides should recognize that whether a stockholder having less than majority ownership possesses "control" is an intensely factual question. *See Kahn v. Lynch Communications*, 638 A.2d at 1114. Because of its potential significance to a resolution of the merits, however (*see* Part II(A), *infra*), the "change of control" issue is one that both sides should address.

### B. Applicability of Standards Governing Director Defensive Actions

It is clear enough from the case law that "[e]nhanced judicial scrutiny under *Unocal* [*Corp. v. Mesa Petroleum Co.*, Del. Supr., 493 A.2d 946 (1985)] applies 'whenever the record reflects that a board of directors took defensive measures in response to a "perceived threat to corporate policy and effectiveness which touches upon issues of control."'" *Santa Fe*, 669 A.2d at 71. The Court of Chancery opinion in the present case invokes *Unocal* in granting injunctive relief, and its recitation of the legal standard was correct.

There is some question, however, whether the Poseidon directors took the actions challenged by Intellisoft in response to a threat, for purposes of applying the *Unocal* standards. Defendants may point out that in cases like *Santa Fe, Unitrin, Time* and *Unocal* itself, the courts applied enhanced scrutiny because the challenged actions followed an unmistakable threat to control -- a hostile tender offer -- while in the present case, the challenged Board actions of February 19 followed merely a suggestion by Intellisoft that it **might** make a competing proposal and, if so, that it **might** solicit proxies in aid of such a proposal. Such tentative expressions of interest, defendants may maintain, cannot be deemed sufficiently serious to impose upon the Poseidon directors the

burden under *Unocal* of going forward with evidence to justify defensive measures taken following such tentative expressions of interest.

In reply, plaintiff could point out that its letter of February 12 cannot be dismissed as a speculative possibility of a threat to control. Certainly, the market took the Intellisoft letter seriously, with Poseidon's stock price increasing on active trading, and with institutional investors threatening to withdraw support for the Microgate Merger Agreement. Thus, Poseidon and Microgate themselves took the letter as a threat to the corporate policy embodied in the Microgate Merger Agreement; indeed, it was the Intellisoft threat that precipitated marathon discussions between the parties leading to the challenged modifications to the agreement. Moreover, Intellisoft's threat "touche[d] on issues of control," plaintiff will argue, since Intellisoft's competing proposal included the explicit threat to replace the Poseidon directors if necessary to accomplish the Intellisoft merger proposal. [5]

There is a further issue, however, whether the actions taken by the Poseidon directors can be characterized as "defensive measures" for purposes of applying the *Unocal* form of enhanced judicial scrutiny. Not every action taken in the face of a threat to control will be subjected to such scrutiny. *See, e.g., Glazer v. Zapata Corp.*, Del. Ch., 658 A.2d 176, 183-184 (1994). In the present case, defendants may argue that the actions taken on February 19 to revise and improve the Microgate Merger Agreement were simply the implementation of a pre-existing corporate strategy that resulted from careful deliberations by the Board and its advisors in the latter half of 1995, in the absence of any threat to control. Accordingly, defendants may contend, their February 19 actions should be cloaked with the full presumptions of the business judgment rule, and not be subject to enhanced scrutiny under *Unocal* and its progeny.

In reply, plaintiff Intellisoft will maintain that, as the Court of Chancery opinion held, director action taken to favor a transaction previously approved by the board and to discourage a transaction sought by a hostile bidder will be examined under *Unocal* standards. Thus, when the directors of Time revised the Warner merger transaction in the face of a hostile Paramount tender offer, they eliminated a stockholder vote on the transaction and recast the economic terms of the deal to cause the post-merger entity to take on very substantial debt. Not surprisingly,

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[5]It is of little use to defendants to claim that *Unocal* should not apply merely because the Microgate Merger Agreement was originally approved before Intellisoft emerged as a competing bidder. *See Time*, 571 A.2d at 1152 (applying the business judgment rule to the original Warner merger agreement). The critical issue is the proper standard to apply to the Board's actions on February 19, after Intellisoft emerged as a potential competing bidder.

the courts agreed that the revised transaction was "reasonably determined to be defensive" in nature, and subject to enhanced judicial scrutiny under *Unocal*. *Time,* 571 A.2d at 1152. Likewise, when the directors of Santa Fe sought to bolster their pre-existing merger pact with Burlington Northern by adopting a poison pill, embarking upon a stock purchase program jointly with Burlington, and amending the poison pill to allow a supportive stockholder to increase its proportional ownership of Santa Fe, the Supreme Court found no difficulty accepting those measures as "defensive" ones that triggered scrutiny under *Unocal*. *Santa Fe*, 669 A.2d at 71-72. Indeed, the *Santa Fe* opinion notes that a termination fee was alleged to have constituted a defensive measure under the circumstances. *Id.* at 65.

Defendants may respond that there is no case in which an inducement (such as a termination fee or a leg-up stock option) granted in order to preserve and improve a merger agreement previously entered into on a "clear day" has, **standing alone**, been deemed a "defensive measure" triggering *Unocal* scrutiny. Nevertheless, since there can be little doubt that the Option Agreement will have at least **some** tendency to discourage Intellisoft from pursuing a hostile competing merger bid, the Poseidon directors' actions on February 19 had at least some defensive content. Thus, defendants' arguments may be more efficiently directed to challenging the **manner** in which the Court of Chancery applied the *Unocal* standards than the fact that it **did** apply *Unocal*. *See* Part II(B), *infra*.

### C. Applicability of the "Entire Fairness" Standard

The validating presumptions of the business judgment rule may be rebutted by proof that "material self-interest of one or more directors on the board that acted upon a transaction so infected or affected the deliberative process of the board as to disarm the board of its presumption of regularity and respect and cast upon the directors the burden (and the heightened risks ...) of the entire fairness form of judicial review." *Cinerama, Inc. v. Technicolor, Inc.*, Del. Ch., 663 A.2d 1134, 1153 (1994) ("*Cede 1994*"), *aff'd*, Del. Supr., 663 A.2d 1156 (1995) ("*Cede 1995*"). Where "one or more directors [but] less than a majority of those voting" suffers from a material conflicting personal interest, the "entire fairness" standard will nonetheless be applied if plaintiff proves that "the interested director *controls* or *dominates* the board as a whole ... ." *Id.* at 1153; *see also Heineman v. Datapoint Corp.*, Del. Supr., 611 A.2d 950, 955 (1992).

A disabling personal interest is a "financial interest ... creat[ing] a reasonable *probability* that the independence of the judgment of [the director] ... could be affected to the detriment of the shareholders generally." *Cede 1994*, 663 A.2d at 1151.[6] Applying this test, plaintiff will maintain that at least three of the seven Poseidon directors suffered from a disabling personal financial interest in approving a merger with Microgate and not pursuing a combination with Intellisoft. For Seaworth and Carter, the agreement with Microgate afforded the promise of long-term employment contracts at salaries at least "slightly higher" than their current compensation; moreover, Seaworth would be assured of a position on the surviving corporation's board of directors, and Carter would become the chief financial officer of a far bigger company than Poseidon. These inducements to prefer Microgate over Intellisoft as a merger partner, plaintiff will argue, are material, and are materially distinct from the unsuccessful argument in *Cede* that director Arthur Ryan had a disqualifying self-interest merely because the possibility of his future employment had been discussed with the prospective merger partner; in fact, it was found that "there was no persuasive evidence of a promise or understanding that he would profit from an MAF takeover." *Cede 1994*, 663 A.2d at 1152. Plaintiff will also argue that director Aldred, by virtue of his firm's ownership of $125 million in Poseidon debentures, has a material personal financial interest in supporting the Microgate merger over a combination with Intellisoft, which Aldred feared would seriously impair the value of the Poseidon debentures due to Intellisoft's leveraged capital structure. Indeed, Aldred's attachment to the Microgate deal was manifest when he took the unusual step (for an outside director) of singlehandedly resuscitating the Poseidon/Microgate negotiations when they foundered last fall.

Plaintiff may attempt to argue that one or more of the other four directors suffered from a disabling personal financial interest, but such arguments will be tenuous at best: there are no facts establishing that any of those other directors stands to gain a direct personal financial benefit by promoting Microgate over Intellisoft as a merger partner. That point, however, does not preclude application of the "entire fairness" standard. In support of applying that standard, plaintiff should instead argue that one or more of the other four directors lacks independence due to domination by Seaworth and, perhaps, Carter. In particular, plaintiff will claim that Stanopoulos (by reason of his subservient employment

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[6]This formulation accommodates the subsequent clarification that the susceptibility to improper influence of a director is to be determined by reference to the director in question, rather than a hypothetical "reasonable person." *Cede 1995*, 663 A.2d at 1167.

relationship), Broadbent (by reason of her role as regular investment banker to Poseidon), and Hwang (by reason of his ongoing receipt of substantial consulting fees from Poseidon) all lack independent judgment and have favored Microgate due to domination by Seaworth.

In response, defendants will reiterate the authorities discussed above in relation to the "change of control" issue, *i.e.* the cases establishing that mere employment or retention as a consultant, while it may create a "reasonable doubt" as to domination and control, *see Rales v. Blasband*, 634 A.2d at 937, does not **establish** domination and control even by a majority stockholder, let alone one or two corporate officers (Seaworth and Carter) who will in any event not be in a position to dominate and control the affairs of the combined corporation.

