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Case Number 174,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

SPANISH BROADCASTING SYSTEM, INC.,	:	
	:	No. 174, 2014
Defendant Below, Appellee/Cross-Appellant,	:	CASE BELOW:
v.	:	Court of Chancery of the State of Delaware, Consol. C.A. No. 8321-VCG
LEHMAN BROTHERS HOLDINGS INC.,	:	**REDACTED PUBLIC VERSION FILED JULY 11, 2014**
Plaintiff Below, Appellant/Cross-Appellee.	:	

APPELLEE'S ANSWERING BRIEF ON APPEAL AND CROSS-APPELLANT'S OPENING BRIEF ON CROSS-APPEAL

Robert S. Saunders (ID No. 3027)
Nicole A. DiSalvo (ID No. 4662)
Ronald N. Brown, III (ID No. 4831)
Matthew P. Majarian (ID No. 5696)
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
One Rodney Square
P.O. Box 636
Wilmington, Delaware 19899-0636
Tel.: (302) 651-3000

Attorneys for Defendant Below and Appellee/Cross-Appellant Spanish Broadcasting System, Inc.

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TABLE OF CONTENTS

PAGE(S)

TABLE OF AUTHORITIES

CASES **PAGE(S)**

AUTHORITIES

NATURE OF THE PROCEEDINGS

Spanish Broadcasting System, Inc. ("SBS" or the "Company") faced a financial crisis after the Lehman collapse in mid-2008. As a means of preserving cash and ensuring the Company's viability, SBS deferred certain dividends on its Series B Preferred Stock, beginning in July 2009. Neither Lehman nor anyone else asserted that SBS's deferrals caused a "Voting Rights Triggering Event" (a "VRTE") under the Certificate of Designations (the "Certificate," A109), and no one objected when SBS announced it would purchase a television station in 2011 and issue senior secured notes in 2012 – actions that the Certificate would have barred if a VRTE had in fact occurred. Indeed, [redacted] But now Lehman claims that a VRTE had occurred and barred SBS's actions. Armed with its admittedly new interpretation of the Certificate, Lehman filed suit on February 14, 2013.

Lehman's claims are premised on a misinterpretation of Section 9(b) of the Certificate, which provides that a VRTE occurs if "at any time, dividends on the outstanding Series B Preferred Stock are in arrears and unpaid (and in the case of dividends payable after October 15, 2008, are not paid in cash) for four (4) consecutive quarterly dividend periods." (A125) The correct interpretation – which SBS has held at all times since Lehman drafted the Certificate, and which Lehman held until November 2012 – is that a VRTE occurs if two conditions are

met: *first*, dividends on the outstanding Series B Preferred Stock must be in arrears (in other words, SBS must have deferred payment of some amount of dividends that have accrued and become payable); and *second*, SBS must have not paid dividends for four quarters in a row. However, [redacted], and Lehman now argues that a VRTE is triggered if SBS falls into arrears and remains so for a year, regardless of how many dividends are unpaid (the "Taylor Interpretation").

At a hearing on SBS's Motion to Dismiss, the Court of Chancery remarked that Section 9(b) appears "ambiguous on its face," and requested that the parties take discovery and eventually file cross-motions for summary judgment. During the course of that discovery ([redacted]), T. Rowe Price – another Series B Preferred stockholder – joined the action, and Lehman amended its complaint. After briefing and oral argument on the parties' cross-motions for summary judgment, the Court of Chancery held (without resolving the disputed meaning of Section 9(b)) that Lehman had acquiesced to SBS's actions, and granted summary judgment in favor of SBS. Lehman appeals from that decision. SBS cross-appeals to raise alternate grounds for affirmance – that the Taylor Interpretation is unreasonable, and that any ambiguity must be resolved against Lehman.

SUMMARY OF ARGUMENT

Beginning in 2009, SBS deferred certain dividends on the Series B Preferred Stock. In 2011 and 2012, SBS incurred debt. [redacted] A few months later, Lehman filed this lawsuit. The Court of Chancery found that Lehman had acquiesced to any purported breaches of the Certificate, and granted summary judgment for SBS. That holding was legally and factually proper, and should be upheld.

Even if the Court does not affirm the specific holding of the Court below, there are numerous other grounds to affirm summary judgment in favor of SBS here. *First*, Lehman is equitably estopped from claiming that a VRTE existed at the time of SBS's debt incurrences in 2011 and 2012 because SBS reasonably relied on Lehman's silence and representations to the contrary. *Second*, even without consideration of equitable defenses, Lehman's claims must be rejected because the Certificate cannot be construed as Lehman suggests. Under the only reasonable interpretation of Section 9(b), no VRTE had occurred at the time of the challenged debt incurrences. *Third*, even if the Certificate is ambiguous, Delaware

law requires that any ambiguity relating to stock preferences be resolved against the creation of additional rights for preferred holders. *Fourth*, even if Lehman does have a valid claim, it would only be entitled to equitable relief, and thus Plaintiffs' claims are properly barred by laches.

1. Denied. Acquiescence requires that a plaintiff have full knowledge of its rights and all material facts, and those elements are satisfied here. Lehman had full knowledge of the terms of the Certificate, full knowledge of SBS's dividend deferrals, and full knowledge that SBS intended to incur debt. The fact that Lehman had not yet invented the Taylor Interpretation does not mean that it lacked "full knowledge" of its rights.

2. Denied. Equitable estoppel requires that a party lack knowledge or the means of obtaining knowledge of the truth of the facts in question, reasonably rely on the conduct of the party against whom estoppel is claimed and suffer a prejudicial change of position as a result of its reliance, and those elements are satisfied here. The "fact" that Lehman asserts here is the alleged existence of a VRTE at the time of SBS's debt incurrences. In 2011 and 2012, SBS (and everyone else) believed that no VRTE was in effect. Lehman claims that equitable estoppel is inapplicable because it did not believe that a VRTE had occurred, but the Taylor Interpretation is not a "fact," and Lehman's prior beliefs are not relevant to the estoppel inquiry. Moreover, SBS's reliance on Lehman's actions was

reasonable. Despite knowledge of the terms of the Certificate and SBS's dividend deferrals, Lehman actively participated in the 2012 Notes Offering. One week after the 2012 Notes were issued, Lehman's counsel sent a letter to SBS confirming the fact that no VRTE had occurred. Finally, SBS was prejudiced by its reliance because, having relied on Lehman's indication that the challenged debt incurrences were permissible, the Company went ahead with the 2012 Notes Offering but now must defend against this lawsuit.

3. Denied. The Certificate is unambiguous and a VRTE is only triggered if dividends on the outstanding Series B Preferred Stock are in arrears and SBS has failed to pay four consecutive quarterly dividends. This interpretation is reasonable, gives meaning to all of the Certificate's terms and comports with the Certificate as a whole. The Taylor Interpretation, on the other hand, reduces key terms to mere surplusage, could have been expressed in simpler terms and is contrary to common industry practices and other courts' interpretations of similar language.

4. If Section 9(b) of the Certificate is ambiguous, the Court should resolve the ambiguity against Lehman because stock preferences must be explicitly stated in the Certificate and may not be presumed or implied. To the extent that a conflict exists between this long-standing interpretive principle and the newer *contra proferentem* doctrine first applied to preferred stock in *Kaiser Aluminum*

Corp. v. Matheson, 681 A.2d 392 (Del. 1996), the conflict is easily resolved: *contra proferentem* may only be used to resolve an ambiguity that does not relate to stock preferences, as was the case in *Kaiser* and every other case applying the *contra proferentem* principle to a preferred stock instrument. However if, as here, the ambiguity relates to preferential rights, it must be resolved against the expansion of stock preferences.

