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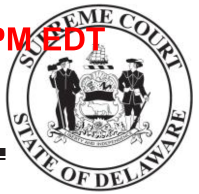

IN THE

Supreme Court of the State of Delaware

LEHMAN BROTHERS HOLDINGS INC., *Plaintiff Below-Appellant*, v. SPANISH BROADCASTING SYSTEM, INC., *Defendant Below-Appellee*.	**No. 174, 2014** COURT BELOW: COURT OF CHANCERY OF THE STATE OF DELAWARE, Consolidated C.A. No. 8321-VCG

APPELLANT'S OPENING BRIEF

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NATURE OF PROCEEDINGS

In October 2003, the media company Spanish Broadcasting System, Inc. (the "Company") issued a series of preferred stock (the "Series B") that entitled its holders to quarterly dividend payments at a specified rate. This right was secured by contract: the certificate of designations for the Series B (the "Certificate") provided that a restrictive covenant — known as a "Voting Rights Triggering Event" or "VRTE" — would come into effect if "at any time, dividends on the outstanding Series B Preferred Stock are in arrears and unpaid . . . for four (4) consecutive quarterly dividend periods." When a VRTE exists, the Certificate prohibits the Company from incurring nearly all types of indebtedness (and holders are entitled to elect two directors to the Company's board), until the VRTE is cleared by consent or by payment of the accumulated dividend arrearages.

For the first five years, the Company complied with the Certificate, paying every dividend either in cash or in kind. In 2009, the Company began skipping three out of every four dividend payments, thereby indefinitely deferring 75% of its dividend obligations. In 2011 and 2012, with dividends having been in arrears and unpaid for well more than four consecutive quarters, the Company incurred over $280 million in new indebtedness.

Plaintiff is a holder of the Series B. Although engaged in the largest bankruptcy in history at the time when the Company began skipping dividend

payments and incurring new debt, Plaintiff filed suit within the applicable limitations period. Plaintiff's complaint did not seek injunctive relief, merely money damages and a declaration of breach. The Company moved to dismiss, and Plaintiff cross-moved for summary judgment as to liability.

Following argument, the Court of Chancery stated that it found the contract language to be "ambiguous on its face" and continued Plaintiff's cross-motion to permit discovery. During this period, a second Series B holder filed suit, asserting contract and declaratory judgment claims, as well as a claim for breach of the implied covenant of good faith and fair dealing. Plaintiff amended its complaint to add a similar good faith and fair dealing claim.

Following discovery, the parties cross-moved for summary judgment. On February 25, 2014, the Court of Chancery issued a decision in which it granted the Company's motion in its entirety, based solely upon the existence of an equitable defense described herein. *See* Memorandum Opinion, Exhibit A hereto ("Op."); *see also* Final Order and Judgment, Exhibit B hereto. This appeal followed.

SUMMARY OF ARGUMENT

In the decision below, the Court of Chancery combined elements of the doctrines of acquiescence and equitable estoppel — applying some elements, omitting others — to form an equitable defense to bar Plaintiff's claims ("acquiescence . . . as I use the term here" (Op. 24)). The equitable defense applied below does not exist under Delaware law, or if it does, it is better known as laches, which the Court of Chancery acknowledged cannot bar Plaintiff's timely filed legal claims. Neither acquiescence nor equitable estoppel bars Plaintiff's claims, and the Company is liable for breaching the Certificate by incurring indebtedness during the pendency of a VRTE.

1. Acquiescence does not bar Plaintiff's claims. The defense applies only where a plaintiff has "full knowledge of his rights and the material facts," but here the Company concedes that Plaintiff's level of knowledge was "ignorance." For that reason (among others), the defense's prerequisite that Plaintiff made a "meaningful choice" and engaged in conduct that acknowledged the legitimacy of the transaction is not satisfied here. Expanding the defense to reach a case like this would have adverse policy consequences.

2. Equitable estoppel, which the Company did not assert in the briefing below, does not bar Plaintiff's claims either. The defense applies only where the party invoking it lacks knowledge or the means of discovering the facts in

question. But here, the Company could read the Certificate language just as well as Plaintiff, and the Company knew of the litigation risk inherent in re-interpreting a public instrument years after its issuance. Further, if the purportedly concealed "fact" was Plaintiff's contemporaneous view that a VRTE existed, the defense fails because Plaintiff held no such view at the time. In addition, estoppel cannot occur through silence in the absence of a duty to speak and actual knowledge; neither was present here. Finally, the Company cannot establish reasonable reliance. As with acquiescence, expansion of the defense to reach these facts would carry adverse policy consequences.

Ultimately, the Court of Chancery's approach is best understood in light of its observation that the acquiescence doctrine "has rarely been addressed in a thorough, doctrinally-satisfying manner." Op. 22. But in crafting a defense that functions in effect as laches — no requirement of actual knowledge, acts acknowledging the legitimacy of defendant's conduct, or facts concealed from defendant — yet applies to claims for money damages filed within the limitations period, the Court of Chancery establishes the wrong incentives. Under settled law, a party contemplating breach understands that it may be sued for damages until the limitations period runs. Under the rule below, however, the limitations period can effectively be terminated upon breach — so long as the breaching party is able to obfuscate and complete its breach before its counter-party acts. Such a rule is

particularly unsound in the context of preferred stock, where investor rights are secured largely by contract. Trading enforcement of negotiated contract rights for a subjective assessment of each investor's state of knowledge and motivations would mark an unattractive departure. Whatever the proper balance between contract rights and "gap-filling" fiduciary duties for preferred holders, introducing a new uncertainty into the contractual foundation of preference rights is unwarranted. The Company should be held to its contract.

