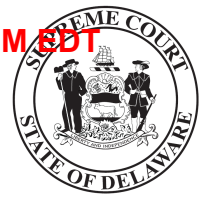
EFiled: Jul 08 2013 07:00PM EDT
Filing ID 53146724
Case Number 272,2013



IN THE SUPREME COURT OF THE STATE OF DELAWARE

SUSAN M. BLAUSTEIN; HILDA K. BLAUSTEIN TRUST, F/B/O SUSAN M. BLAUSTEIN, U/A DATED 8/2/72, by and through its Trustee SUSAN M. BLAUSTEIN; MORTON K. BLAUSTEIN TRUST U/W ITEM XVII-A F/B/O SUSAN M. BLAUSTEIN, by and through its Trustee SUSAN M. BLAUSTEIN; MORTON K. BLAUSTEIN TRUST U/W ITEM XVII-B F/B/O SUSAN M. BLAUSTEIN, by and through its Trustee SUSAN M. BLAUSTEIN; MORTON K. BLAUSTEIN TRUST U/W ITEM XVII-C F/B/O SUSAN M. BLAUSTEIN, by and through its Trustee SUSAN M. BLAUSTEIN; and MORTON K. BLAUSTEIN TRUST U/W ITEM XVIII-C F/B/O SUSAN M. BLAUSTEIN, by and through its Trustee SUSAN M. BLAUSTEIN, Plaintiffs Below, Appellants, v. LORD BALTIMORE CAPITAL CORPORATION and LOUIS B. THALHEIMER, Defendants Below, Appellees.	No. 272, 2013 APPEAL FROM THE OPINION AND ORDER DATED APRIL 30, 2013 AND THE OPINION AND ORDER DATED MAY 31, 2012 OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN C.A. NO. 6685-VCN

APPELLANTS' OPENING BRIEF

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TABLE OF CONTENTS

Page

TABLE OF CITATIONS

Cases: **Page**

STATUTES

OTHER AUTHORITIES

NATURE OF PROCEEDINGS

Plaintiffs, Susan M. Blaustein and her trusts listed in the caption (collectively, "Susan"), have been trying to withdraw from Defendant Lord Baltimore Capital Corporation ("Lord Baltimore") through a stock redemption or other means for over a decade. Lord Baltimore's majority shareholders, consisting of Defendant Louis B. Thalheimer ("Louis") and his sisters, Marjorie Thalheimer Coleman ("Marjorie") and Elizabeth Thalheimer Wachs ("Elizabeth") (together with their respective trusts, "the Thalheimer Shareholders"), have continuously insisted on an unjustified discount of 52% of the net asset value of her stock as the price of withdrawal. They have caused the Lord Baltimore Board of Directors (the "Board") to make corporate decisions regarding redemption of Susan's stock that are driven by their personal interest in (i) supporting comparable discounts claimed in connection with valuing their intra-family gifts of Lord Baltimore stock for personal estate planning purposes, and (ii) enhancing the value of their own Lord Baltimore stock at Susan's expense.

Susan's complaint asserted three claims against Louis and/or Lord Baltimore ("Defendants") – promissory estoppel, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing – arising from a representation made by Louis to Susan and her sister Jeanne. Specifically, in 1998, Louis stated that they could withdraw from Lord Baltimore after a statutory tax-related waiting

period and redeem their shares with no discount to net asset value or other penalty. Susan (and Jeanne) relied upon that representation in joining Lord Baltimore as a shareholder. Defendants moved to dismiss these claims. In a Memorandum Opinion dated May 31, 2012 (the "2012 Opinion") and implementing Order, the Court of Chancery dismissed the promissory estoppel and fiduciary duty claims, along with that portion of the claim for breach of the implied covenant of good faith and fair dealing relating to Louis's representation. The court found, however, that Susan adequately pled breach of an implied covenant in the Lord Baltimore Capital Corporation Shareholders' Agreement (the "Shareholder Agreement") requiring the Board to consider share repurchases, based on the failure to present to the Board, and for the Board to consider, Susan's prior repurchase proposals. The court did not recognize or discuss an implied covenant to negotiate in good faith.

After issuance of the 2012 Opinion, Louis hastily called a special Board meeting for July 5, 2012, ostensibly to consider certain of Susan's prior redemption proposals dating back to 2010. The meeting's outcome, however, was pre-ordained and designed to moot Susan's remaining claim. The four directors controlled by the Thalheimer Shareholders, constituting a majority of the seven-person Board, had no intention of seriously entertaining any of Susan's prior proposals. These directors instead predictably and summarily voted against Susan's proposals in the face of conflicting personal financial interests.

On July 13, 2012, Defendants moved for summary judgment, arguing that the July 5 Board meeting mooted Susan's remaining claim. On September 7, 2012, Susan filed a Motion for Leave to File an Amended and Supplemented Verified Complaint ("Motion") to plead a breach of fiduciary duty claim arising from the conflicted Board action and to assert claims for breach of the implied covenant of good faith and fair dealing. Susan reasserted her surviving implied covenant claim and alleged a second implied covenant claim based on Lord Baltimore's failure and refusal to negotiate a redemption proposal in good faith.

On April 30, 2013, the court issued a Memorandum Opinion (the "2013 Opinion") and implementing Order that, *inter alia*, granted Defendants' summary judgment motion on the surviving implied covenant claim, interpreted Defendants' summary judgment motion to also be directed at Susan's second implied covenant claim, and rejected Susan's new fiduciary duty claim (and alternatively the second implied covenant claim) as futile. Susan now challenges the court's disposition of her second implied covenant claim by summary judgment or otherwise, and failure to permit Susan leave to supplement to include a new claim for breach of fiduciary duty. Susan does not appeal dismissal of claims asserted in her Verified Complaint (except to whatever extent her second implied covenant claim is deemed to have been dismissed by the 2012 Opinion) or the entry of summary judgment on the surviving implied covenant claim from the Verified Complaint.