5. The Court of Chancery erred in holding that Lehman could recover contract damages in this action. As the Court below noted, the usual measure of damages for breach of contract under Delaware law is expectation damages, wherein a plaintiff is put in the position he would have been in if the breach had never occurred. Here, Lehman alleges that SBS breached the Certificate by failing to clear a purported VRTE before incurring indebtedness, but admits that the only way for SBS to clear a VRTE is to pay all accrued and unpaid dividends. Critically, however, the Court may only award undeclared dividends in the exercise of its equitable powers because a standard award of money damages without a concurrent reduction in the amount of current unpaid dividends would lead to a double recovery. Because Lehman's claims could only be remedied by equitable relief, the Court below erred to the extent that it foreclosed consideration of any applicable equitable defenses based on its conclusion that Lehman could recover money damages here.

COUNTERSTATEMENT OF FACTS

A. Lehman Drafted The Certificate.

Lehman admits that it "assisted the Company in assembling an offering memorandum for Series A Preferred Stock" (OB at 6), but that is too modest; Lehman's affiliate drafted all of the Certificate provisions at issue here. In 2003, when SBS required financing to buy a Los Angeles-based radio station, SBS engaged Lehman as its primary advisor. (*See* B700-01) [redacted] (*See* B706) "PIK," a common term of art in financial markets, stands for "paid in kind" and refers to preferred stock for which dividends can be paid in additional shares of stock, rather than in cash. (*See* A1198) Even in early 2003, SBS was aware that [redacted]. (*See* A1610) Nonetheless, [redacted]. (*See* B409)

From the beginning of August 2003, Lehman took the lead in drafting the Certificate. (*See* B735-36) Materials distributed before an August 19, 2003 organizational meeting indicate that Lehman was responsible for the initial draft terms of what was to become the Series B Preferred Stock. (*See* A941; A1623; A1650) The provisions at issue in this action – relating to dividend payments and

voting rights – were not changed between the initial draft terms and the final Offering Memorandum distributed to potential purchasers, other than to add a date. (*Compare* A1659 *with* A1289)

Lehman never discussed or negotiated the VRTE or dividend payment provisions with SBS or anyone else. Indeed, [redacted]. (*See* A1089) [redacted]. (*See* A1476) [redacted]. (*See* A1757) The relevant language of Section 9(b)(i) in that initial draft is identical to the language in the final Certificate. (*Compare* A1780 *with* A1884) SBS never requested any change, and the words are Lehman's alone.

B. Lehman Was The Initial Purchaser Of The Preferred Stock.

In addition to its role as lead underwriter for issuance of the Preferred Stock, Lehman was its initial purchaser and subsequently arranged to sell the majority of its shares to other entities. (*See* A1293; *see also* A1753-54) Lehman claims that none of the investors who acquired the Series A Preferred Stock participated in negotiating the terms of the security. (OB at 7) That misstates the underwriting process, and ignores Lehman's role in defining the terms of the security. As the underwriter of the stock offering, Lehman itself negotiated on behalf of the

eventual purchasers. In addition, before deciding whether or not to acquire the Preferred Stock, each ultimate purchaser "had access to such financial and other information concerning [SBS] and the Series A preferred stock as you have deemed necessary … including an opportunity to ask questions of, and request information from, us and the initial purchasers." (*See* B816)

No later than October 15, 2003, Lehman had placed its entire allocation of the Series A Preferred Stock with investors. (*See* A1753-54) After Lehman and other investors committed to purchase the Preferred Stock, Lehman drafted the Certificate. (*See* A1079-80) The Series B Preferred Stock at issue in this action was then issued in the spring of 2004, pursuant to a transaction in which holders of the Company's unregistered Series A Preferred Stock exchanged their shares for the Series B Preferred Stock. (*See* B634-36) Other than its registration status and name, the Series A Preferred Stock was identical to the Series B Preferred Stock in all ways relevant to this action. (B636)

C. Terms Of The Series B Preferred Stock.

[redacted] (OB at 8-9) That is not how the Certificate is structured. Rather, Section 4(a) of the

Certificate entitles Series B Preferred stockholders to receive, "when, as and if declared by the Board of Directors," dividends accruing at a fixed rate per year. (A119) If "at any time, dividends on the outstanding Series B Preferred Stock are in arrears and unpaid (and in the case of dividends payable after October 15, 2008, are not paid in cash) for four (4) consecutive quarterly dividend periods," a VRTE occurs. (A125) In the event of a VRTE, "the number of directors constituting the Board of Directors of [SBS] will be adjusted to permit the holders of the majority of the then outstanding Series A Preferred Stock and Series B Preferred Stock, voting together as one class, to elect two directors." (A126) The occurrence of a VRTE also bars SBS from taking on certain types of indebtedness. (A131-33)

D. Lehman's Failure And The Global Economic Collapse Of 2008 Force SBS To Conserve Cash.

The global economic crisis of 2008 caused significant upheaval in the financial markets. (*See* B821) Lehman's collapse left SBS in a precarious position because Lehman failed to fund a critical $10 million revolving debt obligation to SBS. (*See* A961) Lehman's failure could not have come at a worse time. Earlier in 2008, [redacted] (*See* B821; A984; A997)

In the spring of 2009, [redacted] (*Id*.) SBS exercised its business judgment in considering its various obligations before deciding whether to defer dividends. (*See* B525) Pursuant to that business judgment, [redacted] (*See* B148-49; B533; A997) Accordingly, [redacted] (*See* A1958-59; B839; *see also* A588-95) Lehman alleges that SBS "re-interpret[ed]" the Certificate at this time (OB at 29), but no evidence supports Lehman's claim. SBS did not change its interpretation of Section 9(b) at any time.

E. [redacted]

Lehman was the holder of SBS's Senior Credit Facility Term Loan due 2012 (the "Term Loan"). (A878-79) Pursuant to the terms of that instrument, SBS was required to send its quarterly and yearly reports to Lehman, and included with each report a calculation of accrued dividends on the Series B Preferred Stock. (*See, e.g.*, B846-53; B861-65; B867-73; B875-81) SBS's decision to defer the July 15, 2009 dividend was publicly disclosed in SBS's Quarterly Report for the period ending June 30, 2009 – which was sent directly from SBS to Lehman on August

12, 2009. (*See* B846; B850) Thus, Lehman had substantially concurrent knowledge of SBS's July 2009 dividend deferral. (*See* A850; B846; *see generally* A859) The same is true of every other deferred dividend, for the same reasons – in each case, Lehman had actual knowledge of the deferral on or soon after the relevant dividend payment date.

Although the occurrence of a VRTE would have given preferred holders the right to elect two directors, no Series B Preferred stockholder (nor any other party) contended that SBS's dividend deferrals caused a VRTE at any time before the filing of this lawsuit on February 14, 2013. In fact, in September 2009, Lehman's [redacted] (B857) [redacted] (A858) Accordingly Lehman remained silent while SBS deferred dividends and incurred indebtedness.

F. SBS Gave Advance Notice Of Its Intent To Incur Indebtedness.

Secure in the knowledge that no VRTE had occurred, SBS conducted its business as usual after 2010. On May 6, 2011, SBS publicly announced that it intended to purchase the KTBU television station (the "Houston Acquisition"), and

concurrently issue an $8 million promissory note. (*See* A1296) Neither Lehman nor any other holder of Series B Preferred Stock asserted that issuance of this promissory note was barred by the Certificate because a VRTE had occurred. On August 1, 2011, SBS completed the Houston Acquisition. (*See* B883; B886-87)

G. [redacted]

SBS's Term Loan due 2012 (held by Lehman) was repaid with the proceeds of the 2012 Notes Offering, [redacted] (A878) [redacted] (*See* A878; B902-05; B911-13) Nonetheless, neither Lehman nor any other market participant complained or alleged that the 2012 Notes Offering was barred by the Certificate because a VRTE had occurred. The offering closed on February 7, 2012. (*See* B921)

[redacted]

[redacted] (B910) [redacted] (*Id.*) [redacted] (B913) [redacted] (B914) [redacted] (*Id.*) [redacted] (B924-30) [redacted] (*See* A880-81) [redacted] (*See id.*; B932-33) [redacted] (B1166) Nonetheless,

[redacted] (OB at 14; A1124; B1177)

[redacted] (*See* A1059)

[redacted] (*See* A1206) [redacted]

[redacted] (*See* A1196) Lehman filed its original complaint in this action on February 14, 2013, and filed its Amended Complaint on October 9, 2013. The Court of Chancery granted SBS's motion for summary judgment on February 25, 2014. This appeal followed.