3. Finally, while the Court of Chancery (which did not rule on the contract issue) stated that the Certificate language concerning a VRTE is "facially ambiguous," Plaintiff submits that a review of the full Certificate makes clear that Plaintiff's construction is the only reasonable construction. Nevertheless, even if the Certificate is ambiguous, then because the instrument is (and always has been) held by public investors, this Court's decision in *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996), requires its construction in favor of those investors, including Plaintiff.

STATEMENT OF FACTS

A. <u>The Company Raises Capital Through the Series B.</u>

The Company is a Delaware corporation headquartered in Miami, Florida. It produces and distributes Spanish-language radio and television content. A1602. Raúl Alarcón, Jr., the Company's Chairman of the Board and Chief Executive, has voting control of the Company through his ownership of shares representing 82.7% of the voting power of the Company's common stock. A1565-66.

In 2000, the Company entered into an agreement to acquire the assets of radio station KXOL-FM. A1505-06. [redacted] A1738-40; A1509-10. The Company was highly leveraged, and it faced constraints in arranging the necessary financing. A1504; A1609; A1611; A1618; A1619.

Lehman Brothers Inc. ("LBI") (a former affiliate of Plaintiff), which previously had served as a Company underwriter (A1495-96), assisted the Company in assembling an offering memorandum for Series A Preferred Stock. A1624; A1641; A1644; A1646; A1709. The Series A was offered pursuant to an exemption from the registration requirements of the Securities Act of 1933. A1745-47; A1748. The investors in the unregistered Series A were beneficiaries of a Registration Rights Agreement under which the Company would exchange the

Series A for substantially identical shares of Series B registered with the SEC. A1750-51.

On October 29, 2003, the Company caused the certificate of designations for the Series A and Series B to be executed and filed with the State of Delaware. A1817. The next day, the Company completed the issuance and sale of 75,000 shares of Series A, each share having a $1,000 liquidation preference. A1529. All of the Series A shares were placed with qualified investors. None of the investors who would acquire the Series A participated in negotiating the terms of the securities. A1462-63. LBI did not retain any shares of Series A for its own account. A1752. On March 26, 2004, the Company completed the exchange of Series A for Series B. A1533.

B. Relevant Provisions of the Certificate

Cumulative Dividends at 10 ¾ percent. The certificate of designations provides that "dividends on the Series B Preferred Stock . . . accrue at a rate per annum equal to 10.75% of the Liquidation Preference." "Certificate" § 4(a) (A1877). The dividends are "cumulative, whether or not earned or declared, on a daily basis . . . and will be payable quarterly in arrears" every October 15, January 15, April 15 and July 15. *Id.* The Certificate provides that Series B holders will receive dividends "when, as and if declared by the Board of Directors." *Id.*

PIK Feature. Before October 15, 2008, the Company had the option to pay dividends in cash or in "dividend shares." This payment-in-kind ("PIK") feature did not continue indefinitely; "[o]n or after October 15, 2008," the Company may pay dividends only in cash. Certificate § 4(a) (A1877).

The "Voting Rights Triggering Event" Provision. As protection against the possibility that the Company might not pay dividends, the Certificate gives the Series B holders specified rights in the event of a Voting Rights Triggering Event ("VRTE"). A VRTE goes into effect 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.

Certificate § 9(b)(i) (A1844).

When a VRTE is in effect: (i) the Series B holders have the right to elect two directors (Certificate § 9(b) (A1884-85)) and (ii) the Company may not incur any "Indebtedness" (Certificate § 11(b) (A1892)). Once triggered, a VRTE remains in effect until "all dividends in arrears shall have been paid in full (and in the case of dividends payable after October 15, 2008, paid in cash.)" Certificate § 9(c) (A1885).

A971-72.

Redemption Provision. On or after October 15, 2008, the Company may redeem all or a portion of the Series B "at any time, in whole or from time to time in part, at the option of the Company, at the Applicable Redemption Price". Certificate § 6(a) (A1878). The Company had to pay a premium for the early exercise of that right: depending on the year the redemption option is exercised, the "Applicable Redemption Price" is from 105.375% to 100% of the Liquidation Preference, plus an amount in cash equal to all accumulated and unpaid dividends. A971-72.

Exchange Provision. The Series B were exchangeable at the Company's option for notes bearing interest at 10¾ percent and due in October 2013. Certificate § 8 (A1882-84).

Put Right. The Certificate also gave the Series B holders an option to require the Company on October 15, 2013, to redeem their Series B shares at a price equal to 100 percent of the liquidation preference of the shares, plus "all accumulated and unpaid dividends." Certificate § 7 (A1880).

C. <u>The Company's Performance Under the Certificate</u>

For the first five years after issuance of the Certificate, the Company timely made all of its quarterly dividend payments. A1541. It made some payments in kind, even though this is expensive, because additional dividend payments come due on the new dividends issued. A2228-31.

[redacted] A1415-18. Following this review, the Company began modifying its public disclosure of its dividend obligations. In 2003 and 2004, the Company's disclosures had described the dividend VRTE by tracking, nearly verbatim, the Certificate's language. *See* A1289. Between 2005 and 2008, the Company issued no disclosures concerning the dividend VRTE provision. On May 15, 2009, the Company included in its 10-Q a risk disclosure stating that "failure to make four consecutive quarterly cash dividend payments will result in the right of the holders of the Series B preferred stock to elect two directors to the board." A1547.