SUMMARY OF ARGUMENT

1. In rejecting the proposed new fiduciary duty claim, the Court of Chancery erroneously held that the redemption provisions of the Shareholder Agreement effectively foreclosed any fiduciary duty claim, even though a majority of the Lord Baltimore Board and shareholders suffered from conflicting financial self-interests. Susan adequately alleged that, in hastily considering and disposing of her proposals at the July 5 Board meeting, the Board was conflicted and acted in circumstances giving rise to the entire fairness standard of review. Basing corporate decisions on personal interests triggers entire fairness scrutiny, particularly in the case of a small, closely held corporation where the controlling shareholders also stand to personally benefit from the redemption decision. The terms of the Shareholder Agreement do not displace the traditional, common law fiduciary duties of corporate fiduciaries.

2. In entering judgment on the alternative claim for breach of the implied covenant of good faith and fair dealing by failing to negotiate in good faith, the Court of Chancery erred (i) first in construing the claim as addressed by Defendants' motion for summary judgment, where the motion was actually directed to a different claim, and (ii) by then granting summary judgment and alternatively rejecting the proposed amended implied covenant claim on futility grounds, again based on the same contract language regarding redemptions.

STATEMENT OF FACTS

A. The Parties

Plaintiffs are Susan Blaustein and several trusts established for her and her immediate family. She and her trusts collectively own 17.59% of the voting stock of Lord Baltimore. A1441-44; A14-17. In addition to original Defendants Louis and Lord Baltimore, the proposed Amended and Supplemented Verified Complaint ("Supplemented Complaint") names as additional defendants Marjorie, Elizabeth, William Coleman ("William") and Donald Kilpatrick ("Donald"). A1444-45. Louis and his sisters Marjorie and Elizabeth, together with their respective family trusts (defined above as the "Thalheimer Shareholders"), collectively own 64.82% of the stock and operate as a controlling shareholder group of Lord Baltimore. A1441, A1445. Louis, Elizabeth, William (Marjorie's husband) and Donald are directors (the "Director Defendants") and constitute the majority of the seven-person Board. A1444, A1445. Donald is referred to as an "independent director" but was appointed by the Thalheimer Shareholders and owes his continued position as director to the Thalheimer Shareholders. *Id*.

B. The History of Lord Baltimore and Susan's Decision to Join

Lord Baltimore is a spin off of American Trading and Production Corporation ("Atapco"). Atapco was formed in the early 1930s to consolidate and expand the business activities of the Blaustein, Rosenberg and Thalheimer families, whose personal fortunes arising from the founding of the predecessor of

Amoco Corporation had become substantial. A1445-46. In or about 1998, members of those families considered splitting Atapco into separate companies and going their separate ways. The Thalheimer family group, led by Louis, transferred their aggregate share of Atapco assets to American Trading Real Estate Company, Inc., an existing corporation that would change its name to Lord Baltimore Capital Corporation and make an election to become an "S" corporation under Section 1362 of the Internal Revenue Code. A1446-47.

Louis induced Susan and her sister Jeanne to join the Thalheimer Shareholders in forming Lord Baltimore by representing that any shareholder seeking to withdraw after a statutory tax-related 10-year waiting period ("the 10-Year Waiting Period") would be allowed to redeem his/her shares with no discount from the then net asset value or other economic penalty. Relying on that assurance, Susan and Jeanne signed the Shareholder Agreement. A1447-49.

C. The Shareholder Agreement

The Shareholder Agreement was executed in 1999. A1450. Paragraph 5 of the Shareholder Agreement strictly limits transfers of shares by shareholders to preserve the S election and prevent transfers of the stock of Lord Baltimore outside the original shareholders' families. Paragraph 6 imposes a severe financial penalty through a forced repurchase of stock by Lord Baltimore at a heavily discounted

price if a shareholder either ceases to be an eligible shareholder or attempts a prohibited transfer. A1450.

Paragraph 7(d) of the Shareholder Agreement provides that, "[n]otwithstanding any other provision of this Agreement, the Company may repurchase Shares upon terms and conditions agreeable to the Company and the Shareholder who owns the Shares to be repurchased, provided that the repurchase is approved either (i) by a majority, being at least four, of all of the Directors of the Company then authorized (regardless of the number attending the meeting of the Board of Directors) at a duly called meeting of the Board of Directors or (ii) in writing by Shareholders who, in the aggregate, own of record or beneficially 70% or more of all Shares then issued and outstanding." A1451.

D. Susan's Attempts to Exit Lord Baltimore Prior to 2010

In late 2001, Susan and Jeanne approached Louis about withdrawing from Lord Baltimore before expiration of the 10-Year Waiting Period. In the ensuing discussions, contrary to Louis's pre-contracting representations, Louis and the other Thalheimer Shareholders sought to impose major price discounts for a stock redemption. A1452-53. In so doing, the Thalheimer Shareholders were prompted by their self-interest rather than any legitimate corporate objective. A1453-54.

In a February 7, 2003 letter, the Thalheimer Shareholders' counsel tied the steep discounts in the redemption value of Susan's shares to a need for consistency

with similar valuation discounts that the Thalheimer Shareholders were claiming for federal gift and estate tax purposes. A1453-54. Counsel candidly stated that "Louis does not want to take a risk that he will be imperiling his own tax planning and the tax planning of other shareholders" and "cannot jeopardize the interests of his own family and of the other shareholders" by taking a different approach to valuing Susan's shares. *Id*.