ARGUMENT

I. ACQUIESCENCE BARS LEHMAN'S CLAIMS.

A. Question Presented: Did the Court of Chancery err in ruling that Lehman's claims were barred by the doctrine of acquiescence?

B. Scope Of Review: "On appeal from a decision granting summary judgment, this Court reviews the entire record to determine whether the Chancellor's findings are clearly supported by the record and whether the conclusions drawn from those findings are the product of an orderly and logical reasoning process. This Court does not draw its own conclusions with respect to those facts unless the record shows that the trial court's findings are clearly wrong and justice so requires." *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 48 (Del. 2006). Questions of law are reviewed *de novo*. *Id.*

C. Merits Of Argument:

The Court of Chancery correctly determined that Lehman acquiesced in any purported breaches of the Certificate, and granted summary judgment in favor of SBS. Acquiescence bars a party's claims when he "'has full knowledge of his rights and the material facts and (1) remains inactive for a considerable time; or (2) freely does what amounts to recognition of the complained of act; or (3) acts in a manner inconsistent with the subsequent repudiation, which leads the other party to believe the act has been approved.'" *Klaassen v. Allegro Dev. Corp.*, --- A.3d ---, 2014 WL 996375, at *8 (Del. Mar. 14, 2014) (citation omitted).

1. Lehman Had Full Knowledge Of Its Rights And The Material Facts At All Relevant Times.

Lehman argues that it "lacked the requisite knowledge" for a finding of acquiescence (OB at 17), but the Opening Brief never explains *what*, exactly, Lehman did not know. The record proves that for years it knew everything necessary to assert its claim, except for the Taylor Interpretation. *First*, Lehman drafted the Certificate and knew when it acquired the Series B Preferred Stock that when a VRTE occurs, the Series B Preferred stockholders could elect two directors to SBS's Board of Directors and prevent the Company from incurring indebtedness. (*Supra* at 7-10, 13-14) *Second*, Lehman knew when it acquired the Series B Preferred Stock that a VRTE occurs "if at any time, dividends on the outstanding Series B Preferred Stock are in arrears and unpaid (and in the case of dividends payable after October 15, 2008, are not paid in cash) for four (4) consecutive quarterly dividend periods." (*Supra* at 7-10, 13-14) *Third*, [redacted] (*Supra* at 11-12) *Fourth*, Lehman knew that SBS intended to incur indebtedness in connection with the Houston Acquisition and the 2012 Notes Issuance before either transaction occurred. (*Supra* at 12-13) Lehman's knowledge of these facts is all that is required to support a finding of acquiescence.

2. Lehman Did Not "Remain[] Silent In Ignorance."

Lehman claims that it "lacked the requisite knowledge" (OB at 17) and repeatedly quotes SBS's counsel as purported proof that its "level of knowledge [w]as 'ignorance.'" (OB at 13, 18) That is wrong. Lehman may have been ignorant of the Taylor Interpretation, but that is irrelevant to a finding of acquiescence. Rather, knowledge of the *existence* of a legal right (not, as Lehman argues, knowledge of a later-argued interpretation of the conditions triggering that right (OB at 21-22)) is all that is required to find acquiescence, and that knowledge is present here.

Lehman's Opening Brief selectively quotes from two cases that actually demonstrate that acquiescence occurred here. (OB at 17-18) The first, *TriState Courier & Carriage, Inc. v. Berryman*, refused to find acquiescence when the plaintiff corporation's acting president was not shown to be "well informed ***of the terms of the Covenant***" alleged to have been violated. 2004 WL 835886, at *9 n.123 (Del. Ch. Apr. 15, 2004) (emphasis added). Accordingly the court in *TriState Courier* refused to find acquiescence when a new party, without knowledge of the contract terms at issue, failed to contemporaneously object to a breach. Here, by contrast, Lehman was always aware of the Certificate's terms,

[redacted][1] Thus, under the *TriState Courier* rubric, Lehman acquiesced.

Tenneco Automotive Inc. v. El Paso Corp. also does not help Lehman. 2004 WL 3217795 (Del. Ch. Aug. 26, 2004). There, the Court refused to find acquiescence when plaintiff did not have knowledge of material facts at issue until it received actual notice of defendant's allegedly impermissible settlement with an insurer. The Court noted that "New Tenneco did not know when a settlement would (if it could) be reached, what the precise terms would be, or how its interests might be specifically affected. Perhaps, it could have guessed accurately, but accurate guessing is not a substitute for the knowledge that is required before one can be deemed to have acquiesced." *Id.* at *12. Again, however, the *Tenneco* Court refused to find acquiescence because the plaintiff did not have actual knowledge of the facts alleged to be a violation of the contract at issue. Here,

[1] A similar factual scenario arose in the recent *Klaassen* case, where the Court found that the plaintiff "fully understood his rights under the Charter" because "[a]t the time of his [allegedly wrongful] removal, he already had obtained legal advice about his rights … both from the Company's General Counsel and from Gibson Dunn, and within hours after the November 1 meeting, [plaintiff] sought legal advice from his personal counsel." *Klaassen v. Allegro Dev. Corp.*, 2013 WL 5739680, at *20 (Del. Ch. Oct. 11, 2013), *aff'd*, 2014 WL 996375 (Del. 2014). The *Klaassen* plaintiff acquiesced when "[d]espite his knowledge, Klaassen failed to assert any claims for seven months." *Id.* Notably, the argument for acquiescence in this case is far stronger than it was in *Klaassen* because here Lehman had advance notice of the actions it would later claim were breaches, but stood silent. Klaassen, on the other hand, was presented with a *fait accompli*.

Lehman knew of SBS's dividend deferrals and learned of SBS's debt incurrences before they happened. (*Supra* at 11-13) Lehman knew the "precise terms" of the debt incurrences, and it knew how its interests would specifically be affected. (*Supra* at 12-13) Lehman had no need to "guess" any of the material facts, and it knew of its rights under the Certificate. Thus, Lehman acquiesced under the *Tenneco* rubric as well.

Lehman also argues that "'the absence of a meaningful choice precludes a finding of acquiescence'" (OB at 17), but Lehman could easily have challenged SBS's debt incurrences at any time. Indeed, *In re Best Lock Corp. Shareholder Litigation* – the case that Lehman relies on for its "absence of a meaningful choice" argument – proves that Lehman *had* a choice here. 845 A.2d 1057, 1076 (Del. Ch. 2001) (refusing to find acquiescence when plaintiffs were cashed out of their stock holdings via a permissible merger). In *Best Lock*, the Court distinguished preferred stock cases by noting "[t]he significant difference between these cases and the claims … [in *Best Lock*] lies in the fact that the defendant corporations in these other cases could only deal with the plaintiffs' stock 'in a manner inconsistent with [their] rights of ownership' if the plaintiffs did not object." *Id.* at 1077 n.82. Here, as the Court of Chancery noted in its opinion below, "the Plaintiffs needed only to *notify* SBS that, under what it insists is the *clear* language of the Certificate, a VRTE was in effect, and therefore a debt

incurrence would constitute a breach." (Memorandum Opinion ("Op.," attached hereto as Exhibit A[2]) at 27-28) *Best Lock* is inapposite here, and "'assent to a proposed corporate act will be inferred in a case where a stockholder, with full knowledge of an intended invasion of his rights and an opportunity to dissent, stands by during the progress of a proceeding which, although unauthorized, is ratifiable, and allows, without objection, his stock to be dealt with in a manner inconsistent with his rights of ownership.'" 845 A.2d at 1077 n.82 (quoting *Bay Newfoundland Co. v. Wilson & Co.*, 37 A.2d 59, 64 (Del. 1944)).

