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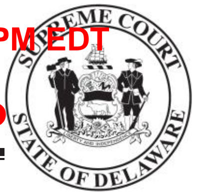

IN THE

Supreme Court of the State of Delaware

LEHMAN BROTHERS HOLDINGS INC.,

Plaintiff Below, Appellant/Cross-Appellee,

v.

SPANISH BROADCASTING SYSTEM, INC.,

Defendant Below, Appellee/Cross-Appellant.

No. 174, 2014

COURT BELOW:

COURT OF CHANCERY OF THE STATE OF DELAWARE,
Consolidated C.A. NO. 8321-VCG

REDACTED PUBLIC VERSION FILED: August 12, 2014

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

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SUMMARY OF REPLY ARGUMENT IN SUPPORT OF APPEAL

The Company concedes that acquiescence applies only where a party has "full knowledge of his rights and the material facts," and it conceded below that Plaintiff remained silent "simply by ignorance." The Company now attempts to show that Plaintiff's ignorance amounted to "full knowledge," but this effort yields only further concessions of Plaintiff's ignorance. Acquiescence does not apply here.

As to equitable estoppel (which the Company did not even assert below), the Company concedes that it must show that it "lacked knowledge or the means of obtaining knowledge of" the facts that Plaintiff did not disclose — an element omitted from the trial court's analysis. The Company further concedes that the "fact" at issue here was not Plaintiff's "opinion" that a VRTE was in effect (an opinion Plaintiff did not hold at the time), but rather "the actual existence of a VRTE" at the time. But the Company did not lack the means to know that a VRTE was in effect. Estoppel does not apply here either.

As set forth in Plaintiff's opening brief, by crafting a defense that bars claims for money damages filed within the limitations period — despite a lack of actual knowledge, approval of the breach, or concealment of facts on the part of the injured party — the Court of Chancery provides parties with the prospect of shedding unwanted contractual obligations by breaching them. This rule would be

particularly unsound in the context of preferred stock, where investor rights are secured largely by contract. Delaware courts should not trade enforcement of negotiated contract rights for assessments of investors' knowledge and motivations. The Company does not rebut this basic argument.

Ultimately, then, this case should end where it began: with the terms of the Certificate. The plain language does not communicate the Company's current interpretation, which is why the Company resorts to "other words" to express it, whether in its briefs or its revised SEC disclosures. Nor can the Company plausibly explain how its current interpretation makes commercial sense. In any event, even if the Certificate is ambiguous, *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996), requires construction in favor of the public investors.

Finally, while irrelevant in light of *Kaiser*, the extrinsic evidence supports Plaintiff. For the first five years, the Company paid every dividend, carefully complying with what it now derides as the "Taylor Interpretation." Then, when the dividend obligation became inconvenient, [REDACTED] Soon thereafter, the Company began evolving its disclosure statements and skipping three of every four dividend payments. This conduct speaks for itself.

The Company should be held liable for its breaches.

SUMMARY OF ARGUMENT IN OPPOSITION TO CROSS-APPEAL

4. Denied. The separate Delaware rule against presuming into existence a stock preference has no application here. As the Company concedes, the preference at issue in this case is expressly stated in the Certificate, *i.e.*, "the VRTE provision . . . is itself a preferential right." The dispute here thus concerns the construction of that expressly stated preference language, and *Kaiser* governs that dispute. Application of *Kaiser* is particularly appropriate here, as this case arises from an issuer's effort to gut the value of a public instrument years after its issuance by "reading out" the enforcement remedy for an obligation that had become inconvenient. [redacted] the Company's decision to effectively avoid 75% of its dividend obligations through an *ex post* re-interpretation of the Certificate is barred by *Kaiser*.

5. Denied. The Company cannot overcome the fact that what Plaintiff seeks here is contract damages, the classic form of legal relief.

REPLY ARGUMENT IN SUPPORT OF APPEAL

I. PLAINTIFF DID NOT ACQUIESCE IN THE BREACHES.

A. Remaining Silent in Ignorance is Not Acquiescence.

The Company concedes that acquiescence does not apply unless a party has "full knowledge of its rights and all material facts." SBS 4. Having also conceded that "the record supports" that Plaintiff was "ignoran[t]," *see* Op. 28 n.65, the Company attempts to reframe the issue. But its effort yields only new formulations of the same concession, *i.e.*, that Plaintiff did not know that a VRTE was in effect at the time of the debt incurrences. Further, the Company's invocation of mistake of law and constructive knowledge principles is unavailing.