Susan and the Thalheimer Shareholders discussed various withdrawal proposals during the 10-Year Waiting Period. The Thalheimer Shareholders continued to insist on discounts of some 52% of Susan's proportionate share of the full net asset value of the corporation. A1453-57. Susan concluded that there was no realistic possibility of redemption before expiration of the 10-Year Waiting Period. She mistakenly believed, however, that her stock would be redeemed in a fair and reasonable manner at the conclusion of the 10-Year Waiting Period, when the tax dynamics of redemption would become much less burdensome. A1457.

E. Redemption Efforts in 2010

The 10-Year Waiting Period expired in early 2009. In a letter to Susan's counsel dated March 31, 2010, Louis outlined a "redemption transaction framework," making clear that the Thalheimer Shareholders continued to insist on the same self-interested "valuation methodology" as before. Susan responded through counsel on April 6 with a detailed "no numbers" formula for a fair

redemption price, rejecting the prior "valuation methodology" urged by the Thalheimer Shareholders that would have transferred over 50% of the value of Susan's shares to the remaining shareholders. A1457-58.

Counsel for the Thalheimer Shareholders sent Susan's counsel an outline of the formula Susan had previously proposed but on which Louis had filled in the numbers, and added "Applied Discount Minority Interest, Marketability" with a specific discount percentage to be filled in later. A1458-59. In a subsequent exchange, counsel for the Thalheimer Shareholders stated that "the directors (and others who must vote on this transaction) would breach their fiduciary duties if they were to authorize payment of more than fair market value," and that determination of fair market value of a minority stock interest "necessarily involves a discount for lack of marketability and a discount for lack of control." *Id*. This excuse again masked the Thalheimer Shareholders' personal objective to bring the price for Susan's redemption in line with their claimed stock valuations for gift tax purposes, and to benefit personally to the extent of the value that Susan sacrificed. *Id.*

On May 20, 2010, Louis sent a proposal reflecting a 52% reduction of the estimated book value of Susan's interest in Lord Baltimore assets as of December 31, 2009, except for a separately valued real estate investment. This discount would have resulted in a redemption price even more severe than the penalty under

the Shareholder Agreement for acts threatening Lord Baltimore's qualification as an "S" corporation. A1450, A1459; A84-A87.

Susan countered on June 16 with two alternatives. Proposal A offered a 15% price reduction against the full value of Susan's shares to cover any legitimate investment dislocation costs that might be incurred in redeeming the shares. Proposal B called for conversion of Lord Baltimore into a limited liability company (already then under consideration), with each shareholder receiving a one-time right to redeem his or her LLC interests on specific terms. Proposal B would facilitate an eventual full value redemption of Susan's shares without affecting valuation of intra-family gifts of Lord Baltimore stock. Louis rejected both proposals without providing any true counterproposal. A1459-60.

Throughout the rest of 2010, Louis and counsel for the Thalheimer Shareholders continued to insist on a discount of over 50% of the value of Susan's shares, purporting to justify that position with outside appraisals of Lord Baltimore stock. These appraisals, like the prior appraisals relied on by Louis, were prepared solely for personal tax planning purposes and did not represent a fair valuation of Susan's stock for redemption pricing purposes. A1460.

F. The Lord Baltimore Board Meeting on July 5, 2012

In its 2012 Opinion, the Court of Chancery dismissed the promissory estoppel and fiduciary duty claims, and the implied covenant of good faith and fair

dealing claim directed to Louis's pre-contract promise. The court found, however, that Susan adequately pled an implied covenant claim requiring the Board to consider share repurchases under the Shareholder Agreement, and that this implied covenant had been breached by the failure to present formally to the Board any of her repurchase proposals. The court concluded that, by acting as "road-blocks" to the Board's consideration of such proposals, Louis, and counsel representing him and the other Thalheimer shareholders, "effectively denie[d] Susan an exit strategy set forth in the agreement." 2012 Opinion at 14.

Prompted by the ruling, Louis called a Board meeting for July 5, 2012, providing notice to the directors on June 7. The stated purpose was to consider Susan's June 16, 2010 proposals, but the outcome was preordained. The true purpose was to support Defendants' summary judgment theory that the remaining claim had been mooted by a Board vote. A1462.

Louis set the July 5 meeting agenda, compiled the Board materials, and determined which of Susan's prior proposals to submit at the meeting, all without seeking any input from Susan, her counsel, or the individual designated by her to serve on the Board. The Board received materials from Louis on June 29, only three business days before the July 5 Board meeting. In the limited time available, Susan, through counsel, provided an unsolicited Position Statement to the Board with a detailed history of the negotiations. Susan's Position Statement advised of

the conflicting self-interest underlying all of the proposals advanced by Louis and/or counsel for the Thalheimer Shareholders arising from (i) the stated desire of the Thalheimer Shareholders to serve their personal tax planning objectives rather than the interests of Lord Baltimore, and (ii) the substantial amount by which they would be enriched personally by their proposed discounted redemption price. A1462-64 and A1475-96.

In light of these conflicts, Susan's Position Statement proposed several measures to ensure a fair and equitable process, free of the influence of such conflicts of interest, by which *any* Lord Baltimore shareholder might seek to redeem his or her stock. These included, *inter alia*, creation of an independent decision-making committee and submission to it of Susan's Proposal A from 2010 for consideration and action (updated to reflect the company's current asset composition and financial picture). A1463-64 and A1475-96.