3. Constructive Knowledge Is Sufficient To Find Acquiescence.

As demonstrated above, Lehman has actual knowledge of the terms of the Certificate at all times, and contemporaneous knowledge of the Taylor Interpretation is not necessary for the Court to find acquiescence. But even if the Court does find that acquiescence requires knowledge of Lehman's later-argued interpretation of the supposedly unambiguous terms of the Certificate's VRTE trigger, the Court of Chancery did not err in holding that constructive knowledge is sufficient here. If, as Lehman itself claims, "the Company could read the Certificate as well as Plaintiff" (OB at 29), then Lehman had constructive knowledge of its purported rights at all times relevant to this action. As the

[2] The Final Order and Judgment is attached hereto as Exhibit B.

Klaassen case demonstrates, that is sufficient to find acquiescence. *See Klaassen v. Allegro Dev. Corp.*, 2013 WL 5739680, at *20 (Del. Ch. Oct. 11, 2013) (finding knowledge of rights granted by certificate of incorporation where plaintiff "was familiar with [defendant's] constitutive documents" and "obtained legal advice about his rights" both before and after later-challenged conduct), *aff'd*, 2014 WL 996375 (Del. 2014).

Lehman's sole argument to the contrary is that, in a number of selected cases, Delaware courts said that constructive knowledge is sufficient but found actual knowledge on the facts in each case. (OB at 19-21) But just because a statement is *dicta* does not mean it is wrong. Delaware courts have never contradicted the long-standing rule that "'[w]hen a man with full knowledge, *or at least with sufficient notice or means of knowledge of his rights*, and of all the material circumstances of the case … lies by for a considerable time, and knowingly and deliberately permits another to deal with property, or incur expense, under the belief that the transaction has been recognized, or freely and advisedly abstains for a considerable lapse of time from impeaching it, there is acquiescence, and the transaction, although originally impeachable, becomes unimpeachable in equity.'" *Papaioanu v. Comm'rs of Rehoboth*, 186 A.2d 745, 749-50 (Del. Ch. 1962) (emphasis added) (citation omitted). Indeed, the Court of Chancery recognized in 2012 that acquiescence (and its sister doctrine, ratification) requires

a lower standard of knowledge than other equitable doctrines. *See ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 2012 WL 1869416, at *17 (Del. Ch. May 16, 2012) (noting that constructive knowledge suffices to find acquiescence, but "[f]or purposes of reformation, however, stricter rules apply. Rather than imputed or constructive knowledge, ratification of a contract subject to reformation requires actual knowledge of the error"), *aff'd*, 68 A.3d 665, 680 (Del. 2013) ("[T]he Vice Chancellor accurately stated Delaware law.").

In this context, an alleged mistake as to interpretation of a contract's terms is similar to an alleged mistake of law, and neither will prevent application of the doctrine of acquiescence. In *Trounstine v. Remington Rand, Inc.*, a preferred stockholder challenged allegedly illegal stock reclassifications, but the Court noted "[i]t is no answer to this for the complainant to say that his delay was occasioned by the mistaken view of the law…." 194 A. 95, 98 (Del. Ch. 1937). That rule is equally applicable here, where Lehman claims that SBS's debt incurrences were clearly barred by the Certificate (*i.e.* the "law" imposed by contract) but at the same time argues that its delay in challenging the debt incurrences is excused by its mistaken understanding of Section 9(b). "The ancient and well established doctrine of equity was that relief would not be granted, defensively or affirmatively, because of a mistake of law …." *Frank v. Wilson & Co.*, 32 A.2d

277, 281 (Del. 1943). The same should be true with regard to a mistake in contract interpretation.

4. [redacted] And Thus Acquiesced.

Lehman claims to have been "silent" with respect to the purported Certificate breaches (OB at 16, 21-22), but that is wrong. "The rule is a general one that he who participates in or acquiesces in an action has no standing in a court of equity to complain against it, even though the act be against the permission of the law." *Trounstine*, 194 A. at 99. [redacted] (*Supra* at 13) Thus, the general rule applies, and "equity will not hear a complainant stultify himself by complaining against acts in which he participated or of which he has demonstrated his approval by sharing in their benefits. This observation has added force where the acquiescence relates to rights of the assenting party that are contractual in nature, as is the situation in this case." *Id.*

5. Lehman's Failure To Assert Its Purported Rights Is Acquiescence.

Lehman argues in its Opening Brief that because the Certificate does not require stockholders to notify SBS that a VRTE has occurred, it did not acquiesce in the purported breaches. (OB at 21-22) That is also wrong. "'He who seeks the

aid of equity to enjoin the violation of an agreement, or for the protection of his contract rights, must himself come into court with clean hands, and ***to entitle himself to relief he must have carried out, as far as possible, his own part of the contract***. So, too, ***he must show that he has used reasonable diligence in asserting his rights and in demanding their protection***, and unreasonable delay in seeking the aid of a court of equity, or acquiescence in the violation of the agreement in question, will generally prove a bar to the exercise of the jurisdiction.'" *Papaioanu*, 186 A.2d at 749 (emphasis added) (citation omitted).

This is particularly important in the context of a preferred stock certificate, interpretation of which will have important and far-reaching effects on the company's capital structure as a whole. As the Court of Chancery has noted:

> The desirability of repose to fundamental questions vitally affecting … the exact character and rights which belong to [a corporation's] shares of stock, not only from the view point of the stockholders who might desire to sell their stock but of other persons who contemplate buying it, as well as from the view point of the corporation, forcefully suggest that there ought to come a time when it could be said with assurance that the status of the rights and burdens attaching to the corporation's securities is definitely fixed. … ***Where action affecting numerous persons, though illegal, is susceptible of ratification, he who desires to object thereto owes some duty to the others to be diligent according as circumstances would suggest in taking his position in respect thereto.***

Romer v. Porcelain Prods., Inc., 2 A.2d 75, 77 (Del. Ch. 1938) (emphasis added). This is in part because "other persons who relied on the capital structure of the company as fixed and definite in accordance with the terms of the [Certificate], bought the common stock during the period of the complainants' silence and inactivity, in complete ignorance of the fact that the complainants were intending to assert a demand which if acceded to would place a burden on the assets and earnings ahead of the common stock's equity." *Id.* at 77. Those common stockholders, who are the ultimate beneficiaries of SBS's equity, "are entitled to be protected against damage thereto which, had the complainants been reasonably diligent in asserting their rights, they would be saved." *Id.* at 58; *see generally Shiftan v. Morgan Joseph Holdings, Inc.*, 57 A.3d 928, 938 n.28 (Del. Ch. 2012) ("[O]ther investors rely on the certificate and other publicly available documents describing the certificate, and granting rights to the preferred stock on the basis of an ambiguous certificate could disrupt the reasonable expectations of the other investors."). Lehman's failure to timely object to SBS's debt incurrences constitutes acquiescence sufficient to bar recovery in this action.

II. LEHMAN IS EQUITABLY ESTOPPED FROM ASSERTING ITS CONTRACT CLAIMS.

A. Question Presented:

Is Lehman equitably estopped from asserting its contract claims?

B. Scope Of Review:

See Section I.B. above.

C. Merits Of Argument:

Equitable estoppel applies "'when a party by his conduct intentionally or unintentionally leads another, in reliance upon that conduct, to change position to his detriment.'" *Nevins v. Bryan*, 885 A.2d 233, 249 (Del. Ch. 2005) (quoting *Wilson v. Am. Ins. Co.*, 209 A.2d 902, 903-04 (Del. 1965)), *aff'd*, 884 A.2d 512 (Del. 2005) (TABLE). Thus, "[t]he party claiming estoppel must demonstrate that: (i) they lacked knowledge or the means of obtaining knowledge of the truth of the facts in question; (ii) they reasonably relied on the conduct of the party against whom estoppel is claimed; and (iii) they suffered a prejudicial change of position as a result of their reliance." *Id*. All three elements are present here. Lehman was silent before SBS incurred indebtedness, [redacted] SBS took all of the actions that Lehman now challenges in reliance on Lehman's conduct. Before this action was filed, SBS had no way of knowing that Lehman would reinterpret the Certificate and impose significant litigation risks and

costs in an effort to extract cash from the Company. On these facts, Lehman is equitably estopped from claiming that a VRTE was in effect in 2011 and 2012.