On July 15, 2009, the Company skipped dividends on the Series B for the first time. A1547. Since that time, the Company has paid only one out of every four quarterly dividends, even though the Company had sufficient cash to pay all four dividends in cash each year. A1550; A1559; A1598; A595; A664; A751. Specifically, the Company has paid only the dividends payable on April 15 of each

year, allowing the other dividends to remain in arrears and unpaid. A1550; A1559; A1598.

D. Plaintiff's Holdings in the Series B

A2187-89; A2112-13.

On September 15, 2008, Plaintiff filed for bankruptcy. Plaintiff's filing was "the largest bankruptcy in history." *In re Lehman Bros. Holdings Inc.*, 469 B.R. 415, 430 (Bankr. S.D.N.Y. 2012). On September 19, 2008, LBI filed for bankruptcy. A1945. Also in September 2008, JPM, as a secured party, claimed rights in certain securities of LBI and its affiliates, including the Series B. A2187-89. Thus, when the Company in 2009 began modifying its disclosure statements and first began skipping dividend payments, JPM claimed and held the Series B position, and both Plaintiff and LBI were engaged in bankruptcy.

In 2010, pursuant to a settlement with JPM regarding rights to LBI's collateral, Plaintiff became subrogated to JPM's rights in certain securities that had been owned by LBI at the time of its bankruptcy, including the Series B. A2187-89.

A1969-87.

A2021-22.

A1367-68; A1438-39.

A1062.

A889-90; A852; A873, 878-79.

E. The Company Incurs Indebtedness During the VRTE.

A1460-61.

On or about August 1, 2011, at a time when dividends had been in arrears and unpaid for eight consecutive quarterly dividend periods, the Company incurred $8 million in additional indebtedness, at an interest rate of 6%, in order to finance the purchase of assets related to the operation of the television station KTBU in Conroe, Texas (the "Houston TV Assets"). A1591.

On January 30, 2012, the Company for the first time issued a disclosure statement that clearly disclosed its new interpretation of the Certificate, stating that a VRTE would occur if the Company "fail[ed] to pay at least one of every four consecutive quarterly dividends on the Series B[.]" A1583.

On February 7, 2012, at a time when dividends had been in arrears and unpaid for ten consecutive quarterly dividend periods, the Company closed an offering of $275 million in 12.5% senior secured notes due 2017 (the "Notes Offering"). A1591; A1586-87.

Both transactions were publicly announced in advance. A1294; A1567. Plaintiff did not seek to enjoin either transaction. Nor did Plaintiff otherwise contemporaneously assert that the Company had breached the Certificate. As the Company's counsel acknowledged, "the record supports" that Plaintiff's failure to assert a VRTE at this time was "simply by ignorance." A2534-35.

See A1432

; A2076

; A2056

; A2079

F. Plaintiff Exits Bankruptcy, Identifies the VRTE and Files Suit.

On March 5, 2012, Plaintiff exited from bankruptcy. A2181.

A1439; A2223.

A1198; A1211; A1223.

Other Series B holders followed suit. On June 17, 2013, T. Rowe Price entities filed a similar lawsuit against the Company, which was consolidated with this action.[1] On December 27, 2013, other Series B holders filed an additional lawsuit in the Court of Chancery. *River Birch Master Fund, L.P., et al. v. Spanish Broad. Sys., Inc.*, C.A. No. 9209-VCG. That action is currently pending.

[1] Following the decision below, T. Rowe Price sold its shares in the Series B.

A2211; SBS 2013 Annual Report (Form 10-K), at 5 (Apr. 15, 2014). The Company asserted at argument below that the deferred dividends for the Series B were accruing interest. A2564-65. But the Certificate does not provide for the accrual of interest on preferred dividends, nor do SBS's financial statements reflect such accrual. SBS Quarterly Report (Form 10-Q), at 4 (May 15, 2014). SBS has made no indication when, if ever, it will pay the outstanding deferred dividends on the Series B.

ARGUMENT

I. PLAINTIFF DID NOT ACQUIESCE IN THE BREACHES.

A. Question Presented: Did the Court of Chancery err in ruling that Plaintiff's claims were barred by the doctrine of acquiescence? This question was raised below (A813-14; A1348-49; A2295-96; A2350; A2463-65; A2533-37; A2548-50; A2556) and considered by the Court of Chancery (Op. 22-32).

B. Scope of Review: This Court reviews *de novo* a trial court's grant of a motion for summary judgment, both as to the facts and the law. *DaBaldo v. URS Energy & Constr.*, 85 A.3d 73, 77 (Del. 2014).

C. Merits of Argument

The Court of Chancery erred in finding that Plaintiff acquiesced in the Company's breaches of the Certificate. Remaining silent in ignorance does not constitute acquiescence under Delaware law, and expanding the defense to reach this case would undermine preferred holders' contract rights.

1. Remaining Silent in Ignorance is Not Acquiescence.

Acquiescence applies where a party has "full knowledge of his rights and the material facts" and, with such knowledge, "(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 . . ." *Klaassen v. Allegro Dev. Corp.*, --- A.3d ---, 2014 WL 996375, at *8 (Del. Mar. 14, 2014) (quoting *Cantor Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 582 (Del. Ch. 1998)).