At the July 5 Board meeting, Louis presented Susan's April 6, 2010 "no numbers" redemption formula and her Proposals A and B from June 16, 2010 as the proposals to be considered by the Board. At Louis's direction, consultants from Cambridge Associates had been retained to add legitimacy to the preordained decision to reject Susan's proposals. The analysis and report by Cambridge Associates was hastily prepared, reflected only input provided by or at the

direction of Louis, and opined that Susan's proposals would adversely affect investment returns and liquidity. A1464-65.

As noted by Susan and Jeanne's jointly appointed director, Mr. Krall, the Cambridge Associates report failed to account for the fact that repurchasing Susan's shares would necessarily improve the return on the remaining smaller block of outstanding stock. He also noted that Susan had repeatedly expressed a willingness to receive her redemption proceeds in installments over time to accommodate any corporate liquidity concerns. Susan's appointed director, Mr. McGaffey, noted that a transaction at Susan's proposed 15% discount should be attractive to the corporation given that redemption at any discounted price is inherently advantageous to a corporation. He expressed extreme concern as a director that a favorable redemption opportunity was not being pursued by the corporation only to protect certain shareholders' personal interests. Messrs. Krall and McGaffey questioned reliance on appraisals clearly prepared for tax purposes to justify substantial discounts in redemption transaction. A1465-66. Even Donald, the director appointed by the Thalheimer Shareholders, acknowledged that the kind of appraisals commonly obtained for tax purposes were not very helpful in this situation. A1466.

Mr. McGaffey proposed a new committee, as requested in Susan's Position Statement, to determine a fair price for Susan's shares. Not surprisingly, Susan's

redemption proposals were rejected by the four Thalheimer directors, who constitute a majority of the seven-person Board, as was the proposal to create a non-conflicted committee. A1466-67. The July 5 Board meeting was thus carefully orchestrated to result in a pre-ordained outcome, which did not include the creation of a process for considering Susan's proposals free of the financial self-interest encumbering the Board. A1467.

G. The Opinions Below

In its 2013 Opinion, the court found that Susan adequately alleged a conflict of interest, viewed the insistence on a 52% discount in the value of Susan's stock as facially unfair, and acknowledged that a decision not to accept reasonable proposals might implicate an implied covenant to negotiate in good faith, if one existed. 2013 Opinion at 16, 45. Nevertheless, the court held that the redemption provisions of the Shareholder Agreement displaced common law fiduciary duties and the implied covenant of good faith and fair dealing in connection with any redemption transaction. *Id.* at 20-21, 44-45. The court did not recognize or discuss an implied covenant to negotiate in good faith in its 2012 Opinion.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN REJECTING THE PROPOSED NEW CLAIM FOR BREACH OF FIDUCIARY DUTY

A. Question Presented

Did the Court of Chancery err in dismissing, and rejecting entire fairness review of, a proposed claim for breach of fiduciary duty, despite finding that Susan adequately pled a conflict of interest on the part of the controlling shareholders arising from their refusal to permit a corporate repurchase at variance with their valuation for personal tax purposes?

This question was addressed below in Susan's opening brief in support of her motion (A1665-74), Defendants' answering brief (A1698-1710), Susan's reply brief (A1734-43, A1745-48), and the court's decision (2013 Opinion at 25-47).

B. Scope of Review

The Court of Chancery's denial of Susan's Motion under Court of Chancery Rule 15(d) on futility grounds presents solely a legal issue; therefore, the denial is subject to *de novo* review by this Court. *See Stegemeier v. Magness*, 728 A.2d 557, 561 (Del. 1999); *Mullen v. Alarmguard of Delmarva, Inc.*, 625 A.2d 258, 262 (Del. 1993). A supplement to a complaint is futile only if it would not survive a motion to dismiss under Court of Chancery Rule 12(b)(6). *See Cartanza v. Lebeau*, 2006 WL 903541, at *2 (Del. Ch.). Dismissal under Rule 12(b)(6) is only appropriate if the complaint fails to state a claim upon which relief can be granted

under "any reasonably conceivable set of circumstances susceptible of proof." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 536 (Del. 2011). In determining futility, a court accepts as true all well-pleaded facts and does not consider facts extrinsic to the complaint, except for documents integral to the complaint and documents not relied upon to prove the truth of their contents. *Id.*; *Cartanza*, 2006 WL 903541, at *2.

C. Merits of Argument

1. Despite the Sufficiency of the Allegations, the Court of Chancery Erroneously Relied on the Redemption Provisions of the Shareholder Agreement to Improperly Extinguish Traditional Fiduciary Duties and the Entire Fairness Standard of Review

Susan properly alleged that the controlling shareholders of Lord Baltimore (the Thalheimer Shareholders), and thus the Board, were conflicted in addressing the proposed redemption of Susan's shares. The conflict arises from the Thalheimer Shareholders' refusal to consider any stock redemption by Susan except at a price reflecting the same 52% discount from net asset value that they claim on intra-family gifts of Lord Baltimore stock for personal estate planning purposes, and their personal interest in enhancing the value of their own Lord Baltimore stock at Susan's expense through such a discount. Under *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993), entire fairness is the appropriate standard of review and Susan adequately alleged a claim for breach of fiduciary duty.

The court assumed, without deciding, that the Thalheimer Shareholders were a control group, but then questioned whether the so-called "independent" director appointed by the Thalheimer Shareholders was controlled. 2013 Opinion at 26, n.56 & 46 n.114. The overall allegations of control by the Thalheimer Shareholder group (A1440-72) created a strong inference of Board domination. The court's focus on whether a single director's independence has been sufficiently challenged is thus misplaced.