1. SBS Lacked Knowledge Or Means Of Obtaining Knowledge Of The Existence Of A VRTE In 2011 Or 2012.

Lehman argues that SBS did not lack knowledge or the means of obtaining knowledge of Lehman's failure to disclose, or of Lehman's view that a VRTE was in effect at the time of the challenged debt incurrences. (OB at 26-27) But Lehman's *actions* and *opinions* are not the "facts" at issue here. Rather, the "fact" at issue here is the actual existence of a VRTE at the time of the challenged debt incurrences. Lehman argues that the estopped party must have actual knowledge of the fact at issue (OB at 28-29), but that is not an element of equitable estoppel. *Nevins*, 885 A.2d at 250 ("[E]ven if Nevins did not know of the defect in the July 16, 2000 Written Consent, he is still equitably estopped from asserting that the Director Defendants are not valid CADERA directors."). Rather, that Lehman did not believe that a VRTE existed [redacted] is actually proof that SBS – and every other investor and market participant – lacked knowledge or means of obtaining knowledge that a VRTE had purportedly occurred earlier. *See U.S. Bank Nat'l v. Swanson*, 2006 WL 1579779, at *1 (Del. Super. Ct. May 1, 2006) (finding that the lack of knowledge requirement was met because the party had no means of obtaining the relevant facts, other than through the other party, which had remained silent), *aff'd*, 918 A.2d 339 (Del. 2006) (TABLE).

2. SBS Reasonably Relied On Lehman's Actions And Silence.

Lehman argues that estoppel by silence is inapplicable here (OB at 27-29),[3] but Lehman was not silent. Barely a week after the 2012 Notes Issuance, Lehman's counsel sent a letter to SBS claiming that the Company had wrongfully *avoided* triggering a VRTE. (*See* B932-33 (alleging "an apparently conscious and willful pattern of making one payment every fourth quarter so as to specifically prevent the holders of the Series B Preferred Stock from exercising their rights to board representation") Moreover, Lehman argues that that Series B Preferred holders were under no duty to take any action upon a VRTE (OB at 29), but that misstates applicable law. It is true that Lehman had no *affirmative* duty to take action, but equity holds that "where many persons will be affected by an act that involves a change of capital structure and a material alteration of rights attached to stock ownership, the stockholder, having knowledge of the contemplated action, owes a duty both to the corporation and to the stockholders to act with the promptness demanded by the particular circumstances." *Fed. United Corp. v. Havender*, 11 A.2d 331, 343 (Del. 1940). Accordingly Lehman is not *liable* to

[3] Lehman's reliance on *American Family Mortgage Corp. v. Acierno* is misplaced. 1994 WL 144591 (Del. Mar. 28, 1994) (TABLE). In that case, the party claiming estoppel was trying to "bury [its] head" to avoid hearing the opposing party's concerns. *Id*. at *5. *Acierno* only stands for the proposition that a party that has received an indication of an objection cannot avoid hearing the objection solely to support an estoppel defense. That did not happen here.

other stockholders for its failure to timely assert a VRTE, but also may not impair their rights by doing so now.

Lehman is also incorrect in arguing that SBS's reliance was not reasonable. (OB at 29-30) To establish equitable estoppel, reliance must be "'reasonable and justified under the circumstances.'" *U.S. Bank Nat'l v. Swanson*, 918 A.2d 339, 2006 WL 3952032, at *2 (Del. 2006) (TABLE) (citation omitted). The Court of Chancery determined that SBS's reliance was reasonable because preferred stockholders with a "significant economic interest" would be expected to "hold a special meeting to fill the board seats created by the happening of a VRTE." (Op. at 29) SBS relied on the complete silence of every preferred stockholder at all times before November 2012 and thus believed that there was no bar to the challenged debt incurrences. *Id*.

On appeal, Lehman makes a number of meritless arguments in an attempt to show that SBS's reliance was unreasonable. (OB at 29-30) *First*, Lehman argues that SBS and Lehman could read the Certificate equally well, and that SBS should have understood that "its decision to re-interpret a public instrument years after its issuance carried a litigation risk." (OB at 29) But SBS's interpretation of Section 9(b) has been exactly the same since Lehman drafted the Certificate. (*Supra* at 11)

[redacted] (OB at 14) In 2011 and 2012

SBS was entitled to rely on the interpretation shared by SBS, Lehman and market participants including other stockholders, financial ratings agencies, financial advisors and law firms. (*See* A788-92; B951; B960; B970; B985; B992-93; B1076 n.(e); B1127-28; B1160; B16-17; B47; B66)

Second, Lehman argues that SBS "succeeded in obfuscating these issues through its SEC disclosure statements and otherwise" (OB at 30), but that assertion cannot be squared with Lehman's claim that "the Company could read the Certificate as well as Plaintiff." (OB at 29) SBS could not have "obfuscated" the meaning of a publicly filed document – the Certificate.

Third, Lehman's bankruptcy is irrelevant and the facts contradict its claim to have been "distracted" at the time of the debt incurrences. (OB at 30) [redacted] (*See* B924-30) [redacted] and its counsel sent a letter to SBS confirming that no VRTE had occurred. Clearly, Lehman was informed as to its rights and the status of the Series B Preferred Stock in general.

3. SBS Changed Position To Its Detriment.

To find that a prejudicial change of position has occurred, courts will consider the general circumstances surrounding the action taken, including any risks the party has incurred due to its reliance. *See Nevins*, 885 A.2d at 249-50.

Here, SBS relied on Lehman's actions as confirmation that no VRTE had occurred at the time of the challenged debt incurrences, and went ahead with the transactions secure in the belief that no VRTE was in effect. That reliance was detrimental to SBS because the Company has now had to expend money defending this action, and could be forced to submit to costly equitable relief rather than simply taking steps to avoid a breach in the first place. *See Steele v. Ratledge*, 2002 WL 31260990, at *4 (Del. Ch. Sept. 20, 2002) (considering the cost of defending litigation as a factor in its analysis of substantive prejudice); *Reserves Dev. LLC v. Severn Sav. Bank, FSB*, 2007 WL 4054231, at *14-16 (Del. Ch. Nov. 9, 2007) (finding equitable estoppel when party had incurred financial burden).

III. NEITHER THE HOUSTON ACQUISITION NOR THE 2012 NOTES ISSUANCE CONSTITUTED A BREACH OF THE CERTIFICATE.

A. Question Presented:

Did the Company breach the Certificate by incurring debt during a VRTE?

B. Scope Of Review:

See Section I.B. above.

C. Merits Of Argument:

Under the Taylor Interpretation, Lehman argues that the Certificate is unambiguous and a VRTE occurs based on the length of time that dividends are in arrears, not how many dividends in a row are deferred. (OB at 31-33) Lehman argues that SBS's interpretation is commercially unreasonable. But the "classic case" on contingent preferred stock voting rights "involved such a share structure, where preferred stockholders gained the ability to vote in board elections if four consecutive dividend payments were missed." Charles R. Korsmo, *Venture Capital and Preferred Stock*, 78 Brook. L. Rev. 1163, 1172 n.39 (2013) (hereinafter "Korsmo, *Preferred Stock*") (citing *Zahn v. Transamerica Corp.*, 162 F.2d 36, 39 (3d Cir. 1947)[4]). Section 9(b) of the Certificate unambiguously utilizes that "classic" structure as the VRTE trigger, and because SBS never missed four consecutive dividend payments, no VRTE existed at the time SBS incurred debt.

[4] The *Zahn* court noted that "if there were four successive defaults in the payment of quarterly dividends, the class or classes of stock as to which such defaults occurred gained voting rights." 162 F.2d at 39.