In addition, defendants may question whether even Seaworth and Carter have a "substantial" conflicting personal interest in the matter. *See Cede 1995*, 663 A.2d at 1169 ("To be disqualifying, the nature of the director interest must be substantial.") Defendants may claim that the employment contracts to be granted to Seaworth and Carter provided for compensation at levels only "slightly higher" than their existing compensation with Poseidon: there is no indication that Seaworth and Carter's jobs were in any way in jeopardy at Poseidon or that their future compensation at Poseidon would not match the minor increase contemplated by Microgate; likewise, there is no proof that Seaworth and Carter would not be well situated to continue their employment even in the event of a combination with Intellisoft. Defendants will also point out that while Seaworth and Carter might have some marginal personal interest in preferring a combination with Microgate for the reasons articulated by Intellisoft, they have a strong personal financial interest, arising from their holdings of 750,000 and 250,000 Poseidon shares, respectively, in assuring optimal treatment of all of the Poseidon stockholders. *See Cede 1994*, 663 A.2d at 1143 (significant stock ownership by directors corroborates defendants' claim of fairness).

## II. APPLICATION OF THE POSSIBLE STANDARDS OF JUDICIAL REVIEW.

### A. The Duty to Obtain the Highest Value Reasonably Available

If the merger with Microgate does constitute a "change of control" of Poseidon, by virtue of Priak's control over the post-merger entity, plaintiff has substantial arguments that the Poseidon directors have failed

in their duty to obtain the highest value reasonably available for the stockholders:

- Perhaps most notably, even the revised Microgate Merger Agreement provides consideration having a current market value ($22.50 per Poseidon share) that is $4.50 per share (about 17%) below the current market value of the March 11 Intellisoft proposal. On its face, the Microgate merger does not represent the "best value reasonably available to the stockholders." *QVC*, 637 A.2d at 44. Indeed, while the directors may have been told that entering into the Option Agreement was an "indispensable condition" to getting Microgate to increase its bid, the directors apparently had leverage over Microgate that could have been brought to be bear to resist such an inflexible negotiating position: as in *QVC*, the "friendly" bid had come under fire and was unlikely to gain the necessary stockholder support; thus, the directors had substantial leverage to extract further competitive bids from both of the known bidders. 637 A.2d at 49-50.
- While the directors are not obliged to accept uncritically the verdict of the market in determining and comparing the merits of competing non-cash bids (*see QVC*, 637 A.2d at 44 n.14), the Poseidon directors, having done nothing to explore what Intellisoft might be prepared to bid, made no such comparison at all. *Id.* at 44 ("board should try to ... achieve an objective comparison of the alternatives."). In any such comparison, moreover, the board "may not, in effect, trade achievable current value for a prospect of greater future value, as it may normally do in the exercise of its good faith business judgment." *Wells Fargo & Co. V. First Interstate Bancorp*, Del. Ch., C.A. No. 14696, Allen, C., slip op. at 10 n.3 (Jan. 18, 1996). Thus, the Poseidon directors' preference of Microgate over Intellisoft based on long-term potential for expansion and acquisitions is at least suspect as a basis for asserting that the best value reasonably available for the stockholders has been achieved.
- The Option Agreement imposes a not insubstantial cost upon a decision by the stockholders of Poseidon to vote down the revised Microgate Merger Agreement. Given the $22 per share exercise price and the size of the option (6.2 million shares), the Option Agreement could be said to represent a

"tax," on a $27 per share Intellisoft merger, of about $31 million (the $5 per share option spread times the number of optioned shares), or over $1 per share if attributed in full to the presently outstanding Poseidon shares. As the Court explained in *Santa Fe*, this kind of constraint upon the exercise of the stockholders' right to vote importantly implicates the rationale of the fiduciary duty of directors as articulated in *QVC* and *Revlon*. *Santa Fe*, 669 A.2d at 68.

- The Option Agreement provides for the kind of consideration -- payment by promissory note five years after exercise -- that the Court condemned in *QVC* as "potentially draconian." 637 A.2d at 49. In light of the very low rate of interest specified in the Option Agreement, delay in payment of the exercise price (about $136 million) would further dilute the value of the shares held by the present Poseidon stockholders; thus, the promissory note feature is an additional dilutive threat that deters Poseidon stockholders from voting against the Merger.
- The Poseidon directors did not conduct an auction even-handedly. It was Microgate that was favored with being management's exclusive negotiating partner; it was Microgate that was favored with access to Poseidon's internal financial information; and it was Microgate that was favored with the Option Agreement giving it a material advantage in the bidding. While director actions favoring one bidder over another are not invalid *per se*, directors bear a burden of presenting evidence that such action in connection with a sale of the company is reasonable in relation to the advantage sought to be achieved. *Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261, 1288 (1989). In this case, the reasonableness of the favoritism shown by Poseidon can be questioned, based on the following arguments:
    - The refusal to afford Intellisoft access to Poseidon's internal data was of no apparent benefit to Poseidon; on the other hand, it is at least possible that such data would have enabled Intellisoft to improve its offer, for the benefit of Poseidon's stockholders. The fact that the directors delegated the handling of Intellisoft's data request to insiders (Seaworth and Carter) who had some level of personal

interest in the situation undermines reliance on the disinterest and independence of the full Board. *See QVC*, 637 A.2d at 44 ("the role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management may not necessarily be impartial," *citing Macmillan*, 559 A.2d at 1285).

- The failure to negotiate or otherwise explore or encourage Intellisoft's expressed interest in a merger with Poseidon, prior to entering into the revised Merger Agreement and the Option Agreement, precludes the directors from asserting that they took action on February 19 to enhance, rather than terminate, the bidding. *See Revlon, Inc.*, 506 A.2d at 183; *Thompson v. Enstar Corp.*, Del. Ch., 509 A.2d 578, 583 (1984).

- The Poseidon directors' concern over the effect of a merger upon the Poseidon debentureholders is reminiscent of the Revlon directors' concern over which of the competing bidders would most favor Revlon's noteholders. 506 A.2d at 182. Indeed, it may be argued that according to the language of the *Revlon* opinion, the Poseidon directors were not permitted, in the context of the sale of Poseidon, to consider the debentureholders' interests at all. *Id.*

Apart from reiterating their position that the Microgate merger does not involve a sale of control, defendants may respond to these arguments as follows:

- The Option Agreement was indispensable to obtaining a significantly higher bid from Microgate, at a time when Intellisoft had not submitted, let alone committed to, any specific proposal at all. In addition to obtaining a 0.05 share increase in the merger consideration (having a market value of $2.50 per share, or about 10%), Poseidon stockholders received assurance, in the form of a "collar," that the merger consideration would be supported at $22 per share,

unless Microgate's stock declined in value to below $46 per share, or by more than 8%.

- The Option Agreement is at most a mild deterrent, if it is a deterrent at all, to further bidding and stockholder voting against the Microgate merger. Even a substantial deterrent to further bidding is not invalid *per se* and can be approved if it is reasonably calculated to achieve the best value available for stockholders. *See, e.g., In re J.P. Stevens & Co., Inc. Shareholders Litigation*, Del. Ch. 542 A.2d 770, 781-782 (1988); *Hecco Ventures v. Sea-Land Corp.*, Del. Ch., C.A. No. 8486, Jacobs, V.C. (May 19, 1986). The fact that the exercise price is payable with an interest bearing promissory note is not significant on the facts of this case: unlike Intellisoft, Microgate has a financial structure that makes payment of such a promissory note relatively risk-free. Unlike the option invalidated in *QVC*, there is no proof that the Microgate Option Agreement has "become 'draconian'" and is meaningfully deterring further bidding. 637 A.2d at 50. To the contrary, it was only after the Option Agreement was entered into that Intellisoft for the first time presented a specific competing merger proposal.
- Even where a sale of control is involved, judicial scrutiny is limited to determining "whether the directors made **a reasonable** decision, not **a perfect** decision." *QVC*, 637 A.2d at 45. In this case, the Option Agreement significantly enhanced the value to be received by Poseidon's stockholders, and did so without unduly deterring further bidding. The directors' approval of the Option Agreement, even if not "perfect," was at least "reasonable" and beneficial to Poseidon and its stockholders.

## B. Application of the *Unocal* Test

Plaintiff's position regarding the application of the *Unocal* standards is laid out in the opinion of the Court of Chancery. Plaintiff's invocation of those standards, however, should reemphasize the claims of self-interest or lack of independence on the part of the Poseidon directors, since those claims bear importantly on the degree of scrutiny mandated

under *Unocal*. *See Polk v. Good*, Del. Supr., 507 A.2d 531, 537 (1986).