The court stated that Susan "has adequately alleged that the Thalheimer Shareholders were self-interested in the decision not to accept Susan's repurchase proposals" and acknowledged that a 52% penalty is unfair, stating: "On its face, a fifty-two percent discount seems unfair." 2013 Opinion at 45. Nevertheless, the Vice Chancellor dismissed the fiduciary duty claim on the grounds that any such claim was trumped by the presence in the Shareholder Agreement of the repurchase provision. That provision, Paragraph 7(d) of the Shareholder Agreement, states:

> [N]otwithstanding any other provision of this Agreement, the Company may repurchase Shares upon terms and conditions agreeable to the Company and the Shareholder who owns the Shares to be repurchased, provided that the repurchase is approved either (i) by a majority, being at least four, of all of the Directors of the Company then authorized (regardless of the number attending the meeting of the Board of Directors) at a duly called meeting of the Board of Directors or (ii) in writing by Shareholders who, in the aggregate, own of record or

> beneficially 70% or more of all Shares then issued and outstanding.

A1451.

Paragraph 7(d) thus provides a mechanism for the corporation to cash out shareholders in whole or in part and a corresponding opportunity for shareholders to liquidate their interest in whole or in part. The parties also agreed on an explicit approval process by the Board or shareholders holding 70% or more of Lord Baltimore's outstanding shares. The Shareholder Agreement did not specify a price, but rather left that to negotiation. Most significantly, Paragraph 7(d) is not a waiver of fiduciary duties and does not strip Lord Baltimore's directors of the fiduciary duties they owe in making a repurchase decision.

But the Court of Chancery essentially endorsed a fiduciary duty-eliminating rule of law by interpreting Paragraph 7(d) as giving Lord Baltimore *absolute* discretion as to agreeable terms and conditions, without any equitable backstop provided by traditional corporate fiduciary duties. This reflects the court's evident belief that if a shareholder agreement addresses a subject, then the common law protections afforded minority shareholders by traditional corporate fiduciary duties are entirely supplanted. *See* 2013 Opinion at 49 (Susan's "fiduciary claims are precluded in part by the explicit terms of the Shareholders' Agreement."). Under the General Corporation Law, however, traditional fiduciary duties cannot be waived contractually. *See Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439

(Del. 1971) ("Management contends that it has complied strictly with the provisions of the new Delaware Corporation Law in changing the by-law date. The answer to that contention, of course, is that inequitable action does not become permissible simply because it is legally possible."); *Auriga Capital Corp. v. Gatz Props., LLC*, 40 A.3d 839, 849 (Del. Ch. 2012) (concluding that fiduciary duties applied in the limited liability company context in the absence of contrary language in the limited liability company agreement pursuant to permissive statutory provision, noting that (a) the DGCL is silent on the existence of fiduciary duties and (b) in *Schnell*, the Supreme Court nevertheless "made emphatic that the new DGCL was to be read in concert with equitable fiduciary duties just as had always been the case…"), *aff'd*, 59 A.3d 1206 (Del. 2012).

This Court recently reversed a holding by the Court of Chancery that common law duties – in that case the implied covenant of good faith and fair dealing – do not come into play when the parties to a contract comply with their contractual obligations. In *Gerber v. Enterprise Products Holdings, LLC*, __ A.3d __, 2013 WL 2477233 (Del.), the Court of Chancery had dismissed a complaint, holding that certain contractual provisions in a limited partnership agreement precluded the plaintiffs from invoking the implied covenant as to a transaction in which limited partnership unit holders were allegedly injured by the general partner's decisions to sell a major asset of the business for a grossly discounted

price and to effect a subsequent merger to eliminate the derivative legal claims relating to the prior sale transaction. In particular, the court held that the limited partnership agreement ("LPA") created a conclusive presumption that the general partner would be deemed to have acted in good faith if certain procedural safe harbors were met, among which was reliance on an expert opinion.

This Court rejected the premise that mere compliance with contractual procedures governing a particular type of transaction can somehow eliminate the implied covenant, and found that the complaint adequately alleged an implied covenant claim because defendants engaged in arbitrary and unreasonable conduct by the manner in which they purported to follow these procedures. 2013 WL 2477233, at *14. Putting aside "the insulating presumption created by" the LPA's safe harbor provision, the Court concluded that the "pled facts permit a reasonable inference that the [merger in question] was the product of a breach of the general partner's duty under the implied covenant" and that the Court of Chancery "reversibly erred" in dismissing the implied covenant claim. *Id*. at *17.

The reasoning of *Gerber* is equally compelling, if not more so, here. Under the Delaware Revised Uniform Limited Partnership Act, which was at issue in *Gerber*, fiduciary duties may be waived by agreement but the implied covenant may not be eliminated. Under the General Corporation Law applicable to Lord Baltimore, however, fiduciary duties may not be waived or eliminated. Moreover,

unlike the LPA in *Gerber*, there are no provisions in the Shareholder Agreement that even arguably can be read as a "safe harbor" giving rise to a presumption of either good faith or compliance with fiduciary duties for the Board or controlling shareholders.

In *Gerber*, the Court reversed dismissal of the implied covenant claim despite the LPA's presumption of good faith, thereby rejecting any notion that a contract can be construed as vitiating common law protections that may not be waived pursuant to statute. Under the same reasoning here, non-waivable common law fiduciary duties, including the duty of entire fairness, cannot simply be eliminated by the Shareholder Agreement.