1. The Company first asserts that "[t]he fact that Lehman had not yet invented the Taylor Interpretation does not mean that it lacked 'full knowledge' of its rights." SBS 4. But this proposition conflates two separate questions. The first is whether a VRTE existed when the Company incurred new debt. That is a question of contract law, and the answer is yes or no. If the answer is yes (*i.e.*, a VRTE was in effect as of the debt incurrences), then a second question arises: did Plaintiff know that a VRTE was in existence at the time? Because there is no dispute that Plaintiff did not know that, acquiescence does not apply.

For the same reasons, the Company's argument that "[t]he record proves that for years [Plaintiff] knew everything necessary to assert its claim, *except for the Taylor Interpretation*," SBS 17 (emphasis added), amounts to the same concession.

Because the "Taylor Interpretation" is merely a shorthand for the construction under which a VRTE was in effect when new debt was incurred, the Company is again conceding that Plaintiff did not know that a VRTE was in effect.

The Company concedes the same point yet again when it enumerates items as to which it contends Plaintiff had full knowledge, but does not include knowledge that a VRTE was in effect. *See* SBS 4 (arguing that Plaintiff "had full knowledge of the terms of the Certificate, full knowledge of SBS's dividend deferrals, and full knowledge that SBS intended to incur debt"). This knowledge argument would succeed only in demonstrating that Plaintiff knew everything other than the thing that mattered — that a VRTE was in effect.

See SBS 29.

Id.

2. Because ultimately there is no dispute that Plaintiff was ignorant of the fact that a VRTE was in effect at the time the Company incurred new debt, the Company attempts to gut the "full knowledge" standard by invoking "mistake of law" principles. Notwithstanding its acknowledgement that "knowledge of the existence of a legal right . . . is required to find acquiescence," SBS 18 (emphasis

omitted), the Company argues that "an alleged mistake as to interpretation of a contract's terms is similar to an alleged mistake of law," *id.* at 23, and that the principle that relief will not be granted due to a mistake of law "should be" applied to a mistake in contract interpretation. *Id.* at 23-24.

The Company's argument is without merit. Mistake of law concepts may be relevant where a party, in light of a mistake that it made, attempts to invoke equity to avoid outcomes that otherwise would obtain, *cf. Comm'rs of Lewes v. Breakwater Fisheries Co.*, 117 A. 823, 825 (Del. Ch. 1922) (granting equitable reformation), *aff'd*, 128 A. 920 (Del. 1923), but Plaintiff seeks no such relief here, either from the terms of the Certificate or from the test for acquiescence. In any event, the notion that a mistake as to one's contract rights is treated as a "mistake of law" has not been the law in Delaware for at least 100 years. As the Court of Chancery explained a century ago:

> Wherever a person is ignorant or mistaken with respect to *his own antecedent and existing private legal rights* . . . either of property *or contract* or personal status . . . equity will grant its relief, defensive or affirmative, *treating the mistake as analogous to, if not identical with, a mistake of fact*.

Stoeckle v. Rosenheim, 87 A. 1006, 1007-08 (Del. Ch. 1913) (quoting 2 JOHN N. POMEROY, EQUITY JURISPRUDENCE § 849 (2d ed. 1905)) (emphasis added); *see also Lutzcovich v. Nedwick*, 134 A.2d 268, 270 (Del. Ch. 1957) (favorably citing *Stoeckle*). As explained in the final revision of the Pomeroy treatise:

> A private legal right, title, estate, interest, duty, or liability is always *a very complex conception*. It necessarily depends so much upon conditions of fact, that it is difficult, if not impossible, to form a distinct notion of a private legal right, interest, or liability, separated from the facts in which it is involved and upon which it depends. Mistakes, therefore, of a person with respect to his own private legal rights and liabilities may be properly regarded,--as in great measure they really are,--and may be dealt with as mistakes of fact.

3 JOHN N. POMEROY, EQUITY JURISPRUDENCE § 849 (5th ed. 1941) (emphasis in original). Pomeroy's explanation also shows why the Company's distinction between knowledge of a right and knowledge that the right was triggered, *see* SBS 18, is illusory. If Plaintiff did not know a VRTE was actually in effect, it did not have full knowledge of its rights at that time.

The Company's cases are consistent with Pomeroy. In *Frank v. Wilson & Co.*, the court emphasizes Pomeroy's prerequisite that "a person correctly apprehends his own legal rights, interests and relations," pointing out that no mistake as to "antecedent and existing legal rights" was claimed. 32 A.2d 277, 282 (Del. 1943). And in *Trounstine*, the mistake alleged was not as to private legal rights, but as to generally applicable principles of Delaware law. *See Trounstine v. Remington Rand, Inc.*, 194 A. 95, 98 (Del. Ch. 1937).