"When the language of a[] ... contract is clear and unequivocal, a party will be bound by its plain meaning because creating an ambiguity where none exists could, in effect, create a new contract with rights, liabilities, and duties to which the parties had not assented." *Nat'l Grange Mut. Ins. Co. v. Elegant Slumming, Inc.*, 59 A.3d 928, 931 (Del. 2013). Thus, "Delaware law respects the freedom of parties in commerce to strike bargains and honors and enforces those bargains as plainly written." *Related Westpac LLC v. JER Snowmass LLC*, 2010 WL 2929708, at *6 (Del. Ch. July 23, 2010); *see also Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1195-96 (Del. 1992). Here, the plain language of the Certificate compels the conclusion that no VRTE had occurred at the time SBS incurred debt in 2011 and 2012.

1. The Certificate Is Unambiguous And No VRTE Existed At The Time SBS Incurred Debt.

A VRTE is triggered "if at any time, dividends on the outstanding Series B Preferred Stock are in arrears and unpaid (and in the case of dividends payable after October 15, 2008, are not paid in cash) for four (4) consecutive quarterly dividend periods." This language unambiguously requires the simultaneous existence of two independent conditions to trigger a VRTE. *First*, dividends on the outstanding Series B Preferred Stock must be *in arrears*; in other words, SBS must have deferred payment of some amount of dividends that have accrued and become payable. *Second*, dividends on the outstanding Series B Preferred Stock must be

unpaid for four consecutive quarterly dividend periods; in other words, SBS must not have paid dividends for four quarters in a row.

SBS's interpretation comports with courts' interpretations of similar language. For instance, in *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 165 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006), the Court of Chancery addressed a certificate of designations that provided preferred stockholders with special voting rights "at any time that the Corporation has failed for two (2) consecutive calendar quarters, to pay any dividends required to be paid by it…." (B6) The Court characterized this provision as meaning that the preferred stock was entitled to an additional seat on the board "if Benihana missed its dividend for two consecutive quarters." *Benihana*, 891 A.2d at 165. Similarly, in *Flerlage v. KDI Corp.*, the Court of Chancery examined a preferred stock agreement that expanded voting rights "if at any time dividends on shares of [the] … Preferred Stock shall not have been paid for two consecutive annual payment dates," and found that language to mean "that the preferred stockholders shall be entitled to … vote[] … after two consecutive dividends on the preferred stock have not been paid." 1986 WL 4278, at *1, *3 (Del. Ch. Apr. 10, 1986). Moreover, in *In re Piece Goods Shops Co.*, 188 B.R. 778, 796 (Bankr. M.D.N.C. 1995), the court addressed a provision giving preferred stockholders a "contingent right to elect two directors of the Company in the event dividends payable are in arrears and unpaid

for two consecutive periods" and paraphrased that right as an "opportunity to elect directors based on two consecutive missed dividends." Admittedly, in none of these cases was the court's interpretation necessary to its holding. Nonetheless, that every court that has ever addressed similar language interpreted it consistently with SBS is powerful evidence that SBS's interpretation is correct.

2. SBS's Interpretation Of The VRTE Provision Is Reasonable, And The Taylor Interpretation Is Not.

SBS's reading of the VRTE provision gives meaning to all of the Certificate's terms, comports with the Certificate's structure as a whole, could not have been expressed in simpler language and is in keeping with common practice. The Taylor Interpretation, on the other hand, violates several bedrock principles.

First, no one – including the Series B Preferred stockholders, the ratings agencies, SBS's bankers, Lehman itself and even Lehman's lawyers – ever voiced disagreement with SBS's interpretation at the time that SBS deferred dividends and incurred indebtedness. (*Supra* at 12-15) That fact alone proves that SBS's interpretation is reasonable.[5]

[5] SBS's interpretation also comports with standard practices followed in numerous preferred stock issuances by measuring the occurrence of a VRTE according to how many dividends are deferred (as SBS interprets the Certificate), not according to the length of time it takes a company to repay deferred dividends (as Lehman argues). Indeed, a VRTE trigger dependent on the number of deferred dividends (rather than the duration of arrearages) is mandatory for corporations listed on the New York Stock Exchange. (*See* A2257) SBS's correct interpretation holds that under the Certificate, a VRTE occurs when dividends are deferred in four

Second, SBS's interpretation of Section 9(b) complies with Delaware law by giving meaning to all of the Certificate's terms. *See Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396-97 (Del. 2010) ("We will read a contract as a whole and we will give each provision and term effect, so as not to render any part of the contract mere surplusage."); *In re IAC/InterActive Corp.*, 948 A.2d 471, 497 (Del. Ch. 2008) ("'Delaware courts … interpret contracts to give effect to each term rather than to construe them in a way that renders some terms repetitive or mere surplusage.'") (citation omitted); E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 7.11 (3d ed. 2004) ("[A]n interpretation that gives effect to every part of the agreement is favored over one that makes some part of it mere surplusage.").

Here, Lehman claims that SBS's reading "renders the key words 'in arrears' … surplusage" (OB at 32), but that is false. Dividends have been in arrears, but it has never been the case that dividends were unpaid for four consecutive quarterly dividend periods. The "in arrears" element of the

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consecutive quarters. Under the NYSE rule, a VRTE occurs when six quarterly dividends are deferred, whether or not the deferrals occur in consecutive quarters. But neither SBS's correct interpretation of the Certificate nor the NYSE's default formulation considers the length of time for which a particular dividend is deferred. The Taylor Interpretation does, and consequently does not conform to standard industry practice. In addition, Standard & Poor's – which evaluates countless similar securities – explains that SBS's interpretation is common in the preferred stock marketplace. (*See* B1066)

conjunctive VRTE trigger ensures that a VRTE does not occur merely because SBS has not paid dividends – when the reason it has not paid dividends is that no dividends are owed. By contrast, the Taylor Interpretation violates this principle. Under the Taylor Interpretation, there would be no reason to use the phrase "and unpaid" because Lehman now reads Section 9(b) as testing only the length of time that particular dividends are "in arrears." (OB at 32)

Third, SBS's interpretation could not have been expressed in simpler terms, but the Taylor Interpretation could easily have been expressed more simply. *See Union Oil Co. of Cal. v. Mobil Pipeline Co.*, 2006 WL 3770834, at *12 (Del. Ch. Dec. 15, 2006) ("Delaware law will not create contract rights and obligations that were not part of the original bargain, especially where, as here, the contract could easily have been drafted to expressly provide for them."); *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1035 (Del. Ch. 2006) ("[C]ourts should be most chary about implying a contractual protection when the contract could easily have been drafted to expressly provide for it."). Lehman admits that, under the Taylor Interpretation, a single deferred dividend triggers a VRTE if it is not paid within a year. (A224) But if that were intended, there would have been no reason to use the cumbersome phrase "four (4) consecutive quarterly dividend periods" rather than simply "a year."

Fourth, SBS's interpretation of Section 9(b) comports with the Certificate's

structure as a whole. Lehman argues that SBS's interpretation is not reasonable because the VRTE trigger does not match its cure. (OB at 32) But that is commonplace. Indeed, the Court of Chancery has enforced a provision triggering preferred voting rights despite explicitly recognizing its unequal triggering and curing events. In *Giammalvo v. Sunshine Mining Co.*, the Court noted that an "initial triggering event" would occur when defendant "failed to pay dividends for two consecutive quarters," but "events that would extinguish these rights" would occur if "the dividend arrearages [were] satisfied." 1994 WL 30547, at *5 & n.8 (Del. Ch. Jan. 31, 1994), *aff'd*, 651 A.2d 787 (Del. 1994) (TABLE). The *Giammalvo* court thus had no difficulty recognizing that a certificate can impose different conditions to cure and trigger a VRTE. So too here.