2. Entire Fairness is the Appropriate Standard of Review

The starting point for application of entire fairness analysis to a stock redemption in a closely-held corporation is *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993). In *Nixon*, plaintiffs were the minority shareholders in a closely-held (but not statutory close) corporation. The individual defendants were directors and controlling shareholders. Plaintiffs alleged that defendants had treated the plaintiffs unfairly by establishing an employee stock option plan and key man life insurance that provided defendants and other corporate employees with a clear path toward stock redemption and liquidity while affording no comparable path for the non-employee minority shareholders. *Id*. at 1370.

Defendants argued on appeal that "the trial court erred in not applying the business judgment rule." *Id*. at 1375. This Court first explained that the existence of a conflict of interest is what gives rise to entire fairness review:

> Since the defendants benefited from the ESOP and could have benefited from the key man life insurance beyond that which benefited other stockholders generally, the defendants are on both sides of the transaction. For that reason, we agree with the trial court that the entire fairness test applies to this aspect of the case. Accordingly, defendants have the burden of showing the entire fairness of those transactions. *Sinclair Oil Corp. v. Levien*, Del. Supr., 280 A.2d 717 (1971) ("*Levien*"); *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983) ("*Weinberger*").

Id. at 1375-76.

The Court continued that the entire fairness test expresses the heightened level of judicial scrutiny the courts must give because of a conflict of interest – as opposed to the minimal scrutiny under the business judgment rule, which presupposes that corporate decisionmakers were free of conflict:

> The entire fairness analysis essentially requires "judicial scrutiny." *Weinberger*, 457 A.2d at 710. In business judgment rule cases, an essential element is the fact that there has been a business decision made by a disinterested and independent corporate decisionmaker. *Aronson v. Lewis*, Del. Supr., 473 A.2d 805, 812 (1984); *Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858, 872-73 (1985). When there is no independent corporate decisionmaker, the court may become the objective arbiter. *Marciano*, 535 A.2d at 404.

Id. at 1376; *see also Weinberger*, 457 A.2d at 710 ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate

their utmost good faith and the most scrupulous inherent fairness of the bargain… . The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.") (quoted in *Nixon*, 626 A.2d at 1376); *Gale v. Bershad*, 1998 WL 118022, at *4 (Del. Ch.) (stock redemptions in a closely held corporation involve an inherent "conflicting self-interested motivation" for directors to redeem stock "for an inadequately low price" because the lower the redemption price, the more their stock increases in value.).

In *Nixon* the actions complained of were obviously within the realm of legitimate corporate planning and the disparate treatment of non-employee stockholders was deemed justifiable in light of the commonly accepted corporate purposes of ESOPs and key man insurance. The Court therefore held that the defendants had, by justifying their actions *at trial*, "met their burden of establishing the entire fairness of their dealings with the non-employee" stockholders. *Nixon*, 626 A.2d at 1379. In the present case, the central action complained of – the refusal to permit a minority shareholder redemption at any price other than the valuation the majority shareholders used for personal tax purposes – has no valid corporate purpose at all, but is solely for the personal benefit and advantage of the majority shareholders.

Nixon affirmed that the self-interestedness of the board and the controlling shareholders necessitated entire fairness review. In this case the court *accepted* the allegations of self-interestedness, yet refused to conduct an entire fairness review. The Court of Chancery thus erred in denying the supplemental claim and precluding entire fairness review.

3. Reversing and Remanding this Case for Further Proceedings under Entire Fairness Review Would Not Create a General Right of Minority Shareholders to be Bought Out

The ruling below suggests concern for a rule of law entitling minority shareholders to a general right to be bought out. Relying on *Nixon,* the court stated that "under Delaware law the directors of a corporation (or controlling stockholders) do not have a special fiduciary duty to minority stockholders or a general duty to buy them out" and that *Nixon* "disclaimed any judicially-created rule that would result in a court imposed buyout." 2013 Opinion at 40, 42. Susan does not dispute these general legal propositions.

But the Court of Chancery overlooked the most important passage from *Nixon*. After noting the "basic dilemma of minority stockholders in receiving fair value for their stock as to which there is no market and no market valuation," this Court concluded its discussion of that problem with the observation that it would be inappropriate "for this Court to fashion a special judicially-created rule for minority investors…when there are no negotiated special provisions in the

certificate of incorporation, by-laws, or stockholder agreements. *The entire fairness test, correctly applied and articulated, is the proper judicial approach*." *Nixon*, 626 A.2d at 1379, 1380-81 (emphasis added). This necessarily means that where, as here, there is patent self-interest that taints the corporate decision-maker, entire fairness review should be invoked to protect the minority from being victimized, especially for unjustifiable reasons having no relationship to the welfare of the corporation.[1]

Susan has been arbitrarily denied an exit from the corporation, even though the Shareholder Agreement contemplates share repurchases on "agreeable" terms. But there can be no agreeable terms when the controlling majority's position is that the repurchase price cannot exceed the aggressive valuation that they used for *personal tax purposes*, when that would require Susan to give up more than half the value of her shares. As the Thalheimer Shareholders' counsel bluntly stated: "Louis does not want to take a risk that he will be imperiling his own tax planning and the tax planning of other shareholders" and "cannot jeopardize the interests of his own family and of the other shareholders" by allowing any higher price. A1453-54. For the Thalheimer Shareholders' personal estate planning purposes,

[1] As the trial court correctly observed: "While other jurisdictions have recognized special fiduciary duties among stockholders in closely-held corporations, the Delaware courts have not adopted a similar approach. Instead, utilizing general corporate law principles, they have mostly relied on entire fairness as a means of protecting minority stockholders." 2013 Opinion at 35-36.

the value of their Lord Baltimore shares was discounted by 52%. This means that Susan must, in effect, pay 52% to receive 48% of her shares' net asset value upon redeeming them, while simultaneously enhancing the Thalheimer Shareholders' stock value by the amount of her loss.