Ultimately, whatever label is applied, because Plaintiff did not know a VRTE was in effect, it did not have "full knowledge of [its] rights and all material facts," and the threshold element for acquiescence is not satisfied.

3. The Company also asserts that mere constructive knowledge is sufficient, but Plaintiff has shown that (i) the Delaware courts find acquiescence where the plaintiff acted on *actual* knowledge, not mere constructive knowledge, and (ii) language to the contrary is *dicta*. *See* Br. 19-21. The Company does not dispute either point. Instead, it asserts that "just because a statement is *dicta* does not mean it is wrong." SBS 22. While as a general proposition that may be so, in the absence of Delaware cases holding that a party has acquiesced out of merely constructive knowledge, a ruling for the Company would break new ground.[1]

Moreover, even the *dicta* on which the Company relies is shakier than the Company suggests. The Company's primary support is *Papaioanu*, the 1962 Court of Chancery case in which the court used the phrase "[w]hen a man with full knowledge, *or* at least with sufficient notice or means of knowledge of his rights, and of all the material circumstances of the case." *Papaioanu v. Comm'rs of*

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[1] The Company argues that the parties in in *Tristate Courier and Carriage, Inc. v. Berryman*, 2004 WL 835886 (Del. Ch. Apr. 15, 2004), and *Tenneco Automotive Inc. v. El Paso Corp.*, 2004 WL 3217795 (Del. Ch. Aug. 26, 2004), knew even less than Plaintiff did here, *see* SBS 18-19, but even if that is true, the cases still demonstrate that inadequate knowledge defeats the defense — a proposition the Company concedes, *see* SBS 16. Further, the Company's discussion of *In re Best Lock Corp. Shareholder Litigation*, 845 A.2d 1057 (Del. Ch. 2001), *see* SBS 20, is superfluous, as the Company does not contest its essential point that acquiescence requires a "meaningful choice." Here, unaware that a VRTE was in effect, Plaintiff did not make a "meaningful choice." Finally, in *Klaassen v. Allegro Development Corp.*, 2013 WL 5739680 (Del. Ch. Oct. 11, 2013), *aff'd*, 2014 WL 996375 (Del. Mar. 14, 2014), the plaintiff did not dispute that he had full knowledge, nor was there any indication that he was ignorant of a critical right or circumstance.

Rehoboth, 186 A.2d 745, 749 (Del. Ch. 1962) (emphasis added) (quotation marks and citation omitted). But the phrase suggesting that constructive knowledge could suffice as an alternative to full knowledge is dropped from this Court's recent statements of the acquiescence standard. *See, e.g.*, *Klaassen*, 2014 WL 996375, at *8 ("full knowledge of his rights and the material facts"). Moreover, while in ruling on reformation in *ASB Allegiance*, this Court in *dicta* drew a distinction between the "knowledge, actual or imputed" formulation repeated in *Frank* and several ratification cases, and the knowledge requirement for reformation, the clear thrust of the Court's reasoning — and its actual holding — was that reformation requires actual knowledge. *See Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 680-82 (Del. 2013).

Ultimately, the Company has failed to identify any Delaware case barring relief on the ground of acquiescence based merely on constructive knowledge.

4. Finally, the Company contests Plaintiff's showing that its mere silence cannot constitute acquiescence, arguing that (i) Plaintiff was not silent because it purportedly "participated" in the Notes Offering, and (ii) Plaintiff's mere "failure to assert its purported rights" can in fact constitute acquiescence. *See* SBS 24-25. As an initial matter, the Company's arguments on this point are irrelevant, as it cannot establish full knowledge. More fundamentally, the argument that Plaintiff

did not remain silent is untrue, as the Company concedes outright later in its brief. *See* SBS 27 ("Lehman was silent before SBS incurred indebtedness.").

In any event, the assertion that Plaintiff "actively participated" in the offering is false. [redacted] *see* SBS 12, [redacted] .[2] [redacted] *Cf. Frank*, 32 A.2d at 283 (distinguishing cases in which the complainants "accepted only that which they were entitled to have in any event").