Defendants' attack on the Court of Chancery's application of *Unocal* should have several prongs. First, with regard to the reasonableness of the Board's perception of a threat to corporate policy and effectiveness, defendants will begin by characterizing the Microgate deal as part of deliberate corporate policy, emerging from thorough deliberation by the full Board in consultation with its advisors. As in *Time*, defendants will say, the Poseidon directors chose a merger partner (and rejected Intellisoft as a merger partner) long before Intellisoft emerged as a hostile bidder. *Time*, 571 A.2d at 1154. The Court in *Time*, moreover, rejected the hostile bidder's claim that the directors were obliged to explore its offer as a predicate to an informed decision. *Id.* at 1153. Just so here, the Poseidon directors were not obligated, they will argue, to have negotiated with Intellisoft or otherwise explored its interest in bidding. Indeed, defendants will point out that the refusal to share internal corporate data with Intellisoft is entirely consistent with their perception of Intellisoft as a threat to the Microgate deal and with the proposition that there is no fiduciary duty to explore all potential bids where the company is **not** for sale. *Cf. In re J.P. Stevens, supra.*

In addition, defendants will challenge the lower court's criticism of their solicitude for the interests of the 10.5% debentureholders. There is nothing wrong, defendants will say, with considering the impact of the Microgate transaction on the debentureholders. In an environment in which existing stockholders will continue to own stock in the continuing corporation, and indeed where no sale of control is occurring, directors can and should consider the effects of a transaction upon the corporation's principal creditors, since such effects relate pointedly, let alone "rationally," to the likely benefits of the transaction to stockholders. *See Revlon*, 506 A.2d at 176. If Poseidon were to enter into a transaction that injured the 10.5% debentureholders by taking on substantially greater financial leverage, the directors could rationally conclude that the cost of capital of the surviving corporation would likely increase, to the detriment of the stockholders. Similarly, and as the directors were advised by knowledgeable representatives before Intellisoft even made a bid, such greater leverage would make future expansion and acquisition more difficult. This consideration, too, is at least "rationally" related to stockholder benefit, where the stockholders are to continue as equity owners in the surviving corporation.

Defendants' position also depends, however, on effectively challenging the trial court's ruling that when they acted on February 19 they were not faced with a cognizable threat to corporate policy and effectiveness. In a circumstance in which Intellisoft was not presenting

a coercively structured tender offer, or even any tender offer at all, characterizing its actions as a threat under *Unocal* depends upon a finding that the Poseidon stockholders were threatened with "substantive coercion," *i.e.* "the risk that shareholders will mistakenly accept an underpriced offer ... " or fail to approve a beneficial merger proposal in the mistaken belief that better value can be had by other means. *See Unitrin*, 651 A.2d at 1384; *Time*, 571 A.2d at 1153 n.17, *quoting* Ronald J. Gilson & Reiner Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 Bus. Law. 247, 267 (1989). Such "substantive coercion" was found to have been present in both *Time* and *Unitrin*; in those cases, however, the source of the coercion was a cash tender offer at a substantial premium over market prices. In the present case, the only threat was that stockholders might mistakenly **vote** (rather than tender) their shares so as to defeat the merger plan developed by the directors. Whether such an impact on voting will be held to constitute a cognizable basis of "substantive coercion" appears to be a matter of first impression under Delaware law.

The opinion in *Blasius Indus., Inc. v. Atlas Corp.*, Del. Ch. 564 A.2d 651 (1988), on which the Court of Chancery relied, indicates that a risk of harm to stockholders cannot justify paternalistic director intervention, where the stockholder vote is the only means by which such "harm" can be brought about. On the other hand, *Blasius* invalidated a form of director intervention far different than the one asserted by plaintiff here: in *Blasius*, the directors' actions (appointing two additional directors immediately after receiving a written consent to expand the board from 7 to 15 and fill the 8 resulting vacancies) eviscerated the stockholders' ability to exercise their voting powers to change control of the board. In the present case, no such pervasive interference with the electoral process has occurred; at most, the directors have engaged in actions that mildly affect the likelihood that a stockholder will vote for the Microgate Merger Agreement. Plaintiff, of course, will maintain that no such effect is justified, since the possibility that informed stockholders will vote a particular way has never been, and cannot be, deemed a threat at all; defendants, on the other hand, will maintain that the risks of a mistaken vote are not wholly different than the risks of a mistaken tender of shares, which the Court in *Unitrin* and *Time* recognized as a threat to which directors could legitimately respond.

And defendants will maintain, of course, that their response to such a threat was reasonable in relation to it, as *Unocal* requires. In this regard, defendants will likely rely most heavily upon the Supreme Court's opinion in *Time*: in that case, the Court found the revised Warner

combination "reasonably related to the threat" posed, where it "had as its goal the carrying forward of a pre-existing transaction in an altered form," and where the directors' actions "did not preclude [the hostile bidder] from making an offer for the combined [] company ... ." *Id.*, 571 A.2d at 1154-1155. Here, defendants will explain, the Poseidon Board's February 19 actions were motivated by a desire to carry forward a pre-existing transaction (indeed, to do so on even more favorable terms), and were not at all preclusive of an Intellisoft bid.

In contrast, plaintiff will attempt to distinguish *Time* and *Unitrin* by reiterating the point that its February 12 proposal did not constitute a cognizable threat at all, or was a threat of the most ethereal sort, justifying at most a minimal response. Plaintiff will reemphasize its arguments, noted in Part II(A) *supra*, that the Board's February 19 actions substantially impair the stockholders' ability to achieve the best transaction available to them and to vote on the matter freely. In response to any argument by defendants that their actions were justified by the improvements obtained in the Merger Agreement, plaintiff will attack the credibility of the defendants' negotiation of the revised Merger Agreement, and invoke the trial court's finding that the defendants failed to exploit adequately the negotiating leverage that Intellisoft's emergence gave them.

### C. Application of the Entire Fairness Test

As the Delaware Supreme Court has observed, "It is often of critical importance whether a particular decision is one to which the business judgment rule applies or the entire fairness rule applies." *Nixon v. Blackwell*, Del. Supr., 626 A.2d 1366, 1376 (1993). Application of the entire fairness rule requires the defendants to satisfy the court that the challenged transaction "was the product of both fair dealing *and* fair price." *Cede*, 634 A.2d at 361.

With regard to fair dealing, *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701, 711 (1983), instructs that the court examine the timing, initiation, negotiation, structure and disclosure of the transaction, to determine whether the transaction is entirely fair to the corporation and its stockholders. In regard to timing and initiation, plaintiff Intellisoft will claim that the Option Agreement and the revised Merger Agreement were entered into without adequate exploration of alternatives, including in particular the possible interest of Intellisoft in presenting a competing bid. Plaintiff will challenge the quality of the negotiation, noting the important role played in the negotiation process by self-interested inside directors like Seaworth and Aldred; plaintiff will likewise question the

speed with which the negotiation of the revised Merger Agreement took place. Plaintiff will also question the structure of the agreements approved by the Poseidon Board on February 19, noting the tendency, discussed in Part II(A), *supra*, of the Option Agreement to deter stockholders from voting against the Microgate Merger Agreement and thereby deprive them of a fully voluntary exercise of their franchise.

With regard to fairness of price, plaintiff might reiterate its objection noted in Part II(A), *supra*, that the merger consideration even under the revised Merger Agreement is substantially inferior on its face even to Intellisoft's current .45:1 exchange proposal. In any event, plaintiff may argue, the Poseidon directors, not having pursued anything resembling a market test, have no basis on which to establish that the terms of the revised Merger Agreement reflect a fair price.

Defendants undoubtedly will stress, in reply, their arguments that they have satisfied any applicable obligation to obtain the best value reasonably available to the stockholders of Poseidon. They will stress the origins of the Microgate Merger Agreement, particularly the selection of Microgate over Intellisoft, in an environment of deliberate, fully informed director action free of any threat to control and untainted by any conflicting personal interests (with the possible exception of director Aldred). As previously noted, defendants will point out that any personal interest on the part of Seaworth and Carter due to assurance of future employment with the continuing company is offset by their personal financial interest, as substantial stockholders of Poseidon, in maximizing the value of their stock holdings. Defendants will stress the benefits of the revised Merger Agreement, and the need to preserve those benefits in the face of a threat, engendered by Intellisoft's February 12 letter, that the original Merger Agreement might go down to defeat without there being any viable alternative, from Intellisoft or anyone else, in place. Thus, defendants may say, the initiation and timing of the challenged transactions were not dictated by self-interested directors but, rather, by external demands by Microgate, Intellisoft and the market. Negotiations with Microgate, defendants may contend, were arduous and at arm's length, and reflected the give and take associated with arm's length negotiations. With regard to the structure of the transaction, defendants may be forced to concede that the Option Agreement does affect a stockholder's willingness to vote against the Merger Agreement, but only minimally; Intellisoft, if it wishes to present a competing proposal and urging the stockholders to vote down the Microgate agreement, is not insurmountably prevented from doing so. Rather, any mild deterrent effect is more than outweighed by the benefit of having obtained a better deal from Microgate. Thus, defendants may contend, this is a case in

which a challenged transaction should be sustained even under the stringent scrutiny mandated by the "entire fairness" rule.