A conflicted corporate decision is subject to heightened judicial review under the entire fairness rule. Applying this rule in the context of Susan's stock redemption does not equate to any general right of minority shareholders to be bought out, which so concerned the court below. Rather, application of the entire fairness standard would accomplish what it is intended to do, namely (i) provide for a standard of conduct that ensures the corporate decision is made free of improper influence, and (ii) provide for effective judicial review of conflicted decisions by imposing the evidentiary burden on the parties with the conflict.

At issue is Susan's contracted-for opportunity to redeem her shares and her right to a non-conflicted corporate decision on whether a repurchase will be approved and at what price. Under these circumstances, the proposed defendants owe fiduciary duties in connection with the repurchase decision and should bear the burden of proving entire fairness. This Court should reverse the dismissal of Susan's fiduciary duty claims and remand the case for further proceedings under the entire fairness standard of review.

II. THE COURT OF CHANCERY ERRED BY ENTERING SUMMARY JUDGMENT FOR DEFENDANTS AS TO THE PROPOSED SECOND CLAIM FOR BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING AND BY ALTERNATIVELY REJECTING THE CLAIM AS FUTILE

A. Question Presented

Did the Court of Chancery err in granting summary judgment on, and alternatively rejecting as futile, Susan's claim that the implied covenant of good faith and fair dealing was breached by Defendants' refusal to consider the repurchase of her stock at any price less than the appraisal price used by the Thalheimer Shareholders for their personal tax objectives?

This question was addressed below in Susan's opening brief in support of her motion (A1663-64, A1674-78), Defendants' answering brief (A1711-15), Susan's reply brief (A1743-47), and the court's decision (2013 Opinion at 16-21).

B. Scope of Review

Defendants' summary judgment motion pre-dated and was not directed to Susan's second implied covenant claim, addressing the refusal to consider repurchase at a price not matching the tax appraisal used by the Thalheimer Shareholders for personal estate planning purposes. Therefore, Susan's pleading allegations on this claim should have been judged on the standard used to determine a motion to amend a complaint, and that is essentially the same standard as used to test the sufficiency of the allegations of a complaint upon a motion to dismiss. This Court's review of the granting of a motion to dismiss, and hence the

denial of a motion to amend on grounds of futility, is *de novo*. *See Cent. Mortg. Co.*, 27 A.3d at 536; *Stegemeier*, 728 A.2d at 561.

C. Merits of Argument

1. The Court of Chancery Failed to Treat the Newly Articulated Implied Covenant Claim in the Proposed Supplemented Complaint as a Separate Theory Whose Allegations Were Subject to Review on the Standard for Futility of an Amendment to a Complaint

In its 2012 Opinion, the Court of Chancery held that Susan pled a colorable claim that Defendants breached the implied covenant of good faith and fair dealing by failing to formally submit her redemption proposals to the Lord Baltimore Board. 2013 Opinion at 14. The Defendants responded by calling the July 5 Board meeting to formally consider certain proposals, thereby purporting to dispose of their duty in that respect. Following the Board meeting, Defendants immediately moved for summary judgment (filed July 13), arguing that the implied covenant claim requiring formal presentation to the Board had now been satisfied and therefore that Susan's implied covenant claim could now be the subject of summary adjudication.

Susan, however, still had an implied covenant claim remaining based on the failure to negotiate in good faith, by refusing to consider any repurchase except at a price discounted to match the Thalheimer Shareholders' stock valuation for personal estate planning purposes. By her Motion and in the proposed

Supplemented Complaint, Susan expressly presented that implied covenant claim, arguing either that the claim could be inferred from her original allegations and remained after the court's 2012 Opinion or, alternatively, that the court should allow it as a new implied covenant claim by amendment to the Verified Complaint. In either case, the record below is clear that Defendants' summary judgment motion was not directed to that claim. A558, A561, A565-66; A1696, A1711-19.

Defendants' summary judgment motion predated and did not address the implied covenant claim at issue in the Supplemented Complaint. Nevertheless, the Court of Chancery erroneously dismissed Susan's well pled allegations that Defendants acted in bad faith when they insisted on an utterly unjustifiable 52% discount in any redemption scenario, and in so doing utilized purported facts from the submissions accompanying Defendants' summary judgment motion on the failure to submit issue.[2] The court should have disregarded the summary judgment submissions when reviewing the second implied covenant claim (alleging arbitrary suppression of the repurchase price for purely self-interested and unjust reasons) and instead evaluated the claim under Rule 15(a).

Under Rule 15(a), a motion to amend should be granted unless the non-moving party can demonstrate prejudice or bad faith by the moving party, or

[2] The Chancery Court relied on proffered facts that Susan had agreed to similar discounts in prior transactions (2013 Opinion at 19-20), to which Susan should not have had to respond in seeking to amend her Verified Complaint.

futility of the amendment. *Cartanza*, 2006 WL 903541, at *2. An amendment is futile if it would not survive a motion to dismiss under Court of Chancery Rule 12(b)(6). *Id*. Under Rule 12(b)(6), a complaint may only be dismissed if it fails to state a claim upon which relief can be granted under "any reasonably conceivable set of circumstances susceptible of proof." *Cent. Mortg. Co.*, 27 A.3d at 536. In determining whether an amendment is futile, a court accepts as true all well-pleaded facts and does not consider facts extrinsic to the complaint, except for documents integral to the complaint and documents not relied upon to prove the truth of their contents. *Id*.; *Cartanza*, 2006 WL 903541, at *2.