This standard reflects the principle underlying the defense: a claim will be barred where the plaintiff has engaged in conduct that "acknowledged the legitimacy" of the transaction. *See Clements v. Rogers*, 790 A.2d 1222, 1238 n.46 (Del. Ch. 2001); *see also Trounstine v. Remington Rand, Inc.*, 194 A. 95, 100 (Del. Ch. 1937) ("Having made his choice, I am of the opinion a court of equity should hold him to his selection."). Thus, while a "conscious intent" to "approve" the challenged conduct may not be required, *see Klaassen*, 2014 WL 996375, at *8, "the absence of a meaningful choice precludes a finding of acquiescence." *In re Best Lock Corp. S'holder Litig.*, 845 A.2d 1057, 1076 (Del. Ch. 2001); *In re Celera Corp. S'holder Litig.*, 2012 WL 1020471, at *11 (Del. Ch. Mar. 23, 2012) ("NOERS arguably did not have a meaningful choice"), *rev'd in part on other grounds*, 59 A.3d 418 (Del. 2012).[2] This standard cannot be satisfied here.

a. First, Plaintiff lacked the requisite knowledge. As this Court reiterated after the decision below was issued, a plaintiff must have "full knowledge of his rights and the material facts." *Klaassen*, 2014 WL 996375, at *8; *see also Tristate Courier & Carriage, Inc. v. Berryman*, 2004 WL 835886, at *9 n.123 (Del. Ch. Apr. 15, 2004) ("I am not persuaded that Ritchie was well informed . . . and therefore I decline to apply this doctrine to bar TriState's claims

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[2] The "conscious intent" caveat applies where a plaintiff with knowledge "freely does something which fairly and reasonably amounts to a recognition of the validity of that act." *Frank v. Wilson & Co.*, 9 A.2d 82, 87 (Del. Ch. 1939), *aff'd*, 32 A.2d 277 (Del. 1943) (cited in *Klaassen*, 2014 WL 996375, at *8 n.80).

based on Ritchie's (lack of) action."); *Tenneco Auto. Inc. v. El Paso Corp.*, 2004 WL 3217795, at *12 (Del. Ch. Aug. 26, 2004) (plaintiff "did not have sufficient knowledge . . . to be charged with acquiescence").

Here, the Company itself characterizes the Plaintiff's level of knowledge as "ignorance." *See* Op. 28 n.65 ("[Company counsel:] whether willfully or by ignorance — the record supports simply by ignorance — [the Plaintiffs] sat on their rights"). ████████████████████████████████████ ████████████████████████ *See* pp. 11-12, *supra*. And when the Company triggered the VRTE and incurred new debt, Plaintiff was in bankruptcy. *See id.* Thus, the entire sequence by which Plaintiff became aware of the VRTE issue and acted — its exit from bankruptcy, retention of new advisors, discovery of the VRTE and prompt filing of suit thereafter — commenced after the breaches were complete. *See* p. 14, *supra*. More broadly, ██████████████████ ████████████████████████████████████, *see* pp. 13-14, *supra,* and the Company's public disclosures were deficient. *See* pp. 10-13 *supra*.[3]

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[3] While the Court of Chancery properly declined to rely on cases where a plaintiff "accepted the benefits" of a merger, *see* Op. 22, n.54, those cases remain instructive on one point: a party's failure to make a full and accurate disclosure can defeat the knowledge required for acquiescence. *See Siegman ex rel. Siegman v. Columbia Pictures Entm't, Inc.*, 1993 WL 10969, at *8 (Del. Ch. Jan. 15, 1993) ("this Court cannot find as a matter of law that defendants' disclosures were accurate and therefore cannot find that the shareholders were fully informed and thus acquiesced"); *Iseman v. Liquid Air Corp.*, 1993 WL 40048, at *2 (Del. Ch. Feb. 11, 1993) ("it appears that plaintiffs were not fully informed").

Despite this record, the court below cited publicly available information (including the Certificate) and ruled that Plaintiff had sufficient constructive knowledge. *See* Op. 25. The error in the court's approach is evident in the fact that the standard ("full knowledge of his rights and all material facts") appears in the decision below only once — in a "but see" citation that *contradicts* authority relied upon by the court for its approach to knowledge, namely *Frank v. Wilson & Co.*, 32 A.2d 277 (Del. 1943). *See* Op. 25 n.59. And while *Frank* (a ratification case) references "imputed" knowledge, its facts turn on actual knowledge. As this Court explained, the complainant did not argue that he was "ignorant or mistaken as to his antecedent and existing legal rights," but instead "insisted from the first that his Class A shares remained unaffected by the amendment," and "[w]ith full knowledge of the facts he chose to accept the dividends." *Frank*, 32 A.2d at 282.

The same pattern holds true among Delaware acquiescence cases containing *dicta* regarding constructive knowledge. *See Papaioanu v. Comm'rs of Rehoboth*, 186 A.2d 745, 749-50 (Del. Ch. 1962) (referencing "full knowledge, or at least sufficient notice or means of knowledge" but finding that "[t]he record in this case clearly demonstrates that all material facts were within the actual knowledge of plaintiff");[4] *Staples v. Billing*, 1994 WL 30548, at *12 (Del. Ch. Jan. 31, 1994)

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[4] The *Papaioanu* language is nearly identical to the formulation repeated in *Klaassen*, with one striking exception — the phrase referencing constructive knowledge has since been dropped. *Compare Papaioanu*, 186 A.2d at 749-50

(referencing *Papaioanu*'s "full knowledge, or at least with sufficient notice or means of knowledge" language, but finding acquiescence where plaintiff had actual knowledge). Further, while in *Brown v. Fenimore*, 1977 WL 2566, at *2-3 (Del. Ch. 1977), in finding that a co-founder of an auto parts business had acquiesced in a stock issuance, the court referenced his "knowledge, actual or imputed" of his co-founders' contribution to the business they jointly founded, there is no indication that the co-founder disputed such knowledge (or that he could credibly do so), and the record further showed that he had participated in the meeting at which the issuance was authorized. *Id.* at *1-3.