# *APPENDIX A*

| Category | POSEIDON | MICROGATE | INTELLISOFT |
|---|---|---|---|
| # shares outstanding | 25,000,000 | 80,000,000 | 85,000,000 |
| Principal officers | Seaworth (CEO)<br>Carter (CFO)<br>Stanopoulos (VP)<br>Seaworth | Priak (CEO)<br>Seldenham (VP)<br>O'Connell (CFO - not a director)<br>Priak (and Priak family trusts) -- 23,200,000, or 29% | Ertamian (CEO) |
| Significant stockholders | (750,000/ 3%); Carter (250,000/1%); Aldred (150,000); Intellisoft (6.8 mill./3.5%) | Priak (and Priak family trusts) -- 23,200,000, or 29% | Ertamian (6,800,000, or 8%) |
| Current stock price | $23/share | $50/share | $60/share |
| Aggregate market cap. at current price | $575 million | $4 billion | $5.1 billion |
| Other stock price history | late 10/95 - +$1.50<br>1/5/96 - $18.50<br>1/8/96 - $20.50<br>2/12/96 - $23 | | |
| 1995 net inc. (and per share) | $38 million ($1.52/share) | $300 million ($2.75/share) | $510 million ($6/share) |
| 1995 revenues | $250 million | $3.2 billion | $4.5 billion |
| Principal debt issues | $100 mm. sen. sec. line of credit<br>$300 mm. 10.5% sub. debentures | $1.8 bill. bank debt<br>$500 mm. 8% sub. debentures | $4.5 bill. bank debt<br>$2.5 bill. sub. debentures |

# *APPENDIX B*

## CHRONOLOGY OF KEY EVENTS

| DATE | EVENT |
|---|---|
| **1995** | |
| June | St. Helena retreat for Poseidon officers/advisers |
| 10/6-7 | Poseidon Board meeting re: strategy |
| 10/16 | Broadbent/Carter meet with Seldenham and Microgate investment banker |
| 10/25 | Ertamian (Intellisoft) calls Seaworth |
| 11/17 | Microgate/Poseidon merger talks break off |
| 12/19 | Microgate/Poseidon merger talks resume following Aldred/Prior meeting |
| **1996** | |
| 1/6 | Poseidon Board approves Merger Agreement |
| 1/8 | Press release announcing Merger Agreement |
| 2/12 | Intellisoft public letter to Poseidon, following distribution of Poseidon/Microgate proxy statement |
| 2/15-18 | Poseidon/Microgate negotiate revised Merger Agreement |
| 2/19 | Poseidon Board approves revised Merger Agreement and Option Agreement |
| 2/21 | Poseidon supplemental proxy statement; suit filed |
| 3/11 | Intellisoft second public letter to Poseidon, with .45/1 ($27/share) offer |
| 3/13 | Seaworth letter rejecting Intellisoft offer |
| 3/21, 24 | Court of Chancery enters preliminary injunction; Delaware Supreme Court argument |
| 3/25 | Poseidon and Microgate stockholder meetings to vote on the revised Merger Agreement |

No. 175, 1996

IN THE
SUPREME COURT
OF THE
STATE OF DELAWARE

March Term, 1996

POSEIDON NETWORK SYSTEMS CORPORATION,
a Delaware Corporation,
DONALD P. SEAWORTH, MARY L. CARTER,
E.G. ALDRED, SUSANNAH K. BROADBENT,
TIMOTHY G. GOLDENSTERN, VICTOR HWANG,
and NIKOS STANOPOULOS,

Appellants,

-against-

INTELLISOFT, INC.,
a Delaware corporation,

Appellee.

BRIEF FOR APPELLANTS*

Counsel for Appellant
Christopher Blum
Joy Goldberg

James Moschella
Brooklyn Law School
250 Joralemon Street
Brooklyn, N.Y. 11201
(718) 780-7970

*With the exception of changes to typographical errors, this brief has been reprinted in its original form. The staff of *The Delaware Journal of Corporate Law* has made no revisions.

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---

BRIEF FOR THE APPELLANTS

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## QUESTIONS PRESENTED

I. Whether Poseidon's directors, a majority of whom are stockholders, are entitled to the protection of the business judgment rule where they thoroughly addressed the merits of the Merger and Option with Microgate and secured superior value for their shareholders?

II. Whether execution of a long-term strategy through merger with Microgate was a sale of control where the parties had no such intent and the unaffiliated public retained 75% of the resulting entity?

III. Whether the Option granted to Microgate by Poseidon was a proportional response in accordance with their well-considered judgment that Intellisoft's huge debt posed a threat to the long-term interests of shareholders and other Poseidon constituencies where various avenues to gain control remained viable?

## TABLE OF CONTENTS**



**Page numbers have been changed to correspond to *The Delaware Journal of Corporate Law* page numbers.

## TABLE OF AUTHORITIES

**Delaware Supreme Court**

**Court of Chancery**



**Statutory and Legislative Materials**

## NATURE OF THE PROCEEDINGS

Defendants below appeal the interlocutory order of the Court of Chancery, entered March 21, 1996, enjoining the furtherance or consummation of the Merger and Option Agreements between Poseidon Network Systems Corp. and Microgate Enterprises, Inc., dated February 18, 1996. The opinion of the Court of Chancery is attached as Appendix A.***

## SUMMARY OF THE ARGUMENT

Poseidon's loyal directors acted in the best interests of the company when they assiduously pursued a strategic combination with Microgate, the most compatible partner, and moved to secure the deal against disruption by inferior suitors like Intellisoft.

I. The Board satisfied their duties of loyalty and care in acting to merge with Microgate and negotiated an eminently fair deal for shareholders. A majority of the directors held its stock; they had no self-interest in conflict with its public holders when they considered and agreed to a merger with Microgate. In tandem with Poseidon's financial officers, investment bankers, and counsel, they reviewed available strategies, closely investigated Microgate and alternative partners, and arrived at a fairly priced deal after a long period of hard bargaining.

II. No duty to achieve the highest value reasonably available was triggered where the Board never abandoned its merger strategy for any other and where the unaffiliated public retained 75% of Poseidon-Microgate. Priak, a minority Microgate holder, would be unable to override the public and his right to nominate three of seven directors would actually limit his influence. The directors properly maximized value by not pursuing nebulous alternative offers like Intellisoft's.

III. The Option granted to Microgate was a proportional response to the serious threat Intellisoft posed to the long-term interests of all Poseidon constituencies. It was granted following Intellisoft's vague, disruptive communication, and only after conscientious analysis revealed that its massive debt would retard essential expansion. The Option, which extracted substantial shareholder value from Microgate, carried forward Poseidon's considered strategy and did not bar proxy challenges, a firm, unconditional Intellisoft bid, or the entry of other bidders.

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***Since the Memorandum Opinion has been reprinted *infra*, Appendix A is not attached to this brief.

## STATEMENT OF FACTS

### Poseidon and Its Directors

Appellant Poseidon Network Systems is a Delaware corporation (R. 1).[1] It specializes in the development of software for network applications (R. 2), and its 25 million outstanding shares outstanding are publicly held and traded on the NASDAQ (R. 2). Poseidon has grown considerably since 1992 (R. 3-4). However, Poseidon's Board of Directors and management saw deceleration of the growth of the firm in the last year (R. 3-4).

A seven member board manages Poseidon: 1) Donald P. Seaworth, Chairman of the Board and Poseidon's Chief Executive Officer ("CEO") since 1991; 2) Mary L. Carter, Chief Financial Officer ("CFO") since 1992; 3) Nikos Stanopoulos, Vice President for International Marketing; 4) Susannah K. Broadbent, a professional investment banker. Ms. Broadbent is an officer of The Santa Clara Company, which has served as an underwriter of Poseidon securities; 5) E.G. Aldred, President and controlling stockholder of Silicon Investors, Inc., a high technology venture capital firm; 6) Victor Hwang, a principal and 30% owner of HCT Software Consulting Enterprises ("HCT"), an engineering consultant. HCT earned fees from Poseidon totalling $350,000 and $625,000 in 1994 and 1995, respectively; 7) Timothy G. Goldenstern, professor emeritus of finance at the University of California (Irvine) and director of a number of unrelated public companies (R. 3). Seaworth, Carter and Stanopoulos also hold 750,000, 250,000, and 25,000 shares, respectively, of Poseidon common (R. 3). Silicon Investors owns $125 million of a $300 million issue of 10.5% subordinated debentures in addition to 150,000 shares of common (R. 3). Poseidon's only debt other than the debentures is $100 million drawn down from a line of credit with Calbanks, N.A (R. 4). Poseidon traded at $18.50/share before the Merger (R. 4).

### Microgate and Intellisoft

Microgate Enterprises, Inc. is a Delaware corporation dealing broadly in network software. About 71% of its 80,000,000 shares reside in unaffiliated public hands. Microgate is a $4 billion company at the current price of $50/share, and carries debt of $2.3 billion (R. 5). In 1995, Microgate earned $300 million on revenues of $3.2 billion (R. 5). Ernest Priak, the only large shareholder, with 29%, is CEO and Chairman of the seven member Board of Directors (R. 4-5). Appellee Intellisoft, Inc. is a $5.1 billion company ($60/share), with a debt load of $7 billion (R. 2, 7, 16). It deals in network software, and has

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[1]References denoted (R. _) are to the page in the record of proceedings below.

expanded through an aggressive acquisition program (R. 1-2). Leon Ertamian, its President and CEO, owns an 8% block (R. 2).

Poseidon's Strategic Planning

In June 1995, key officers and advisers of Poseidon met to chart the firm's course. Seaworth, Carter and Stanopoulos were among the officers attending; Broadbent contributed financial expertise as a representative of Santa Clara (R. 5). Discussions focused on acquisition strategies as a means to long-term growth. Broadbent's presentation assessed the possibility of combination with a larger entity, and, specifically, the advantages and disadvantages of Microgate and Intellisoft as partners (R. 5). Carter and Broadbent were tasked with detailed examination of the possible merger strategy (R. 6).