Finally, the Company's argument that mere silence constitutes acquiescence also fails. Plaintiff has demonstrated that the Court of Chancery erred in suggesting that Plaintiff had a duty to act under the Certificate, *see* Br. 21-22, and the Company concedes the point. *See* SBS 29 ("[i]t is true that Lehman had no affirmative duty to take action") (emphasis omitted). The Company argues, however, that "[h]e who seeks the aid of equity . . . must show that he has used reasonable diligence." SBS 24-25 (quoting *Papaioanu*, 186 A.2d at 749). But Plaintiff does not seek the aid of equity. It seeks contract damages, a form of legal

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[2] The Company creates a similar misimpression when it states that [redacted]

relief. *See* Point V, *infra*. For this reason, the Company's quotation of *Romer v. Porcelain Products, Inc.*, 2 A.2d 75 (Del. Ch. 1938), *see* SBS 25-26, where plaintiffs sought an injunction and a declaration voiding an amendment to a certificate of incorporation, likewise misses the point. Further, the plaintiffs in *Romer* waited over four years before bringing suit, "shrewdly biding their time and . . . deliberately playing with the situation." *Id.* at 77. That is not so here.

B. Expanding the Defense to Apply Here Would be Bad Policy.

In its opening brief, Plaintiff demonstrated that by crafting a defense that functions to shorten the limitations period in contract actions seeking purely legal relief — without requiring the non-breaching party's actual knowledge, acts approving of the breaches, or concealment of facts from defendant — the Court of Chancery establishes the wrong incentives. *See* Br. 22-25. In particular, under the rule below, breach becomes a tool by which a limitations period can effectively be terminated, provided that the counter-party (though charged with constructive knowledge of its rights) is in fact caught unawares. Such a rule would be particularly unsound in the context of preferred stock, where investor rights are secured largely by contract. 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 does not take issue with any of this.

II. PLAINTIFF IS NOT EQUITABLY ESTOPPED FROM RECOVERING DAMAGES.

Seizing upon the Court of Chancery's incorporation of certain estoppel by silence elements into its acquiescence analysis, the Company argues that the estoppel defense independently bars Plaintiff's claims. But the Company's arguments only illustrate why the Company did not even assert the defense below.

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

The Company concedes that a party claiming estoppel must first demonstrate that it "lacked knowledge or the means of obtaining knowledge of the truth of the facts in question." SBS 27. And the Company concedes that "the 'fact' at issue here is the actual existence of a VRTE at the time of the challenged debt incurrences," and not Plaintiff's "opinions" that a VRTE existed (an opinion Plaintiff did not hold at the time). *See id.* at 28. Because the Company did not lack the means of obtaining knowledge as to whether a VRTE was in effect at the time of the debt incurrences, the defense fails.

The Company's own cases illustrate this point. *U.S. Bank Nat'l v. Swanson*, 2006 WL 1579779, at *1 (Del. Super. Ct. May 1, 2006), *aff'd*, 918 A.2d 339 (Del. 2006), is a classic case of equitable estoppel, in which the estopped party failed to disclose a fact unavailable to the other party. There, a payoff quote issued by U.S. Bank was incorrect, amounting to "a false representation," and the court found that

the purchaser "had no means of knowledge of the real facts other than through the U.S. Bank." *Id.* Similarly, in *Nevins v. Bryan*, 885 A.2d 233 (Del. Ch. 2005), *aff'd*, 884 A.2d 512 (Del. 2005), the fact at issue was that a written consent appointing directors was defective because it was not fully signed. But the estopped party never shared the document with the directors, instead representing to them that they had become valid directors. *Id.* at 249. Here, by contrast, the "fact" supposedly withheld was "the actual existence of a VRTE at the time." SBS 28. The Company did not lack the means to know whether a VRTE was in effect.

B. Silence Cannot Suffice for Estoppel Here.

Plaintiff's opening brief also demonstrated that estoppel does not apply here for two further, independently sufficient reasons: (i) estoppel by silence requires the estopped party to have actual knowledge of the fact in question, which Plaintiff lacked here, and (ii) estoppel by silence requires the existence of a duty, which Plaintiff (and the other passive investors under the Certificate) lacked here. *See* Br. 27-29. The Company's responses are without merit.