Similarly, in ruling on the defense of reformation in *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 680-82 (Del. 2013), this Court in *dicta* concerning ratification cited the "knowledge, actual or imputed" formulation used in *Frank*, drawing a contrast between that formulation and the actual knowledge requirement for reformation, but upheld reformation based on *actual* knowledge.

Even in *Nevins v. Bryan*, 885 A.2d 233 (Del. Ch. 2005), *aff'd*, 884 A.2d 512 (Del. 2005), where the court used the formulation "knew (or should have known)" and the word "notice," stating that the plaintiff had "at least constructive

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("full knowledge, *or at least with sufficient notice or means of knowledge* of his rights, and of all the material circumstances") (emphasis added), *with Klaassen* 2014 WL 996375, at *8 ("full knowledge of his rights and the material facts").

knowledge" of his rights and the material facts, *id.* at 246-47, 253-54, the court's discussion indicates that it rejected based on the factual record the plaintiff's claim that he lacked knowledge (finding the claim not credible) and in effect inferred actual knowledge. For example, the plaintiff claimed that he had not received certain email attachments that he had requested, but the court found that he had in fact received them. *See id.* at 242, 247. Based on the record, the court concluded that the plaintiff "had full knowledge". *Id.* at 247.

Ultimately, a plaintiff that is not even aware of the issue could not have made a "meaningful choice" to "acknowledge the legitimacy" of the conduct. By the time Plaintiff here became aware of the existence of the VRTE, the breaches had been completed. Under Delaware law, one cannot acquiesce out of ignorance.

b. Beyond Plaintiff's lack of knowledge, its silence here was not conduct that acknowledged the legitimacy of the breaches, because that is not how the Certificate works. In stating that the Certificate "places the responsibility" upon holders to act in the face of a VRTE, and that "neither [Plaintiff nor T. Rowe] pursued their resulting right to seats . . . or otherwise acknowledged the VRTE" (Op. 26-27), the Court of Chancery misread the document. While the Certificate provides an option to elect two directors upon a VRTE, it is only that — an option. Indeed, here there were reasons not to exercise the option, including the control and domination of the Board by Alarcón. A1565-66. Nothing in the Certificate

requires that the holders do anything to trigger or preserve a VRTE. Rather, the covenant comes into effect automatically when triggered by the Company's conduct, *see* Certificate §§ 9(b) (A1884-85), 11(b) (A1892-93), and it remains in place until the Company takes an affirmative act to clear it, including securing the consents of holders or paying all accumulated dividend arrearages. *See* Certificate § 9(c) (A1885). Put simply, it is the design of the instrument that the holders are passive investors. Even if they remain silent for a time, they are due their rights.

* * *

The acquiescence defense has never been applied to bar a case like this one. Plaintiff was a passive investor that was in bankruptcy and ignorant of the issue at the time of the breaches. Despite confusion about the issuer's dividend policies — confusion to which the issuer contributed — Plaintiff, after it obtained possession of the instrument and exited bankruptcy, identified the breach and promptly filed suit. That is not acquiescence.

2. <u>Expanding the Defense to Apply Here is Bad Policy.</u>

Expanding the doctrine to apply to a case like this one would be bad policy.

a. First, the new rule would upend settled principles regarding contract damage claims. Under current law, where a party breaches, it has an expectation that it may be sued for damages until the limitations period runs. *See* 10 *Del. C.* § 8106 ("no action based on a promise . . . shall be brought after the expiration of 3 years from the accruing of the cause of such action"). The three-year period for

contract damage actions has been in place since at least 1877. *See Stewart v. Apel*, 10 Del. 189 (Del. Super. Ct. 1877). A party still may decide that it is more efficient to breach the contract, but in evaluating that decision, the party is aware that until the limitations period runs, it may have to pay damages.

The doctrine of laches does not disturb these principles because, as the Court of Chancery recognized, it does not bar legal claims filed within the limitations period. *See* Op. 18; *see also Petrella v. MGM, Inc.*, 572 U.S. ____, No. 12-1315, slip op. at 12-13 (May 19, 2014) ("in [the] face of a statute of limitations enacted by Congress, laches cannot be invoked to bar legal relief"). And equitable defenses that might apply to legal claims require a more significant showing of deliberate conduct than does laches. *See* DONALD J. WOLFE, J. & MICHAEL A. PITTENGER, CORP. & COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 11.04(a) ("a much more definite apparent assent to the acts complained of [is] required in acquiescence than in laches") (citing *Frank*, 9 A.2d at 86-87); *see also Petrella*, No. 12-1315, slip op. at 19 (explaining that estoppel might apply if plaintiff engaged in "intentionally misleading representations," and that "[t]he test for estoppel is more exacting than the test for laches," with the "gravamen of estoppel" being "misleading" conduct and "consequent loss," while for laches, "timeliness is the essential element").