Accordingly, the Court of Chancery was prohibited from using "facts" proffered by the Defendants in a summary judgment motion directed to a completely different claim in considering the sufficiency of the allegations within the four corners of the proposed Supplemented Complaint. In other words, Defendants' opposition to the motion to supplement on grounds of futility should have been treated as equivalent to a motion to dismiss and the only issue for review was the sufficiency of the allegations in the Supplemented Complaint.

2. Susan Properly Alleged an Implied Covenant of Good Faith and Fair Dealing Underlying the Repurchase Provisions of the Shareholder Agreement

The Court of Chancery erroneously entered judgment on Susan's proposed implied covenant claim relating to the arbitrary cap on the repurchase price, and

erroneously held in a footnote that the proposed amendment "would be futile for failure to state a claim." 2013 Opinion at 17 n.30. To the extent that the court deemed this implied covenant to have been asserted in the Verified Complaint and dismissed by the 2012 Opinion, that decision too was reversible error. Despite acknowledging that the Board's decision not to accept reasonable proposals might implicate an implied covenant to negotiate in good faith (*id*. at 15-16), the court reasoned that Section 7(d) of the Shareholder Agreement entirely eclipses the implied covenant. This rationale cannot survive in the light of this Court's holding in *Gerber* that even the express terms of a contract addressing a particular subject do not displace non-waivable common law protections such as the implied covenant of good faith and fair dealing. This is so because the implied covenant always exists in the background and may be invoked to assure that the terms of the contract are executed in a manner consistent with concepts of good faith and fair dealing. Literal compliance with the contract does not insulate the acts of a party from examination under the implied covenant.

As a threshold matter, the Court of Chancery's interpretation that Section 7(d) affords Lord Baltimore absolute discretion in all circumstances to reject any repurchase does not do justice to the actual language of the provision. Section 7(d) sets forth a process for redemption, but it postpones for a later day the price determination to be made with the simple statement the repurchase will occur on

terms and conditions "agreeable to the Company and the Shareholder…." A88. Deferring the price issue for later discussion does not portend a waiver of the implied covenant, even if such waiver were legally permissible. *See Gerber*, 2013 WL 2477233, at *13 n.48.

The provision in Section 7(d) stating that the terms and conditions be mutually agreeable connotes an expectation of cooperation, not an invitation to arbitrary or capricious behavior. It certainly suggests, and Susan certainly believed, that the agreement meant to incorporate – not *preclude* – an expectation that the parties would act in good faith to come to a mutually agreeable price. Yet the court below read the provision as precluding any such expectation. According to the court's interpretation, the contract gives Lord Baltimore (which means in practice, the controlling shareholders) the *absolute discretion to refuse* for any reason or no reason, even when the refusal is motivated by financial self-interest.

Were there any doubt regarding the implied covenant that a repurchase request would be addressed in good faith, such doubt would be readily dispelled by Susan's allegations regarding the parties' reasonable expectations at the time of contracting. Susan plainly alleged a desire, expressly stated to Louis and the other Thalheimer Shareholders before signing the contract, to be able to redeem her shares at their full proportionate value after the 10-Year Waiting Period, and was induced by Louis's express assurances in that regard to enter into the Shareholder

Agreement. The course of dealings and understandings of the parties at the time of contracting thus make it clear that the repurchase afforded by Section 7(d) was the intended avenue by which Susan would be able to extricate herself from the corporation when the time came. A1441-42, A1448-49, A1450-51. In this context, Section 7(d) must be read to include an implied covenant that Lord Baltimore would not seek effectively to imprison Susan as a Shareholder indefinitely by insisting on a facially unreasonable 52% penalty for redeeming her stock.

The Court of Chancery failed to credit these allegations of the reasonable expectations of the parties at the time of contracting, in declining to recognize an implied covenant to negotiate in good faith in both the Verified Complaint and the Supplemented Complaint. The court thereby ran afoul of the standard well developed in Delaware, and recently reaffirmed by this Court in *Gerber*. Fair dealing is "a commitment to deal 'fairly' in the sense of consistently with the terms of the parties' agreement and its purpose." 2013 WL 2477233, at *12. In *Gerber*, this Court reversed the Court of Chancery's dismissal of a claim alleging breach of the implied covenant, even though the defendants in that case complied literally with the terms of the LPA by obtaining a fairness opinion by which they could claim a safe harbor under the agreement. This Court looked beyond literal compliance with the safe harbor to hold that the plaintiff alleged a breach of the

implied covenant by averring that the controlling defendants essentially used the express procedure set out in the partnership agreement as a ruse. *Id*. at *12-14. The Court noted that plaintiff could not have anticipated that the defendants would seek to use a facially deficient fairness opinion in blessing transactions that were manifestly unfair to the limited partners. *Id*. at *14.

Here, similarly, Susan could not possibly have imagined that the Thalheimer Shareholders would take a tax position that would constrain them to insist on a facially unreasonable sacrifice of over half of the value of her shares, all of which would redound to their personal benefit, as the price of redemption. Had she imagined such a turn of events, she surely would not have entered into a Shareholder Agreement that is in reality a trap that keeps her locked into an investment from which she is unable to escape without paying her captors 52% of the net asset value of her holdings in order to get back just 48%.

The Court of Chancery acknowledged that the failure to negotiate toward a "reasonable price" could be significant "where a party has an obligation to negotiate in good faith." 2013 Opinion at 15-16. The court should have recognized such an obligation, and allowed the implied covenant claim to proceed.

CONCLUSION

The Court of Chancery should be reversed and the case remanded for further proceedings.

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Dated: July 8, 2013

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CERTIFICATE OF SERVICE

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