1. The Company first asserts that "actual knowledge" of the facts that the party failed to disclose is not required for estoppel. *See* SBS 28. But the case the Company cites is not an estoppel by silence case. To the contrary, after the party in *Nevins* signed a written consent appointing individuals as new directors (but caused the consent to be defective by failing to forward it to other directors for

signature), it then — for over a year — made numerous affirmative representations to the appointed directors and third parties indicating that they were valid directors. *Nevins*, 885 A.2d at 238-39. Again, the requirement of actual knowledge "applies in its full force only in cases where the conduct creating the estoppel consists of silence or acquiescence." 3 JOHN N. POMEROY, EQUITY JURISPRUDENCE § 809 (5th ed. 1941); *see also* Br. 28-29.[3]

2. Notwithstanding its concession that "Lehman had no affirmative duty to take action" upon a VRTE, the Company argues that Plaintiff had a duty to act under "applicable law" because many parties would be affected by the Notes Offering. *See* SBS 29 (emphasis omitted). But the Company's sole case, *Federal United Corp. v. Havender*, 11 A.2d 331 (Del. 1940), concerns a plaintiff seeking equitable relief, and the quote on which the Company relies is from the court's laches analysis. *See Federal United*, 11 A.2d at 343-44. Again, Plaintiff seeks only legal relief.

3. Finally, the Company asserts that Plaintiff "was not silent." SBS 29. Again, that is not correct. Elsewhere in its brief, the Company affirmatively asserts that "Lehman was silent before SBS incurred indebtedness." SBS 27.

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[3] The Company suggests that a party can "unintentionally" induce reliance, *see* SBS 27, but in the cases it cites the estopped party is responsible for the problem in the first place. *See Nevins*, 885 A.2d at 238 (party bungles written consent); *U.S. Bank*, 2006 WL 1579779, at *1 (bank issues incorrect quote). Here, the VRTE came into existence based upon the actions of the Company.

see SBS 27,

C. **The Company Cannot Establish Reasonable Reliance.**

Even if the Company could somehow overcome the above problems with its estoppel theory, the Company still could not establish reasonable reliance, because (i) the Company could read its own Certificate, (ii) the investors were under no duty to respond to the Company's failure to pay dividends either before or after that failure triggered a VRTE, (iii) the Company made incomplete and misleading disclosures regarding the VRTE trigger in its SEC disclosure statements and should not now be heard to blame those it misled and (iv) Plaintiff was in bankruptcy. *See* Br. 29-30. The Company's responses are without merit.

First, the Company argues that it does not matter that it could read the Certificate as well as Plaintiff, because the Company has always held the same interpretation of the Certificate,

See SBS 30-31. This is a *non sequitur.* The Company concedes that the fact at issue was "the actual existence of a VRTE," SBS 28, and there is no dispute that the Company could determine that just as well as Plaintiff. Further, even if Plaintiff's "opinion" that a VRTE was in effect were the relevant "fact," Plaintiff did not hold that opinion at the time, so there was nothing for Plaintiff to disclose.

Finally, the Company's assertion that it never changed its interpretation is contradicted by the record. *See* Point III.C, *infra*.

Second, the Company argues that its conduct could not have been misleading, because the Certificate was public. *See* SBS 31. But the Company did not use the actual Certificate language in conjunction with its SEC filings following its first missed dividend and instead limited disclosure to paraphrases bearing little resemblance to the actual Certificate language. *See* Br. 10, 13. Indeed, even several of the Company's own advisors were confused about its performance of its dividend obligations. *See* Br. 13-14.

Third, the Company asserts that Plaintiff's bankruptcy was "irrelevant," [redacted] *See* SBS 31. [redacted] *See* Br. 13-14.

Ultimately, the Company cannot overcome its concession that Plaintiff had "no affirmative duty" to speak under the Certificate, and the only question of interest raised by its story of reliance is this: If, as the Company asserts, it never changed its interpretation of the Certificate, why was it waiting and listening for an objection from investors?

III. A VRTE WAS IN EFFECT NO LATER THAN JULY 2010.

The parties' contract construction dispute centers on the phrase "in arrears and unpaid . . . for four (4) consecutive quarterly dividend periods." Certificate § 9(b) (A1843). Under Plaintiff's reading, these words describe a status of dividends (their being "in arrears and unpaid") which, if continued for four consecutive quarterly dividend periods, results in a VRTE. The Company asserts that the clause describes a failure to pay four quarterly dividends in a row.[4]

A court facing competing interpretations seeks to ascertain the meaning of the language as it "would be understood by an objective, reasonable third party." *Osborn ex. rel Osborn v. Kemp*, 991 A.2d 1153, 1159 (Del. 2010) (citation omitted). Contrary to the Company's assertions, the fact that its interpretation was first publicly challenged in this lawsuit does not prove it is reasonable. Delaware courts confine their analysis of ambiguity to the document and do not look to extrinsic evidence. *O'Brien v. Progressive N. Ins. Co.*, 785 A.2d 281, 289 (Del. 2001) (holding that courts look solely to contract language to determine ambiguity and rejecting even splits in judicial authority as *prima facie* evidence of ambiguity). The Court will read the contract "as a whole" and, if possible, interpret it "to reconcile all of the provisions of the document." *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996).