Here, by creating a defense that functions in effect as a form of laches — no actual knowledge, no acts affirming the legitimacy of the conduct, no facts withheld from the defendant — yet bars even legal claims filed within the limitations period, the Court of Chancery upends the long-settled arrangement and creates the wrong incentives. Under the rule below, where a party finds that its contractual commitments have become inconvenient, it would face a more favorable landscape: so long as it can obfuscate and complete its breach before its counter-party acts, it may effectively terminate the limitations period upon breach. Such a rule would destabilize and undermine adherence to contracts.

b. The ill effects of this rule would be felt with particular force in the realm of preferred stock. "[T]o a very large extent, to ask what are the rights of the preferred stock is to ask what are the rights and obligations created contractually by the certificate of designation." *LC Capital Master Fund, Ltd. v. James*, 990 A.2d 435, 447-48 (Del. Ch. 2010) (quoting *HB Korenvaes Invs., L.P. v. Marriott Corp.*, 1993 WL 205040, at *5 (Del. Ch. Jun. 9, 1993)).[5] Preferred holders are thus often held to the preference rights they secure at the bargaining table, *see LC Capital Master Fund, Ltd.*, 990 A.2d at 449-50, and for that reason, it is important that they be able to exercise those rights.

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[5] Indeed, the Certificate's drafters in fact attempted to protect these contractual rights. *See* Certificate § 9(h)(iv) (A1887) (requiring holder consent). *Cf. In re Mobilactive Media, LLC*, 2013 WL 297950, at *12 n.152 (Del. Ch. Jan. 25, 2013) (rejecting acquiescence argument in part due to non-waiver provision).

Moreover, while a debate exists as to the proper balance between this contractual foundation and the use of fiduciary duties as "gap-fillers," *see generally* Leo E. Strine, Jr., *Poor Pitiful Or Potentially Powerful Preferred?*, 161 U. PA. L. REV. 2025 (2013), whatever the proper balance, there is no warrant for introducing into the contract side of the equation the uncertainty created by the approach below. To the contrary, destabilizing preferred instruments by providing issuers with the prospect of potentially terminating preference rights upon their breach is inadvisable.[6]

Ultimately, the approach below in effect trades the reliability of negotiated contract rights for a subjective evaluation of an investor's motivations and intentions. The Court of Chancery's assurance that outcomes may vary depending upon the size of the plaintiff's preferred holdings and its degree of interest in the breach, *see* Op. 32, only underscores the difficulty with such an approach.[7] Whatever changes might be called for in the area of preferred stock, weakening its contractual foundations is not one of them.

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[6] The Company may assert that the rule below incentivizes monitoring of investments. But notwithstanding the unusual circumstances here, current law already provides incentives. An investor that does not sue before the transaction is completed may lose injunctive remedies, and stands to lose even money damage claims if it does not file suit within the limitations period.

[7] Indeed, the Company is now relying on the decision below in actions brought by smaller Series B holders. *See Brevan Howard Credit Catalyst Master Fund Ltd. v. Spanish Broad. Sys., Inc.*, No. 9209-VCG, 2014 WL 1335663, Opening Br. in Support of Mot. to Dismiss, pp. 14-17 (Del. Ch. Mar. 31, 2014).

II. PLAINTIFF IS NOT EQUITABLY ESTOPPED FROM RECOVERING DAMAGES.

A. Question Presented: Is Plaintiff equitably estopped from asserting its contract claims? The Court of Chancery raised this question *sua sponte* and considered it. Op. 22-32.

B. Scope of Review: This Court reviews *de novo* a trial court's grant of a motion for summary judgment, both as to the facts and the law. *DaBaldo v. URS Energy & Constr.*, 85 A.3d 73, 77 (Del. 2014).

C. Merits of Argument

While the Court of Chancery nominally applied the acquiescence doctrine, it characterized its application here as effectively working an "estoppel by silence or estoppel by inaction." Op. 23 n.56. And in listing the elements of the defense of "acquiescence . . . as I use the term here," the court cited a treatise section regarding equitable estoppel. Op. 24. But the Court of Chancery's analysis of equitable estoppel omits key elements, and does not correctly apply others. Plaintiff is not estopped from seeking money damages here.

1. The Company Did Not "Lack Knowledge or the Means of Discovering" the Facts in Question.

As the Court of Chancery recently explained, equitable estoppel applies only where "the party claiming estoppel lacked knowledge or the means of obtaining knowledge of the truth of the facts in question." *Kuhns v. Bruce A. Hiler Del.*

QPRT, 2014 WL 1292860, at *19 (Del. Ch. Mar. 31, 2014) (Glasscock, V.C.); *see also U.S. Bank Nat'l v. Swanson*, 2006 WL 1579779, at *1 (Del. Super. Ct. May 1, 2006) ("it must be shown that the party claiming estoppel lacked knowledge of the truth of the facts in question"), *aff'd*, 918 A.2d 339 (Del. 2006).

This element was omitted from the Court of Chancery's analysis, and the Company cannot satisfy it. If the "fact" Plaintiff did not disclose was the existence of a VRTE or risks related thereto, the Company could read the Certificate as well as Plaintiff. If the "fact" was Plaintiff's view that a VRTE was in effect, the defense fails because Plaintiff held no such view at the time.