Fifth, SBS's interpretation does not negate or make unreasonable the inclusion of a PIK option, as Lehman argues. (*See* OB at 32) Prior to October 15, 2008, the Series B Preferred stockholders were not entitled to *any* cash dividend payments at all. After October 2008, the Series B Preferred stockholders became entitled to at least one cash dividend payment in every four consecutive quarterly dividend periods (and eventually all dividends that accrued on the stock), but lost the right to receive dividends-on-dividends if SBS paid in kind. Thus SBS's interpretation provides more guaranteed cash after the end of the PIK period, which is exactly what "reasonable investors" would expect.

IV. DELAWARE LAW REQUIRES THAT AMBIGUITY RELATING TO STOCK PREFERENCES BE RESOLVED AGAINST THE PREFERRED STOCKHOLDERS.

A. Question Presented:

If the Certificate is ambiguous, should the ambiguity be construed against the expansion of the Series B Preferred stockholders' contractual preferences? This question was raised below (A795-803; A1333-38; A2274-79; A2322-33), but the Court of Chancery did not resolve any ambiguity in the Certificate.

B. Scope Of Review:

See Section I.B. above.

C. Merits Of Argument:

Lehman argues that any ambiguity in the Certificate should be construed in favor of the Series B Preferred stockholders (OB at 31, 33-34), but that is not Delaware law. If Section 9(b) of the Certificate is ambiguous, the Court should resolve the ambiguity against Lehman because stock preferences do not exist unless they are explicitly stated in the Certificate and may not be presumed or implied. To the extent that a conflict exists between this long-standing interpretive principle and the newer *contra proferentem* doctrine first applied to preferred stock in *Kaiser*, the conflict is easily resolved: *contra proferentem* may only be used to resolve an ambiguity that does not relate to stock preferences,[6] as was the case in

[6] Stock preferences are rights over and above those enjoyed by other classes of the company's stock. *See, e.g.*, *Shintom Co. v. Audiovox Corp.*, 888 A.2d 225, 228

Kaiser and every other case applying the *contra proferentem* principle to a preferred stock instrument. However if, as here, the ambiguity relates to preferential rights, it must be resolved against the expansion of stock preferences.

1. The Court's Holding In *Avatex* Endorsed Conflicting Doctrines For Interpretation Of Certificates Of Designation Under Delaware Law.

As noted in *Elliott Associates, L.P. v. Avatex Corp.*, there are two "precedential parameters" pursuant to which Delaware courts will interpret the terms of a certificate of designations. 715 A.2d 843, 852-53 (Del. 1998). The first doctrine holds that "[a]ny rights, preferences and limitations of preferred stock that distinguish that stock from common stock must be expressly and clearly stated, as provided by statute. Therefore, these rights, preferences and limitations will not be presumed or implied." *Id.* On the other hand, "when there is a hopeless ambiguity

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(Del. 2005) ("Preferred stock, as the term implies, is entitled to certain preferences over other stock."); *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 593-94 (Del. Ch. 1986) (noting distinction between "'preferential' rights (and special limitations) on the one hand and rights associated with all stock on the other"). Examples of such preferences are dividend rights, redemption rights, liquidation preferences, voting rights and provisions designed to protect the preferred stock's liquidation preference. *See Rock Solid Gelt Ltd. v. SmartPill Corp.*, 2012 WL 4841602, at *1 (Del. Ch. Oct. 10, 2012). The VRTE provision at issue here is a "protective provision," and thus a stock preference. *See Benchmark Capital Partners IV, L.P. v. Vague*, 2002 WL 1732423, at *13 (Del. Ch. July 15, 2002) ("[T]erms of preferred shareholders' protective provisions 'must ... be clearly expressed and will not be presumed.'") (second alteration in original), *aff'd sub nom. Benchmark Capital Partners IV, L.P. v. Juniper Fin. Corp.*, 822 A.2d 396 (Del. 2003).

attributable to the corporate drafter that could mislead a reasonable investor such ambiguity must be construed in favor of the reasonable expectation of the investor and against the drafter." *Id.* at 853. In *Shiftan*, then-Chancellor Strine noted that *Avatex*'s juxtaposition of these principles leads to a "direct conflict in a very particular context": "[i]f a certificate can be read to either give special rights to the preferred stock or not to do so, who wins?" 57 A.3d at 937 & 938 n.28. If the Court finds Section 9(b) to be ambiguous, that is precisely the question that must be answered here.

2. The *Avatex* Conflict Is Easily Resolved: Stock Preferences Cannot Be Expanded By Resolution Of Ambiguity.

For nearly 100 years, Delaware law has recognized that "unless [stock] preferences are stated in the certificate of incorporation, they shall not exist." *Gaskill v. Gladys Belle Oil Co.*, 146 A. 337, 339 (Del. Ch. 1929) (interpreting Delaware Revised Code of 1915).[7] In other words, ambiguous language can never

[7] Delaware courts have repeatedly reemphasized this interpretive principle since. *See, e.g.*, *Penington v. Commonwealth Hotel Constr. Co.*, 151 A. 228, 234 (Del. Ch. 1930) ("[P]referred stock enjoys only those preferences which are specifically defined…."), *modified sub nom. Penington v. Commonwealth Hotel Const. Corp.*, 155 A. 514, 520 (Del. 1931) ("[C]laims for special preferences must be clearly provided by the charter contract."); *Ellingwood v. Wolf's Head Oil Ref. Co.*, 38 A.2d 743, 747 (Del. 1944) ("Nothing is to be presumed in favor of preferences attached to stock, and when a corporate charter attempts to confer preferences upon any class of stock provided for by it the same should be expressed in clear language."); *Rothschild Int'l Corp. v. Liggett Grp. Inc.*, 474 A.2d 133, 136 (Del. 1984) ("Stock preferences must also be clearly expressed and will not be presumed."); *Waggoner v. Laster*, 581 A.2d 1127, 1134 (Del. 1990) ("Since stock

be interpreted in a way that would create new or additional preferences. *See generally Benchmark*, 2002 WL 1732423, at *13 n.57 ("I do not understand [the rule of strict construction's] analytical methodology to be substantively different from that taught in *Avatex*, 715 A.2d at 853 n. 46."). This rule of construction is fundamentally statutory, *see* 8 *Del. C.* § 151(a), but also reflects the long-established notion that, because stock preferences are in derogation of the common-law presumption that all shares of stock carry equal rights, any transfer of rights from the common to the preferred must be explicit. That statutory principle should not be violated by application of the *contra proferentem* doctrine to expand stock preferences beyond those explicitly granted in the Certificate.

3. *Contra Proferentem* Has Never Been Invoked To Resolve Ambiguity Relating To Stock Preferences.

Application of the *contra proferentem* principle to expand stock preferences – as Lehman advocates (OB at 33-34) – would be unprecedented, and neither *Kaiser* nor any other case is persuasive evidence that the principle should be applied to resolve any ambiguity in Section 9(b). Although the Court's opinion in

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preferences are in derogation of the common law, they must be strictly construed."); *Bernstein v. Canet*, 1996 WL 342096, at *3 (Del. Ch. June 11, 1996) ("[T]he Court may not presume that the COD grants a right, and instead must resolve any ambiguity against granting the alleged preference or right."); *Avatex*, 715 A.2d at 853 n.46 ("'Stock preferences must also be clearly expressed and will not be presumed.'") (citation omitted); *Benchmark*, 2002 WL 1732423, at *13 ("[T]erms of preferred shareholders' protective provisions 'must ... be clearly expressed and will not be presumed….'").