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[4] The Company does not dispute Plaintiff's showing, *see* Br. 35, that the Company incurred new "Indebtedness" in August 2011 and February 2012.

A. <u>Only Plaintiff's Interpretation of the Clause is Reasonable.</u>

1. "An interpretation that conflicts with the plain language of a contract is not reasonable." *Bank of New York Mellon v. Commerzbank Capital Funding Trust II*, 65 A.3d 539, 555 (Del. 2013). Under the actual language of the Certificate, if dividends are "in arrears and unpaid" and remain so "for four consecutive quarterly dividend periods," a VRTE occurs. These words describe a condition of unpaid dividends persisting over a specified period. If the intended trigger were a series of successive payment failures, the Company's failure to pay the selected number of dividends (and not the status of dividends "at any time") would have been the subject of the operative clause of the VRTE.[5] It is not.

Indeed, while the Company stresses the importance of the word "unpaid," it cannot express its interpretation without rewriting the language to make "the Company" (rather than "dividends") its grammatical subject, and in so doing, omitting the word "unpaid." The Company argues: "dividends on the outstanding Series B Preferred Stock must be *unpaid* for four consecutive quarterly dividend periods; *in other words, SBS* must not have paid dividends for four quarters in a row." SBS 34-35 (second emphasis added). The first part of this sentence, which

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[5] An example of this approach is provided by the governing documents of the preferred stock at issue in *Benihana*, which provisions are inaccurately described by the Company as "similar" to the Certificate. *See* SBS 35. Voting rights under the *Benihana* instrument are triggered if "at any time that *the Corporation has failed* for two (2) consecutive calendar quarters, to pay any dividends…." A78-79 (emphasis added).

uses some of the actual text (and retains "dividends" as its grammatical subject), does not communicate the Company's reading. Only by restructuring the language to use "other words" can the Company communicate its interpretation.

That materially revising the language is necessary to express the Company's interpretation is demonstrated even more vividly by the Company's evolving SEC filings, in which, following its reinterpretation of the Certificate language, the Company ultimately scrapped the contract language entirely and re-wrote the language in order to explain its new interpretation. *See* Br. 10, 13.

2. The Company's interpretation also is substantively unreasonable. The Series B is not convertible into equity and does not participate in profits. Its value depends entirely on the dividend payments and, ultimately, repayment of principal. Further, the Company and its underwriters approached the offering as a "debt alternative" and marketed it to the Company's existing bondholders at a stated dividend rate of 10 3/4%. *See* Op. 4, 6. Yet only Plaintiff's interpretation provides a remedy for material non-performance of the dividend obligation. It makes perfect sense that protracted dividend arrearages would trigger a VRTE, just as the failure to pay interest on a debt instrument would trigger default remedies.

By contrast, the Company's interpretation provides the Company with no incentive to pay 75% of its dividends on a current basis. Belying its assertion that

it has always understood it had an option to skip, the Company for five years paid every dividend when it first became payable. *See* Br. 10.

2. A provision should not be interpreted to result in a conflict with the "overall scheme" of the security. *See Norton v. K-Sea Transp. Partners L.P.*, 67 A.3d 354, 360 (Del. 2013). Only Plaintiff's reading complies with this principle.

First, only Plaintiff's reading is consistent with inclusion of the PIK. For five years after issuance, the Company may defer cash dividends by issuing additional shares. Certificate § 4(a) (A1877).[6] This gives the Company flexibility but, if used, results in higher capital costs, as dividends accrue on the newly issued shares. If the Company *also* had the option to simply skip three out of four cash dividends, there would be no reason for the PIK to be available for every quarterly dividend. The Company's economically rational choice would be to skip three of four dividends, and no Series B investor would have a reasonable expectation that the Company would do otherwise. The Company's interpretation effectively makes payment of more than one of four dividends a gratuitous pre-payment.

The Company does not dispute that the "skipping" option makes the PIK option superfluous with respect to three out of four dividends during the PIK period. The Company suggests that investors would benefit from expiration of the

[6] The Company suggests [redacted] *See* A1610, A1612.