2. <u>Silence Cannot Suffice for Estoppel Here.</u>

Estoppel by silence also cannot apply in the absence of a duty to speak and actual knowledge. Neither was present here.

a. "Estoppel by silence" applies only where the plaintiff had a duty to speak. *See Am. Family Mortg. Corp. v. Acierno*, 1994 WL 144591, at *5 (Del. Mar. 28, 1994) (rejecting estoppel defense because, *inter alia*, "[w]here one is not bound to speak, mere silence will not operate as a waiver.") (citation omitted); *Betty Brooks, Inc. v. Ins. Placement Facility of Delaware*, 456 A.2d 1226, 1228 (Del. 1983) ("[i]n that there is no duty on the part of the carrier to inform its insured of the provision, its silence cannot be construed as a waiver, nor can silence create an estoppel"), *overruled in part on other grounds by Woodward v.*

Farm Family Cas. Ins. Co., 796 A.2d 638 (Del. 2002); *Hannigan v. Italo-Petroleum Corp. of Am.*, 181 A. 4 (Del. Super. Ct. 1935) (estoppel by silence "will not apply unless it appears that there is . . . a clear duty . . . to speak or act"); 3 JOHN N. POMEROY, EQUITY JURISPRUDENCE § 808(a) (5th ed. 1941) ("there must be a right . . . to speak and . . . an obligation or duty to do so").

Here, the Certificate imposed no duty on Plaintiff to speak or act — just the opposite. *See* Point I.C.1, *supra*. Beyond the Certificate, the Court of Chancery identified only a generalized sense that under the circumstances, it was incumbent to speak because the Company would rely on silence. *See* Op. 29 ("because preferred stockholders with a significant economic interest in the Series B shares . . . did not request that the Company hold a special meeting to fill board seats . . . reliance was reasonable"). But this is simply another way of asserting that reliance was reasonable, something that is not the case here, as discussed below.

b. Estoppel by silence also does not apply in the absence of actual knowledge. *See* 3 JOHN N. POMEROY, EQUITY JURISPRUDENCE § 809 (5th ed. 1941) (requirement of "actual knowledge . . . applies in its full force only in cases where the conduct creating the estoppel consists of silence or acquiescence"); 31 C.J.S. ESTOPPEL AND WAIVER § 104 (2004) ("Equitable estoppel cannot be successfully asserted against a person who was ignorant of the facts and the true state of affairs if such person commences remedial action with promptness after becoming

acquainted with the facts"). This is because, in the context of estoppel, "silence, to constitute a waiver, must be deceptive silence, and it must be accompanied by an intention to defraud which amounts to a positive beguilement." *Faill v. Faill*, 303 A.2d 679, 682 (Del. Super. Ct. 1973) (citing 92 C.J.S. WAIVER, at 1064-65 (1955)). Here, Plaintiff lacked the required knowledge. *See* Point I.C.1, *supra*.

3. The Company Cannot Establish Reasonable Reliance.

As the Court of Chancery noted, equitable estoppel applies only where "the defendant in fact relied to her detriment on the plaintiff's silence." Op. 24. The reliance must be "reasonable and justified under the circumstances." *Dep't of Natural Res. v. Front St. Props.*, 2002 WL 31432384, at *5 (Del. Oct. 29, 2002); *see also Realty Growth Investors v. Council of Unit Owners*, 453 A.2d 450, 457 (Del. 1982) ("unreasonable reliance on an unjustified inference" insufficient). The Company cannot establish reasonable reliance here, for multiple reasons.

First, the Company could read the Certificate as well as Plaintiff, and understood that its decision to re-interpret a public instrument years after its issuance carried a litigation risk. *See* Point II.C.1, *supra*.

Second, under the Certificate, the Series B holders were under no duty to take *any* action upon a VRTE. *See* Point II.C.2, *supra*.[8]

[8] While the Court of Chancery does not rely on the "acceptance of a benefit" theory to find acquiescence, it suggests that Plaintiff's purported acceptance of the "benefit" of the Notes Offering "lends additional credence" to a finding of reliance.

*Third***,** having succeeded in obfuscating these issues through its SEC disclosure statements and otherwise, *see* pp.10-13, *supra*, the Company could not reasonably rely on those it sought to confuse.

Fourth, the Company does not dispute that Plaintiff was engaged in bankruptcy. Relying on a distracted investor to point out that one has changed one's interpretation of a public instrument is not reasonable.

Fifth, to the extent that reliance is based on the notion that the Company would have expected Plaintiff to disclose its belief that a VRTE was in effect, the defense also fails because Plaintiff did not so believe at the time.

* * *

The doctrine of equitable estoppel does not apply under these facts. As with acquiescence, expanding the doctrine to apply here yields a defense that functions in effect as laches — no actual knowledge, no acts approving the legitimacy of the challenged conduct, no fact concealed from the other party — yet bars legal claims for money damages filed within the limitations period. Whatever label such a defense is accorded, it presents an undesirable departure from current law, as discussed above. The Company should be held to its contract.

See Op. 30 n.66; *see also id.* at 22 n.54. While the court does not identify what the benefit of the Notes Transaction that damaged Plaintiff was (and repayment of a prior loan that is already owing and due would not suffice, even aside from Plaintiff's lack of knowledge of the VRTE issue), the issue need not be resolved here, as the reliance element fails for the numerous reasons set forth above.

III. THE COMPANY IS LIABLE FOR ITS BREACHES OF THE CERTIFICATE.

A. **<u>Question Presented</u>:** Did the Company breach the Certificate by incurring debt during a VRTE? This question was raised below (A794-A805; A1330-47; A2255-84; A2314-47; A2381-A2413; A2426; A2432-54; A2471-A2497; A2500-29; A2538-47; A2550-64). The Court of Chancery stated that the language was "facially ambiguous" (Op. 29), but declined to rule on the issue.