Over a four month period, Broadbent, Carter and the investment bankers at Santa Clara worked on a variety of studies (R. 6). They found that Poseidon could not prosper in the long run unless it pursued either an acquisition program or a merger with a larger firm (R. 6). Industry conditions dictated that merger was more likely to succeed. Broadbent and Carter related their process and conclusions to the Board at a two day meeting, October 6-7, 1995 (R. 6). The Board agreed with their findings, and discussed implementation. Broadbent and Carter stated that Microgate was their choice (R. 6). Microgate, relatively debt-free, would fare better in acquisition battles than the heavily-laden Intellisoft (R. 6). The Board agreed, and resolved that Carter (the CFO) and Broadbent (an investment banker) should initiate and supervise negotiations (R. 7).

Poseidon's Lengthy Pursuit of the Optimum Long-Term Partner

Poseidon's negotiators contacted Microgate through Strauss, Holbert & Co., another investment banker, and began discussions with John Seldenham, Microgate's CEO, on October 16 (R. 7). The prospective partners shared internal projections and confidential data (R. 7). The negotiations were fruitful; within two weeks only certain management issues and a specific stock exchange ratio remained unresolved (R. 7). At this point, Ertamian of Intellisoft called to ask about "an acquisition" of Poseidon. Seaworth replied that the firm was not for sale (R. 8). Ertamian neither gave any details nor made further inquiries (R. 8).

Most corporate governance issues were quickly resolved (R. 8). Poseidon, although smaller, would maintain a voice in management of the combined entity. While Priak, with 25%, remained CEO, Carter would become CFO (R. 8). Seaworth would be President of the Poseidon subsidiary and a director of the combined entity; he replaced a Microgate officer on the Board (R. 8). Five year employment agreements for each, with only a minimal increase in compensation, secured Poseidon's ongoing influence (R. 8). One corporate governance issue and the exact

ratio remained open (R. 8). Microgate offered .37 shares per Poseidon share; Poseidon insisted on no less than .42 (R. 8). Microgate asked that Priak retain the right to designate three of seven directors of the combination, which Poseidon resisted (R. 8). After a four week impasse, and after two weeks of talks, Poseidon gave that right in exchange for a ratio of .40 ($20/share) (R. 9).

The "Marriage," First Proxy Statement and Intellisoft's Appearance

On January 6, 1996, Poseidon's Board gathered to consider the Merger Agreement (R. 9). The Board heard extensive review of the history of the transaction and of its advantages and disadvantages (R. 9). Santa Clara investment bankers, Seaworth, Carter and Broadbent offered information, and a lawyer retained for the negotiations reviewed legal considerations. (R. 9). After discussion, the Board voted unanimously to approve the transaction (R. 9). In a press release, Seaworth referred to the deal as a "marriage made in business heaven" (R. 10). Poseidon's market price rose to $20.50 (R. 10).

In early February, Poseidon and Microgate sent their joint proxy statement in preparation for shareholder votes on the merger. Only after the proxy was sent did Intellisoft appear (R. 10). Ertamian, in a public letter, denigrated the value of the Microgate merger in general terms (R. 11). He mentioned the brief phone call, made three months earlier, and accused Poseidon of making the deal "without exploring the alternative of a combination with Intellisoft" (R. 11). He offered no price or terms, but purported to be "prepared to present" a competing stock-for-stock proposal. This was subject to "due diligence" and a proper termination of the Microgate Agreement (R. 11). Ertamian further stated that Intellisoft "may" seek to solicit proxies against the Agreement or pursue election of Poseidon directors who would consider "all value maximizing transactions" (R. 11). Poseidon's next annual meeting would take place in May (R. 11). Finally, Intellisoft requested internal data to "formulate and present its best offer" (R. 11).

A Sweetened Microgate Merger Addresses Shareholder Concerns

After Intellisoft's missive, the market valued Poseidon at $23/share. A Board majority still advocated merger with Microgate (R. 11-12). The Board responded to the concerns of institutional shareholders and recommenced negotiations to sweeten the deal (R. 12). The sessions lasted three days, and resulted in a new deal on February 18 (R. 12). Poseidon extracted an increase in the ratio from .40 to .45 ($22.50, about a $62 million increase and 22% premium) and a "collar" to protect shareholders against declines in Microgate prices prior to the exchange (R. 12). The collar guaranteed a minimum price of $21/share by increases in the ratio to a cap of .48 Microgate shares (R. 12). The deal would be worth more than $21 even if Microgate declined to

$46.75/share; a further decline to $43.75 would be insulated by increases in the ratio. If the shares did drop to $43.75, this would amount to a shareholder benefit of $58 million.

In return, Microgate insisted upon assurance that the deal was final (R. 12). Poseidon agreed to grant a call option on Poseidon stock (R. 12). Microgate's right to purchase 6.2 million shares of new Poseidon stock (approximately 19.9%) would be triggered by termination of the Agreement other than by mutual consent or Microgate's material breach (R. 13). The strike price of $22/share, the average of the last 30 trading days and near current market price, was payable in cash, by a five-year Microgate note at 4%, or in Microgate common stock (R. 12-13).

The Board scrutinized the Merger and Option Agreements at a special meeting on February 19, 1996 (R. 13). Seaworth outlined events since the last meeting; Broadbent and another investment banker were questioned closely on the revised Agreement (R. 13). Aldred reported debtholder concerns regarding the effect of a combination with the highly-leveraged Intellisoft. While legal counsel advised that an Intellisoft combination would not be a default under the indenture, Broadbent cautioned that the value of the 10.5% debenture would be impaired and default made more likely (R. 13). The directors were told that the Option was necessary to gain substantial benefits from Microgate (R. 13-14). Goldenstern, the finance professor, asked of the Option's effect on bidding if the company was sold. Broadbent noted some deterrent effect, and urged the Board to weigh this against the benefit gained from the Merger Agreement (R. 13). The Board voted unanimously to adopt, and delegated response to Intellisoft's request for confidential information to Seaworth and Carter (R. 14). After they consulted with legal counsel, Seaworth offered to provide the information if Intellisoft would execute an agreement barring acquisition proposals and efforts to elect directors not nominated by the Poseidon Board (R. 14).

The Revised Proxy, the Injunctive Action and Final Letter

On February 21, 1996, a month before the parallel meetings, Poseidon by proxy informed its shareholders of the new Agreements and the response to Intellisoft (R. 15). That day, Intellisoft sued to enjoin the performance of the Agreements. Expedited discovery was undertaken, and oral argument set for March 15, 1996 (R. 15). On March 11, Ertamian sent another public letter to Seaworth (R. 15). He stated that Intellisoft was now "prepared to discuss" a merger, at the equivalent of $27 per Poseidon share, but subject to "compliance with all agreements applicable to Poseidon" and "elimination or invalidation of the Option Agreement" (R. 16). No other details were enumerated. Poseidon's Board decided by telephone not to commence discussion at this late stage (R. 16).

## ARGUMENT

### I. POSEIDON'S ADOPTION OF THE MERGER AND OPTION AGREEMENTS WAS A PROPER EXERCISE OF BUSINESS JUDGEMENT BECAUSE ITS BOARD WAS DISINTERESTED AND FULLY-INFORMED THROUGHOUT THE PROCESS.

The Board's action is protected by the business judgement rule because the Merger and Option Agreements were undertaken on an informed basis, in good faith and in the honest belief that the Agreements were in the company's best interests. Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946, 954 (1985). The Agreements clearly had rational business purposes, and, as such, this Court should not substitute its judgement for that of the Board. Paramount Communications, Inc. v. QVC Network Inc., Del. Supr., 637 A.2d 34, 46 (1994) ("QVC II"); Unocal, 493 A.2d at 954. The plaintiff below did not prove that Poseidon's directors breached either their duties of due care or loyalty, so the business judgement rule attaches to protect the directors' decisions from further scrutiny. Cede & Co. v. Technicolor, Inc., Del. Supr., 634 A.2d 345, 361 (1993); Cinerama, Inc. v. Technicolor, Inc., Del. Supr., 663 A.2d 1156, 1162 (1995).

#### A. Standard and Scope of Review

This Court reviews legal conclusions of the Chancery Court *de novo*. Cede, 634 A.2d at 360. The Chancery Court's findings, based on a paper record, will be accepted only if they are supported by the record and "the product of an orderly and logical deductive process." Id.

#### B. Poseidon's Directors Satisfied Their Duty of Loyalty Because They Individually Lacked Material Interest and Collectively Were Motivated Only by Long-Term Corporate Interests.

Poseidon's directors were loyal because they placed the best interests of the corporation and its shareholders ahead of any self-interest. Cede, 634 A.2d at 361. Any personal interests on their part were not "material" in relation to both the director's independence and the collective independence of the board. Id. at 363. Absent a finding of material interest, Board actions are entitled to the protection of the business judgement rule.

A four-person majority of the seven directors, Goldenstern, Stanopoulos, Broadbent and Hwang, had no reason to favor the Microgate merger over one with Intellisoft. Goldenstern was a finance professor, completely free of self-interest. Although Stanopoulos was a Poseidon officer, he was not offered future employment and, as a holder

of 25,000 Poseidon shares, would benefit directly from any higher bid. Finally, Broadbent and Hwang, on behalf of their firms, had a natural interest in providing future services to Poseidon-Microgate. However, subsequent to the merger, neither would have influence over retention of their firms by the resulting company. Only the best interests of the corporation influenced the decisions of these four directors.