PIK period because thereafter the Company would be required to pay at least one cash dividend every four quarters in order to avoid a VRTE, *see* SBS 39, but while that is true under the Company's interpretation, it does not explain why a PIK option was provided for quarterly dividends that the Company was free to skip.

Similarly, only Plaintiff's reading is consistent with the Company's option to exchange the Series B for notes maturing in 2013 and bearing 10 3/4% interest. A1882. Exercisable exclusively at the Company's option, the provision must have been intended to confer a benefit on the Company. Yet, under the Company's interpretation, the Company would be exchanging an instrument that allowed it to defer 75% of its cost of capital payments for one that allowed no such deferral.

Second, Plaintiff's reading matches what is required to cure the VRTE. *See* Br. 32 (payment of all dividends in arrears). The Company's response that nonpayment VRTEs generally are cured by paying all dividends in arrears, *see* SBS 39, misses the point. Under the Company's interpretation, the Company can maintain arrearages for years, in unlimited amounts, and for indefinite duration. The forfeiture of this supposed but implausible entitlement, based on missing only one extra dividend, creates a disconnect between trigger and cure.

B. <u>The Company's Interpretation is Unreasonable.</u>

1. Under Delaware law, a court will reject a proposed interpretation that leads to an absurd transaction that the parties would not have entered into

intentionally. *See Osborn*, 991 A.2d at 1160-61 (rejecting as unreasonable a proposed interpretation of an option to purchase real estate for "a pittance" where, in view of the underlying economics, it "stretch[ed] the bounds of reason" to conclude that "a college graduate and professional tax preparer" would have agreed to the "pittance" resulting from the proposed interpretation). Here, it stretches the bounds of reason that any investor, much less the financial institutions to whom the Series B was marketed, would have purchased a "debt alternative" if, in fact, it provided the Company with an option to defer payment of 75% of dividends indefinitely, without any mechanism for compensating holders for deferring the lion's share of dividends payable over a ten-year period.

2. The Company's argument that its interpretation is consistent with interpretations of similar language or posited norms for preferred stock, *see* SBS Br. 36 n.5, fails for two reasons. *First*, contract terms are not construed to conform to normative standards. Rather, even "boilerplate" provisions must be interpreted taking into account the particular words used. *See Quadrant Structured Prods. Co. v. Vertin*, 2013 WL 5962813, at *4 (Del. Nov. 7, 2013) (appeal following remand with instructions to issue opinion analyzing wording differences between the no action clause in that proceeding and no action clauses analyzed in prior decisions).

Second, the Company's authorities do not support its argument. The cases cited by the Company as "powerful evidence that SBS's interpretation is correct,"

SBS 35-36, do not even involve a disputed interpretation of a voting rights provision.[7] Similarly unavailing is the Company's reliance on the New York Stock Exchange Rules. *See* SBS 36 n.5. Those rules impose "minimum" voting rights requirements applicable to NYSE-listed preferred and recommended for non-listed preferred. A2257. "Under the NYSE rule, a VRTE occurs when six quarterly dividends are deferred, whether or not the deferrals occur in consecutive quarters" (A2257), whereas the Certificate (according to the Company) would allow for thirty defaults *without triggering voting rights*. The NYSE rules hardly establish that SBS's interpretation "comports with standard practices." Rather, under Plaintiff's interpretation, the Series B is compliant; under the Company's, it is not.[8]

[7] The cases relied on by the Company involve differing language, contexts and interpretative issues. *Flerage v. KDI Corp.*, 1986 WL 4278 (Del. Ch. Apr. 10, 1986), involved a *noncumulative* preferred stock, such that the possibility of voting rights being triggers by arrearages did not even exist. *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 165 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006), not only involved materially different language, but the triggering event described by the court, *i.e.*, "miss[ing] its dividend for two consecutive quarters" raises the question (unaddressed in *Benihana*) of whether the first quarter missed dividend, if missed again in second quarter, would trigger voting rights. Similarly, in *In re Piece Goods Shops Co., L.P.*, 188 B.R. 778 (Bankr. M.D.N.C. 1995), while the court observed that missing consecutive dividends would trigger a VRTE, it did not consider, because the issue was not before it, whether one dividend that remained "in arrears and unpaid" would likewise trigger the remedy.

[8] The Company also cites a comment in a law review article that a decision involving voting rights triggered by consecutive defaults was a "classic case," SBS 33, but even the author observed that preferred stock in fact comes in "bewildering variety" and is "highly heterogeneous [in] nature." Charles R. Korsmo, *Venture Capital and Preferred Stock*, 78 BROOK. L. REV. 1163, 1171 (2013).