B. **<u>Standard of Review</u>:** This Court reviews *de novo* a trial court's grant of a motion for summary judgment, both as to the facts and the law. *DaBaldo v. URS Energy & Constr.*, 85 A.3d 73, 77 (Del. 2014).

C. **<u>Merits of Argument</u>**

Plaintiff submits that only its reading of the Certificate is reasonable, such that a VRTE has been in effect since no later than July 2010. But even if the Certificate is ambiguous, then because the instrument is (and always has been) held by public investors, *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996), requires its construction in favor of Plaintiff, such that a VRTE has been in effect since no later than July 2010. The Company's incurrence of indebtedness during that VRTE constitutes a breach of the Certificate.

1. <u>A VRTE was in Effect No Later Than July 2010.</u>

a. A VRTE occurs, *inter alia*, 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." Certificate § 9(b)(i) (A1884).

Plaintiff's reading of this language, under which a VRTE is triggered if dividends are in arrears and unpaid for four consecutive quarterly dividend periods, is reasonable. The Company's reading, under which a VRTE is triggered only by a failure to pay at least one of every four consecutive quarterly dividends, is not.

First, the Company's reading renders the key words "in arrears" (the words deleted from Company disclosure statements after it re-interpreted the Certificate) surplusage. This violates basic canons of construction, *see Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396-97 (Del. 2010), and largely defeats the investment-protection purpose of the clause.

Second, the Company's reading of the VRTE trigger (failure to pay "at least one of four" dividends) does not match what the Certificate provides as its cure, *i.e.*, that "all dividends in arrears shall have been paid in full." *See* Certificate § 9(c) (A1885). *See Bank of New York Mellon v. Commerzbank Capital Funding Trust II*, 65 A.3d 539, 550 (Del. 2013) ("a contract must be read as a whole").

Third, if the Company could simply defer payment of most dividends, there would have been no reason to include the expensive PIK option. *See* A2228-31.

Fourth, "courts should be most chary about implying a contractual protection when the contract could easily have been drafted to expressly provide

for it." *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1035 (Del. Ch. 2006). Here, the Company's 2012 disclosure shows the language the drafters could have used if the intention was what the Company now claims.

b. Even if the Certificate is ambiguous, *Kaiser* requires its construction in favor of Plaintiff. In *Kaiser*, which involved a dispute over preferred holders' stock conversion rights, the certificate of designations was "hopelessly unclear." 681 A.2d at 397. The Court declined to consider extrinsic evidence and instead applied *contra proferentem* against the issuer, observing that the issuer is better-positioned to "clarify the meaning of contract terms in advance of disputes than are investors generally." *Id.* at 398 (citation omitted). As the Court explained, this approach protects "the reasonable expectations of the investors." *See id.* at 399.

The *Kaiser* rule is firmly embedded in Delaware law. Last year, this Court again applied the rule in *Commerzbank*. The Court reiterated that in interpreting a contract that establishes public investor rights, reliance on extrinsic evidence concerning the negotiation is not appropriate, because public investors purchase after the contract negotiation. *See Commerzbank*, 65 A.3d at 551-52. "Therefore, a different interpretive approach is needed — one that will take into account the public securityholders' legitimate contractual interests." *Id.* The correct approach is to construe the contract against the drafter. *See id*. This serves to protect the "reasonable expectations" of investors. *See id.*

Here, there is no dispute that the Series B was acquired and still is held by public investors.[9] *Kaiser* requires that any ambiguity be resolved in their favor.

c. Finally, while under *Kaiser* the extrinsic evidence is not relevant, here the evidence overwhelmingly confirms that the Company's current interpretation was not the intention of the drafters. Among other things, (i) [redacted] (iv) the Company paid every dividend for five years (some even "in kind"), a course of performance it would not have followed were "skipping" an option. *See* A2339-41; A1317-20; A1338-46.

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[9] The Company argued below that *Kaiser* does not apply to preference rights, and that the rule against presuming into existence an unexpressed stock preference should be applied here instead. *See* A798-803. As *Shiftan v. Morgan Joseph Holdings, Inc.*, 57 A.3d 928, 937-38 (Del. Ch. 2012), demonstrates, the Company's view of *Kaiser* is wrong; the "very particular" situation hypothesized in *Shiftan*, in which (unlike this case) the ambiguity goes to whether or not any preference right was intended to be created in the first place, would present no difficulty under the Company's reading of *Kaiser*, because *Kaiser* simply would not apply. Plaintiff reserves the right to address any of the various factual assertions concerning *Kaiser* (*e.g.*, a former affiliate of Plaintiff was involved in the underwriting, a public investor was committed to purchasing before the Certificate was published) that the Company chooses to renew on appeal.

2. The Company Breached by Incurring Debt During a VRTE.

On or about August 1, 2011, the Company incurred over $8 million in new debt, and on or about February 7, 2012, the Company closed the $275 million Notes Offering. *See* p. 12, *supra*. These debt incurrences satisfy the definition of "Indebtedness", *see* Certificate § 2 (A1871). By incurring Indebtedness during a VRTE, the Company has breached the contract. *See* Certificate § 11(b) (A1892).

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that the decision below be reversed, that the Company be held liable for its breaches, and that the case be remanded to the Court of Chancery for a determination of damages.

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