Seaworth and Carter both received employment contracts, but any self-interest stemming from the contracts was dwarfed by their countervailing interests as Poseidon shareholders. Granted, the proposed contract offered employment for five years with compensation slightly higher than their present compensation, but the fact that they held more than one million shares between them was more significant to Seaworth and Carter. If Intellisoft were to offer a higher ratio, every dollar of increase would yield $750,000 to Seaworth and $250,000 to Carter. The interests of Seaworth and Carter as shareholders dictate support of any credible higher bid.

Finally, Aldred's noteholder interest was neither material to his actions nor to those of the Board collectively. Noteholders and shareholders alike preferred Microgate's less-leveraged financial position. Noteholder values would be better protected, and long-term shareholder interests would be furthered because Microgate-Poseidon would be in a better position to finance essential future expansion and acquisitions.

Furthermore, any self-interest Aldred may have possessed was immaterial to the collective independence of the Board because there is no evidence that his participation dominated or unduly swayed the Board's decision-making process. See R. Van De Walle v. Unimation, Inc., Del. Ch., 1991 WL 29303, at *14 (1991). Poseidon had seven directors and all Board actions were adopted unanimously. Moreover, Aldred was not an officer and throughout the negotiations played only a minimal role. Since any interest on his part did not infect the collective independence of the Board, the business judgment rule presumption of loyalty attaches.

### C. Poseidon's Directors Satisfied Their Basic Duty of Care by Exhaustively Reviewing Alternative Strategies and Seeking Appropriate Professional Advice Before Adoption of the Merger.

Although the basic propriety of the Board's decision-making process was not challenged below, all members of the Board were fully apprised of the merits of the transaction at each stage of development. The Board pursued the merger strategy only after several months of strategic planning studies were made by an investment bank and key corporate financial officers. The Board considered a merger with Intellisoft, but ultimately preferred Microgate because its conservative

debt would place Poseidon-Microgate in a better position to pursue expansion.

Later Board actions regarding the Merger and Option Agreements were equally well-informed. This issue is discussed fully, infra Point III(B), in the context of the Board's assessment that an Intellisoft offer was a cognizable threat which warranted a defensive response.

D. The Merger Agreement Adopted by Poseidon's Board is Entirely Fair Because it was Thoroughly and Deliberately Negotiated, Fully Disclosed, and Offers Superior Value to Poseidon's Shareholders.

Even assuming *arguendo* that either of the two duties was breached, the Merger and Option Agreements should still be upheld as entirely fair and beneficial to Poseidon as a whole. Entire fairness scrutiny focuses upon two basic and interrelated factors: fair dealing and fair price. Weinberger v. UOP, Inc., Del.Supr., 457 A.2d 701, 711 (1983). However, such scrutiny has typically been applied to freeze-outs, with a thoroughly developed record in actions for appraisal, fraud and/or breach of fiduciary duty. See Cinerama, 663 A.2d 1156 and Cede, 634 A.2d 345 (4% shareholder who dissented to freeze-out brought claims for appraisal, fraud and breach of fiduciary duty); Weinberger, 457 A.2d 701 (minority shareholders claimed breach of fiduciary duty in second stage of cash-out merger). In these cases, enhanced scrutiny benefitted minority shareholders who found themselves at the mercy of the majority through no fault of their own.

In contrast, Intellisoft, a competing bidder which willingly placed itself in the minority, does not deserve the level of protection afforded shareholders thrust into minority involuntarily. Absent detailed valuations which both sides would prepare to evaluate price at a later stage, this Court should recognize that fair price is concomitant with the Board's impeccable fair dealing.

The negotiation and adoption of the Agreements were emblematic of great care and consistent with entire fairness. Negotiations with Microgate were initiated only after several months of studies indicated that a merger was essential to survival in the industry. Negotiations spanned nine months and were hard-fought; at one point they broke off due to differences over price and corporate governance issues. Additionally, the deal was structured to assure that present Poseidon shareholders would have a voice in the resulting company through continued public ownership and proportionate Board representation. The integral Option was granted in exchange for significant shareholder value and did not materially impede other serious bidders. Finally, Poseidon's negotiators fully disclosed all material information to the Board throughout and the Board fully disclosed all information to the shareholders by proxy. See id., 457 A.2d at 711 (stating factors that

affect fair dealing to be "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.").

Moreover, the price obtained was entirely fair. The same factors that led this Court to approve the price obtained by directors in Cinerama validate the price obtained by Poseidon's directors. 663 A.2d at 1176-77. Poseidon's senior management accepted Microgate's share offer as in-line with its prior studies and chose not to seek competing bids. See id. Seaworth (3%) and Carter (1%), were major shareholders in Poseidon and had the greatest insight into the deal; they were ready to exchange their shares along with the other shareholders. See id. Santa Clara, an "expert in the marketplace," indicated to the Board that the price was fair. See id.

Finally, there is no indication that the public sale value was greater than that obtained. Intellisoft's nebulous "offer" cannot be taken as a credible indicator of the value of Poseidon shares. Microgate matched the market's estimate of the premium that an alternative bidder would have to pay to overcome Microgate's initial exchange offer. Although significant institutional investors, typically bent on short-term value maximization, expressed concern over the initial ratio, there is no indication that these price concerns were not allayed by the augmented ratio.

Although the combination of scrupulous fair dealing and a reasonable fair price render the Poseidon-Microgate merger entirely fair, a more appropriate standard of review given the state of the record and Intellisoft's aggressive nature would be that dictated by Unocal. Intellisoft's complaint is not motivated by fear of inadequate compensation for its 3.5% interest, but rather by fear that its takeover plans will be thwarted. The Board's actions should be assessed as the defensive measures they truly are.

## II. NO DUTY TO IMMEDIATELY ACHIEVE THE HIGHEST VALUE REASONABLY AVAILABLE WAS TRIGGERED WHERE THE POSEIDON BOARD NEVER ABANDONED THE PLAN OF A COMBINATION WITH MICROGATE AND WHERE NO MAJORITY OR CONTROL SHAREHOLDER RESULTED.

Revlon v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986), and its progeny require that the informed merger choice of the Board be respected, as it neither (1) initiated an "active bidding process" seeking to sell itself or to effect a business reorganization involving a clear breakup of the company nor (2) abandoned its long-term strategy, in response to a bidders offer, to pursue an "alternative transaction" involving the breakup of the company. In re Santa Fe Pac. Corp. Shareholder Litig., Del. Supr., No. 224, 1995, 1995 WL 710391, at *10 (Nov. 22, 1995) ("Santa Fe"). Most importantly, the Poseidon-Microgate merger would not result in a shift in control away from the "large fluid, changeable and changing market," a prerequisite to invocation of the duty to maximize shareholder value under Revlon. Id.

### A. Standard and Scope of Review

See supra Point I(A) for the proper standard and scope of review.

### B. Poseidon's Board Neither Initiated an Active Bidding Process Nor Abandoned Its Long-Term Strategy, but Acted Skillfully to Optimize the Carefully Considered Microgate Deal.

Poseidon, by doing no more than "seek[ing] to sell itself," did not initiate an active bidding process or abandon its long-term goal. Arnold v. Society for Sav. Bancorp, Inc., Del. Supr., 650 A.2d 1270, 1290 (1994); Paramount Communications, Inc. v. Time, Inc., Del. Supr., 571 A.2d 1140, 1151 (1990) ("Time-Warner") (making a merger agreement or taking other action that might be construed to put a firm either "in play" or "up for sale" alone does not trigger Revlon duties). All of the Board's actions, from adoption of the initial Agreement through the Option, were designed to reach their consensus goal and not to sanction other bids.

Encouragement of and action to secure *a* bid is not synonymous with an initiation of *general* bidding. Santa Fe, 1995 WL 710391, at *10. This Court found no bidding process initiated in Time-Warner, where the Time Board took similar actions in execution of long-term strategies. The Time Board adopted "structural safety devices" to protect its stock-for-stock merger with Warner from potential threats, 571 A.2d

at 1151, and ultimately recast the deal into a stock purchase after Paramount's unwanted tender offer. Id. at 1148. Such safety devices, adopted either to keep the company from being put into play by a Merger Agreement or at the insistence and for the protection of a merger partner, "do[] not trigger Revlon." Id. at 1151; see Santa Fe, 1995 WL 710391, at *10 (finding no Revlon duty was triggered where a competing tender was used as leverage against a chosen strategic partner). Nor did revision of the deal make a sale inevitable and trigger the duty; Time was free "to go forward with a pre-existing plan rather than adopt an alternative to Paramount's proposal." Time-Warner, 571 A.2d at 1151 n.16 (referring to an alternative such as an auction or sale to a third party bidder).

The brief phone call and the letters sent by Ertamian did not cause Poseidon's Board to initiate an auction or abandon the strategy for any alternative action that made sale inevitable. Revlon, 506 A.2d at 182. The revised Agreement and Option were the only actions taken by the Board that could be viewed as alternative to the original Agreement. This is indistinguishable from Time-Warner as the intent of the second generation agreements was to carry out the strategic plan, not to abandon it or solicit bidders. Time-Warner, 571 A.2d at 1151.