Kaiser did not address the principle that stock preferences are to be strictly construed, the Court of Chancery opinion in the same case may explain why: it noted the principle of strict construction of preferences, but held that the case before it involved ambiguity that did not relate to stock preferences.[8] *See Matheson v. Kaiser Aluminum Corp.*, 1996 WL 33167234, at *2-3 (Del. Ch. Apr. 8, 1996) ("[W]e are not really talking about a preference as such. We are talking about a protection against changing a preference."), *aff'd*, *Kaiser*, 681 A.2d 392 (Del. 1996). Here, by contrast, the VRTE provision – which controls the required rate of dividend payments and the Series B Preferred stockholders' right to elect directors – is itself a preferential right. *See Benchmark*, 2002 WL 1732423, at *13 (noting that protective provisions are preferences); *SV Inv. Partners, LLC v. ThoughtWorks, Inc.*, 7 A.3d 973, 991 (Del. Ch. 2010) (noting preference in the form of "a springing right to board control"), *aff'd*, 37 A.3d 205 (Del. 2011). Post-*Kaiser* cases applying *contra proferentem* implicitly recognize the same distinction, and only apply the *Kaiser* principle to construe ambiguity when doing so will not result in the expansion of stock preferences. *Cf. In re Appraisal of Ford Holdings, Inc. Preferred Stock*, 698 A.2d 973, 978 (Del. Ch. 1997) (applying *Kaiser* rule to resolve ambiguity regarding statutory waiver, not stock preference);

[8] Moreover, *Kaiser* involved an expedited appeal, which may further explain why the Court failed to even mention the long-standing rule against implying stock preferences from an ambiguous certificate provision.

Gildor v. Optical Solutions, Inc., 2006 WL 4782348, at *9 (Del. Ch. June 5, 2006) (applying *Kaiser* rule to resolve ambiguity as to stockholder's address of record, not stock preference); *W. Fin. Co. v. Contour Energy Co.*, 2000 WL 33521112, at *2 (Del. Ch. May 19, 2000) (applying *Kaiser* rule to resolve ambiguity in director-election procedure, not stock preference; noting "it is correct that the rights and preferences of the preferred must be explicitly set forth in the certificate"), *interlocutory appeal refused*, 755 A.2d 387, 2000 WL 975115, at *1 (Del. 2000) (TABLE) ("[N]othing in the interlocutory order implies rights in the preferred stock itself beyond those expressly stated in the Certificate of Designation."); *Bank of N.Y. Mellon v. Commerzbank Capital Funding Trust II*, 65 A.3d 539, 551-52 (Del. 2013) (applying *Kaiser* rule to resolve ambiguous definition of "parity securities," not stock preference).

4. Applying The *Contra Proferentem* Principle To Expand Stock Preferences Is Bad Policy.

Fundamentally, preferences consist of economic value transferred by contract from the common stockholders to holders of preferred stock. *See* Leo E. Strine, Jr., *Poor Pitiful Or Potently Powerful Preferred?*, 161 U. Pa. L. Rev. 2025, 2027 (2013) (hereinafter "Strine, *Powerful Preferred*") (defining preferences as "additional rights that may have economic value"). Any expansion of stock preferences by interpretation of a certificate of designations would result in the removal of an equivalent amount of value from the common stockholders as a

whole. *See Shiftan*, 57 A.3d at 938 n.28 ("[G]ranting rights to the preferred stock on the basis of an ambiguous certificate could disrupt the reasonable expectations of the other investors."); *Romer*, 2 A.2d at 77 (noting, when preferred stockholder alleged violation of certificate, that "other persons who relied on the capital structure of the company as fixed and definite … bought the common stock … in complete ignorance of the fact that the complainants were intending to assert a demand which if acceded to would place a burden on the assets and earnings ahead of the common stock's equity"). Thus, when stock preferences are ambiguous, a conflict between the competing interests of the preferred and common arises. That conflict is properly resolved in favor of the common stockholders, and against the interests of the preferred.

Unlike common stock, which is traded widely on open markets, preferred stock is "a bespoke security" negotiated and held by sophisticated investors, with terms that are "typically finely tailored, heavily negotiated, and 'sealed with a thick stack of documents.'" Korsmo, *Preferred Stock*, at 1171 (citation omitted); *see also* Strine, *Powerful Preferred*, at 2029 ("No one has to buy preferred stock. Those who do are quite sophisticated."). Recognizing the nature of sophisticated investors such as Lehman, Delaware courts view their claims with suspicion. "To the extent preferred stockholders fail to extract contractual preferences, they are entitled to no better treatment than other stockholders." *Id.* at 2027-28; *see also*

Examen, Inc. v. VantagePoint Venture Partners 1996, 873 A.2d 318, 321 n.6 (Del. Ch. 2005) ("VantagePoint is a sophisticated investor that negotiated the purchase of Examen's preferred stock. If it wanted a class vote on mergers, it should have bargained for that right. It obviously knew how to bargain for class voting rights related to its preferred stock…."), *aff'd*, 871 A.2d 1108 (Del. 2005); *Alta Berkeley VI C.V. v. Omneon, Inc.*, 2011 WL 2923884, at *4 (Del. Super. Ct. July 21, 2011) ("The Court may not, 'by judicial action, broaden the rights obtained by a preferred stockholder at the bargaining table.'") (citation omitted), *aff'd*, 41 A.3d 381 (Del. 2012). Given preferred stockholders' sophistication and ability to contractually carve out their own special rights, "it is unclear why the law should extend such a special solicitude to the preferred." Strine, *Powerful Preferred*, 161 U. Pa. L. Rev. at 2039. Rather, good policy dictates that the Court's solicitude be extended to the common stockholders, who are less able to defend their rights, and, by extension, the value of their securities.

V. LEHMAN SEEKS EQUITABLE RELIEF, AND LACHES BARS ITS CLAIMS.

A. Question Presented:

Did the Court of Chancery err in holding that Lehman could recover contract damages in this action? This question was raised below (A815-18; A1349-50; A2297-2302; A2353-60) and considered by the Court of Chancery. (Op. at 19-21)

B. Scope Of Review:

See Section I.B. above.

C. Merits Of Argument:

The Court of Chancery erred in holding that Lehman could be entitled to legal – not merely equitable – relief in this action. Lehman alleges that SBS breached the Certificate by failing to clear a purported VRTE before incurring indebtedness. (OB at 12-14) Thus, the remedy Lehman sought in this action was the sum of all accrued and unpaid dividends at the time of SBS's purported breaches.

Any award of accrued and unpaid dividends to Lehman would require the Court to compel SBS's Board of Directors to declare and pay a dividend.[9] This is,

[9] Such an award would be inappropriate in any case because Lehman has not established fraud or a gross abuse of discretion. *See Moskowitz v. Bantrell*, 190 A.2d 749, 750 (Del. 1963) (refusing to compel payment of undeclared dividend; holding "[t]he principle of law applicable to the relief sought is well settled"); *Baron v. Allied Artists Pictures Corp.*, 337 A.2d 653, 659 (Del. Ch. 1975) ("[T]he basic question is whether or not the board has wrongfully refused to pay dividends even if funds did exist which could have been used for such purpose. The

in essence, a demand for specific performance. *See Certainteed Corp. v. Celotex Corp.*, 2005 WL 217032, at *6 (Del. Ch. Jan. 24, 2005) ("A claim for specific performance … requir[es] a party to perform its contractual duties."). And even if the Court could award "damages" without requiring a forced dividend payment, such an award would constitute an unfair double recovery for Lehman unless the Court were to simultaneously reduce the amount of outstanding unpaid dividends – which would itself constitute equitable relief. Thus under any theory Lehman seeks equitable relief in this action, and the Court below erred to the extent that it foreclosed consideration of any applicable equitable defenses based on its conclusion that Lehman could recover money damages here.

established test for this is whether the board engaged in fraud or grossly abused its discretion."). Critically, "stockholder plaintiffs are not creditors and dividends are not due them until such dividends are declared." *Treves v. Menzies*, 142 A.2d 520, 523 (Del. Ch. 1958).

CONCLUSION

For all of the foregoing reasons, the judgment below should be affirmed.

/s/ Robert S. Saunders
Robert S. Saunders (ID No. 3027)
Nicole A. DiSalvo (ID No. 4662)
Ronald N. Brown, III (ID No. 4831)
Matthew P. Majarian (ID No. 5696)
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM LLP
One Rodney Square
P.O. Box 636
Wilmington, Delaware 19899-0636
Tel.: (302) 651-3000

Attorneys for Defendant Below and Appellee/Cross-Appellant Spanish Broadcasting System, Inc.

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