This "refusal to entertain offers . . . comport[s] with a valid exercise of business judgment" where Revlon duties are not invoked. Mills Acquisition Co. v. Macmillan, Inc., Del. Supr., 559 A.2d 1261, 1285 n.35 (1989). Intellisoft made a nonspecific, conditional, late intimation of an offer, timed to disruptively follow a proxy. The first clue of price was given only after suit had been filed, four days prior to the injunction hearing, and again was nonbinding, riddled with conditions and timed to follow the revised proxy. Finally, after lengthy study, the Board adjudged an Intellisoft combination inferior to the Microgate deal. Since no Intellisoft communication provided new information to invalidate this judgment, Poseidon's Board correctly moved to finalize and secure the Microgate merger. See id. (describing these considerations as factors in determining whether an offer is properly rejected).

### C. Enhanced Scrutiny Under Revlon Is Not Warranted Because There Is No Controlling Shareholder in the Combined Firm and No Other Factor Indicative of a Loss of Control by Poseidon's Public Shareholders.

No enhanced scrutiny of Board actions is warranted because control never passes from the shareholding public. This Court has never applied enhanced scrutiny under Revlon where there was no majority shareholder in the resulting entity. Priak will hold only about 25%. Moreover, his retention of the right to nominate a minority of the combined board does not significantly increase his control.

This Court has closely scrutinized transactions because of a change in control only where it is clear that shareholders will lose the opportunity to gain a control premium. In QVC Network, Inc. v. Paramount Communications, Inc., the duty clearly applied where Sumner Redstone of Viacom would control 70% of the combined corporation's voting stock. Del. Supr., 635 A.2d 1245, 1251 (1993) ("QVC I"). This Court acted to protect the primacy of the shareholder vote in assessment of an offered premium where control will be lost. Id. at 1265. Poseidon-Microgate will have a 75% public majority; the franchise interest is not threatened and enhanced scrutiny is not warranted.

While one case suggests that in some situations less than 50% may amount to control, the reasoning of that case leads to a contrary conclusion here. See Robert M. Bass Group, Inc. v. Evans, Del. Ch., 552 A.2d 1227 (1988) (assessing, in the Unocal context, the adequacy of the price management paid for shares in a defensive restructuring). The court noted that "for companies having a large number of stockholders, 80% to 83% of all eligible shares typically vote in contested matters" and essentially found that an interest of 39.2%, 50% of that lesser turnout, was sufficient. Id. at 1244. Also important was that management expected 39% to have control and that previous versions of the plan, seeking over 50%, were revised to avoid attack as a change in control. Id. at 1243.

Under this rationale, there is no change in control in the Microgate-Poseidon merger. There is no evidence in the record that the parties harbored an intent to give Priak control of the combined entity or expected the deal they negotiated to result in a change. The focus on corporate governance issues in negotiations undercuts any conclusion of such intent.

Moreover, in a practical sense, the influence of Priak's 25% will be shaky, at best, in a company otherwise broadly held. Even if only 83% of all shares voted on a given issue, his power increases only to the equivalent of 30%. Any shift in control is even less severe because more than 13.5% of all shares will be held by former Poseidon shareholders, who can exert their influence to maintain their equity stake and to oppose any action that might deprive them of their rightful control premium.

Finally, the words "sale of control" should be read to cover only shifts in control which preclude a future control premium. They should not be invoked merely because a transaction makes exertion of a controlling interest somewhat more difficult or unlikely, a definition which, contrary to this Court's holdings, would bring under Revlon every situation where the shareholders of a smaller publicly held corporation become a minority in the combined one. See Arnold, 650 A.2d at 1290 (holding that there was no sale of control where plaintiff was merely "relegated to minority status"); see also Time-Warner, 571 A.2d at 1151 (holding that the huge increase in size of the resulting company -- larger than Microgate-Poseidon -- did not preclude the

minority from someday receiving a control premium through acquisition).

Priak's retention of the right to elect three directors adds little to his practical control. Essentially, Priak constitutes a separate class, with the right to designate a minority. The public holders will elect a majority of four directors; Seaworth from Poseidon will hold the seventh seat until the next annual meeting. This mechanism limits what could otherwise constitute a more significant power. See DEL. CODE ANN. tit. 8, § 216 (1974 & Supp. 1994) (making plurality vote for directors the default rule). His influence will be limited to three seats where, under the default rule, his vote could impact selection of all seven. A majority of directors will still be elected by public shareholders, just as they are in Poseidon. Means by which management may freeze-out public holders without a shareholder vote will still be curbed by unaffiliated voting power.

### D. Given the Public Nature of the Merger and the Nonappearance of Other Bidders, and Intellisoft's Disruptive Late Entry, the Poseidon Board Acted Properly to Maximize Value by Completing The Microgate Deal.

Assuming *arguendo* there was a sale of control, Poseidon's directors were not required to conduct an auction "according to some standard formula." Macmillan, 559 A.2d at 1286. Directors are not precluded from treating bidders differently when enhancing the interests of stockholders is the ultimate goal. Id.; QVC I, 635 A.2d at 1270; In re J.P. Stevens and Co., Inc. Shareholders Litig., Del. Ch., 542 A.2d 770 (1988). The focus is not on the form of the auction, the directors' recognition of the duty, or on fairness to bidders, but on the service of the ultimate interests of shareholders. Bare inquiries or suspect offers like Intellisoft's need not be treated as bids and cultivated if shareholder interests would be better served by an alternate course.

When Intellisoft appeared, it added no new information to what Poseidon had already considered -- no price and no commitment, but plenty of conditions. Poseidon's Board and officers determined that, given the absolute necessity of expansion and the harmful effect of high leverage on that strategy, an amount of Microgate's stock with lower present market value could be more valuable over time than a facially superior amount of Intellisoft's. QVC I, 635 A.2d at 1268 ("[W]here competing transactions involve stock as part of the consideration . . . directors may take long-term strategic considerations into account"); J.P. Stevens, 542 A.2d at 782 (stating that factors other than price, such as form of consideration, may be assessed). Intellisoft's vague promise of some nominally higher offer did not add enough to the mix to warrant the reversal of prior conclusions and release of information as if a credible bid had appeared.

Thereafter, the Poseidon Board acted skillfully to maximize shareholder value by renegotiating with the only serious bidder to date. The announcement of the Agreement and public communication by Intellisoft put other potential bidders on notice that this was the time to enter the fray. There is no evidence that any other bidders appeared in the two months since the announcement. While not a formal market check, this lack of interest justified the board in acting to maximize value from the only serious bidder. Cinerama, 663 A.2d at 1177 ("[W]hen it is widely known that some change in control is in the offing and no rival bidders are forthcoming over an extended period of time, that fact is supportive of the board's decision.").

The Option was a necessity to entice Microgate into a higher bid, did not foreclose other bidding, and was granted in exchange for greatly enhanced value. Revlon, 506 A.2d at 183 (stating that lock-ups which encourage further bidding are permissible); J.P. Stevens, 542 A.2d at 782 n.8 (stating that it is permissible "that the consideration [of the lock-up flows] to one who had previously been involved [who], but for the consideration, would not be involved further"). If the Microgate Agreement was performed, which appeared likely to the directors, the Option would be unexercisable and costless to the shareholders. Tens of millions of dollars of benefits in the higher ratio and collar would accrue. While it potentially lessened shareholder premiums if exercised in the face of an alternate merger, the Board properly considered this and decided that the benefits outweighed any detriment.

The second Intellisoft letter, sent post-suit, contained an intimation of value but was properly discounted by the Poseidon Board as mere window-dressing for purposes of the injunctive action. Intellisoft filed suit on February 21, and expedited discovery was commenced. The letter was dated almost three weeks later, two months after the announcement of the terms of the initial agreement, four days before scheduled oral argument and only two weeks prior to voting on the Microgate merger. In addition to its suspect timing, the second letter, like the first, was vague, conditional and lacked binding effect. Nothing Intellisoft did rendered their belated, disruptive "offer" any more than a chimera; Poseidon's directors fulfilled their duty to maximize value by closing the Microgate deal.

## III. THE COURT OF CHANCERY ERRED IN SUBSTITUTING ITS JUDGMENT FOR THE JUDGMENT OF THE POSEIDON BOARD THAT THE OPTION WAS A PROPORTIONAL RESPONSE TO THE INTELLISOFT THREAT.

If enhanced scrutiny is warranted, the two-prong Unocal test is the only suitable standard. See supra Point I(D). Poseidon's Board had reasonable grounds to believe that Intellisoft was a danger to corporate policy and effectiveness and the Option granted was a defensive measure proportional to both the seriousness of that threat and the substantial value received from Microgate. Unocal, 493 A.2d at 955; Macmillan, 559 A.2d at 1288. Accordingly, the Board's decisions are protected by the business judgment rule. Santa Fe, 1995 WL 710391, at *10.

### A. Standard and Scope of Review

See supra Point I(A) for the proper standard and scope of review.

### B. Poseidon's Board Acted Reasonably Because It Was Amply Informed in the Good Faith Pursuit of a Long-Term Strategic Plan.

The Poseidon Board correctly determined that a combination with Intellisoft warranted a defensive response. See Unitrin, Inc. v. American Gen. Corp., Del. Supr., 651 A.2d 1361, 1375 (1995). Refusal to entertain an Intellisoft offer was a valid business judgment because of the directors' exhaustive decision-making process and good-faith investigation. See Unocal, 493 A.2d at 955-56. Beginning in June 1995, the Board met on numerous occasions to chart the corporation's expansion. The Board's financial experts, including investment bankers, presented and explored several options. Both Intellisoft and Microgate were targeted as merger candidates.

The Board recognized, however, that Microgate presented a better long-term strategic fit. A major concern of both the Board and planning committee was maintaining Poseidon's conservative debt. Intellisoft was burdened with $7 billion worth of debt while Microgate had only $2.3 billion. The Board concluded that Microgate's less leveraged financial position would facilitate essential future expansion and acquisitions. Intellisoft's massive debt would impede Poseidon-Intellisoft from borrowing the funds necessary to expand. Moreover, a Poseidon-Intellisoft merger would decrease the value of the 10.5% debentures and make default more likely. This would further erode public confidence in Poseidon debt and hinder future borrowing for expansion. Legal counsel, investment bankers, and the directors all reasonably believed that a merger with Microgate was the best path Poseidon could take.

These long-term considerations are consonant with the factors that this Court has repeatedly held to be within the Board's discretion. See id.; Unitrin, 651 A.2d at 1385. A board may find a cognizable threat in the inadequate price of an unsolicited offer, its nature and timing, the risk of nonconsummation, and most significantly, the "impact on 'constituencies' other than shareholders," including debtholders. Unocal, 493 A.2d at 955. "The open-ended analysis mandated by Unocal is not intended to lead to a simple mathematical exercise: that is, of comparing the discounted value of [the target's] expected trading price at some future date with [an] offer and determining which is higher." Time-Warner, 571 A.2d at 1153.

Time-Warner parallels this case and exemplifies the broad discretion a board may exercise in perceiving a threat. In both instances, the boards explored several opportunities for expansion, including mergers with both contestants, and chose to combine with the one that provided a better strategic "fit." Id. at 1152. Time was justified when it later elected to restructure its deal with Warner in lieu of negotiation of Paramount's all-cash, all-shares tender offer. Paramount argued that by nature its offer was not threatening. This Court held that argument to be a "fundamental misconception" of the standard of review, and refused to "substitut[e] its judgment as to what is a 'better' deal for that of a corporation's board of directors." Id. at 1153. Poseidon's Board should likewise be allowed to recognize other threats to the corporation and its shareholders and to refuse to negotiate with Intellisoft, a candidate considered and rejected. Id. at 1154.

Compared to Paramount's firm all-cash, all-shares tender, Intellisoft's offer was so nebulous as to be no more than a threat of disruption. Even the timing of Ertamian's "offer" to follow issuance of Poseidon's proxy statement was designed to upset and confuse a shareholder vote. Moreover, Intellisoft has expanded through "an aggressive program of acquisitions." Only Intellisoft's non-binding representations give any assurance to Poseidon that this latest acquisition will be a stock-for-stock merger, as opposed to a coercive acquisition which would eliminate its shareholders' interests and render its strategic plan a nullity.

There is no bad faith on the part of Poseidon's directors, as the grant of the stock option yielded millions of dollars to its shareholders. See J.P. Stevens, 542 A.2d at 780 (finding no bad faith where target board obtained significant concessions in return for grant of a break-up fee). The numerous indications recognized by the Board during the extensive investigation render the directors' belief that Intellisoft posed a serious threat to its strategic plan manifestly reasonable. This reasonableness is materially enhanced because a majority of the Board is disinterested and independent. Unocal, 493 A.2d at 955; see supra Point I(B). While Seaworth, Carter, and Stanopoulos were Poseidon officers, the remaining four directors were independent. Goldenstern lacks any connection which might rationally be construed as creating an interest in

favoring Microgate. Aldred's facial interest as a noteholder is not material because of the convergence of noteholder and shareholder interests in favoring a merger with Microgate. Moreover, while advising or consulting relationships may have existed between Broadbent, Hwang, and Poseidon, the Microgate merger does not contemplate continuation of these relationships. Seaworth and Carter, without control of Poseidon-Microgate, cannot dictate retention of Santa Clara or HCT.

### C. The Option Was Proportional as a Defense to the Serious Intellisoft Threat and in Relation to Value Received From Microgate.

The Option grant is protected by the business judgment rule because it was reasonable in relation to the Intellisoft threat and the benefit received from Microgate. See Unitrin, 651 A.2d at 1376; Macmillan, 559 A.2d at 1288. The Option is not a "draconian" defense because it doesn't coerce Poseidon shareholders to accept the Microgate merger or preclude a takeover by Intellisoft or others. Since it is not draconian, the Option is permissible because it is within a "range of reasonableness." Unitrin, 651 A.2d at 1387; QVC II, 637 A.2d at 45-46 (The inquiry is "whether the directors made a *reasonable* decision, not a *perfect*" one (emphasis in original)).

The Option is not draconian because it furthered Poseidon's well-considered strategy and left a number of avenues open to Intellisoft. In Time-Warner, the Time Board's reformation of the Warner merger and refusal to negotiate with Paramount was not coercive as it did not attempt to "cram down" on its shareholders a management-sponsored alternative, but carried forward "a pre-existing transaction in an altered form." 571 A.2d at 1154-55. In addition, the response was not preclusive as Paramount could tender for the combined entity or make its offer independent of nullification of the Time-Warner agreement. Id. As in Time-Warner, the renegotiated Poseidon-Microgate Agreements merely carry the preexisting transaction forward. Further, competing bids or proxy fights may be impeded by the Option, but success is not precluded.

The reasoning in Unitrin, where this Court held that mere inhibition of a challenger's ability to wage a proxy fight and institute its own merger was not preclusive under Unocal, also validates the Poseidon Option. Unitrin, 651 A.2d at 1388-89. The defensive measure in Unitrin was a selective stock repurchase plan intended to give the Unitrin board voting control in the face of a hostile offer. This Court held that this drastic measure was permissible so long as a proxy contest remained a viable, even if more problematic, alternative for the offeror. Id. at 1388-89 n.39 ("'[T]he powers of corporate democracy' remain[ed] available as a viable alternative to turn the Board out in a proxy contest"). The Poseidon Option is a less severe impediment than the repurchase plan in Unitrin; it does not significantly chill either an Intellisoft offer or an

unsolicited offer from a third party. Intellisoft, as a dissident stockholder, can still prevail in an effort to obtain control of Poseidon by proxy contest or tender offer.

Since the defensive responses of the Poseidon Board are not "draconian," the Option was proper because it falls within a "range of reasonableness." Id. at 1387-88 (stating that the rationale for the judicial restraint implicit in the range of reasonableness standard is the need to give boards "latitude in discharging [their] fiduciary duties to the corporation"). Stock options are a statutorily authorized form of business decision which a board may routinely make in a non-takeover situation. See DEL. CODE ANN. tit. 8, § 157. Due to the aggressive nature of Intellisoft's recent acquisition program, their acquisition of Poseidon stock, the coercive timing of their offer and the adverse impact a Poseidon-Intellisoft combination would have on Poseidon's future, the non-draconian Option corresponded in degree to the threat posed by Intellisoft. See Unitrin, 651 A.2d at 1389 (delineating factors to consider in reasonableness analysis).

This reasonableness is supported further by the absence of the numerous, more preclusive responses which the Poseidon Board could have instituted. In QVC II, the option granted to Viacom included a "put feature" which required that Paramount pay Viacom in cash the difference between the strike price and market price of Paramount stock. 637 A.2d at 39. Viacom could reap their profit without purchasing the stock, which was "both unusual and highly beneficial to Viacom." Id. The Viacom option compounded the impediment posed by several defenses already in place. Id. (including a no-shop provision, a "poison pill" rights plan which exempted Viacom, and a $100 million termination fee payable in addition to the put feature). In contrast, Poseidon has no other defenses in place. Moreover, the Microgate Option has no put feature, so Microgate must pay for its Poseidon shares. Even if Microgate paid by an unregistered promissory note, the effect on Poseidon's balance sheet would be minimal. With its light debt, Poseidon could easily borrow in the event of exigency prior to the note's maturity.

Finally, the Microgate Option was necessary to gain significant benefits from Microgate. See Macmillan, 559 A.2d at 1288. By grant of the Option, Poseidon extracted a ratio higher than its initial asking price. See J.P. Stevens, 542 A.2d at 782. The Option also secured a collar which insulated Poseidon shareholders from declines in Microgate's price. The collar would save the shareholders in excess of $50 million in the event of a significant decline. If the Poseidon-Microgate merger were consummated, a wholly reasonable assumption, the option would not be exercised and the benefits would be costless to Poseidon. The Option, granted after the directors reasonably determined that Intellisoft posed a threat to corporate policy, was a proportional response which corresponded to that threat and to the benefits gained from Microgate.

## CONCLUSION

For the foregoing reasons, Appellant respectfully requests that the decision of the Court of Chancery, New Castle County, be reversed and the preliminary injunction lifted.

February 15, 1996

Respectfully submitted,

Counsel for the Appellant