The Company's reading results in a gross anomaly, not a norm. SBS cites no example of a cumulative preferred stock that has been construed to allow arrearages to accumulate for years without providing holders any contractual remedy whatsoever. In each case it cites, voting rights were triggered as a result of far more limited dividend non-payments (measured either by duration or amount) than the dividend non-payments by the Company here.

3. The Company's arguments that surplusage and alternative drafting principles support its construction also are without merit.

First, the Company's interpretation renders "in arrears" as surplusage, as any dividends that the Company fails to pay will also be in arrears. While the Company argues that "in arrears" is needed to "ensure[] that a VRTE does not occur . . . when the reason [SBS] has not paid dividends is that no dividends are owed," SBS 37-38, the Company cannot demonstrate how this could occur. The Company has pointed to the situation where, upon an exchange at the option of the Company of Series B for notes (*see* Certificate § 8 (A1882-84)), a holder that failed to surrender its Series B would not thereafter receive dividends for four quarterly dividend periods. A187. According to the Company, a VRTE would thereby occur but for the requirement that the accrued but unpaid dividends also be "in arrears." *See* A186-87. In fact, however, upon the exchange, each holder is stripped of *all of its rights as a holder*, which rights include the right to declare a

VRTE. Certificate § 8(f) (A1884). The Company's interpretation is unaltered by eliminating "in arrears," rendering those words surplusage.

Further, both parties have argued that the other's interpretation creates surplusage arising from the inclusion of both "in arrears" and "unpaid."[9] If both readings yield a surplusage, that does not afford a basis to prefer one over the other, and the Court must look elsewhere. *Commerzbank*, 65 A.3d at 551.

Finally, the rule does not require that surplusage be avoided at the cost of imposing an unreasonable reading. *See Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 588 (Del. Ch. 2006) (rejecting an interpretation that would give independent meaning to the two components of "indemnify and hold harmless" where to do so would create an interpretation not intended by the parties). As evident from *Majkowski*, the mere use of redundant "belt and suspenders" phrases in drafting does not compel adoption of unintended interpretations merely to achieve independent effect of every word.

Second, the rule regarding clearer alternate drafting choices does not support the Company. According to the Company, if a single quarterly dividend deferred for "a year" would trigger a VRTE, the drafters would have identified the measuring period as "a year" rather than "four (4) consecutive quarterly dividend

[9] Plaintiff disputes that "unpaid" is surplusage under its interpretation. If the word were eliminated, an investor could assert a VRTE by aggregating a prior period of arrearages that had since been paid with a later period of arrearages that was ongoing but had not continued for four dividend periods.

periods." SBS 38. But using "a year" in this context would raise the question of whether the intended measuring period had to include a calendar year. The more precise language selected avoids any such issue. *See Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1186, 1189 (Del. 2010) (holding that certificate provision defining the duration of directors' staggered terms as expiring at the annual meeting "held in the third year following the year of their election" was ambiguous). In any case, the rule is better directed at the Company's interpretation, as shown by its evolving public disclosure statements.

C. The Extrinsic Evidence Supports Plaintiff.

Although irrelevant under *Kaiser*, the extrinsic evidence supports Plaintiff.

1. "The parties' course of performance under a contract is a powerful indication of what the correct interpretation of that contract is." *Senior Hous. Capital, LLC v. SHP Senior Hous. Fund, LLC*, 2013 WL 1955012, at *31 (Del. Ch. May 13, 2013) (*citing GMC Capital Invs., LLC v. Athenian Venture Partners I, L.P.*, 36 A.3d 776, 784 (Del. 2012)); *see also Radio Corp. of Am. v. Philadelphia Storage Battery Co.*, 6 A.2d 329, 340 (Del. 1939) ("[A] construction given . . . by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great weight, and will, when reasonable, be adopted and enforced by the courts").

The Company's pre-litigation course of conduct here is powerful evidence that it has long understood Plaintiff's interpretation to be correct. For the first five years after the Certificate was issued, the Company paid every dividend. Br. 10.

A1415-16 at 151:22-152:12 (emphasis added); *see also* A1416 at 152:13-19

A1417-18 at 152:23-154:4.

On May 15, 2009, the Company made this new public "disclosure":

> Under the Series B preferred stock certificate of designations, *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 (emphasis added). Following this disclosure, the Company began skipping three of every four dividend payments.

This conduct speaks for itself.

2. By contrast, Plaintiff's conduct is not extrinsic evidence supporting the Company. The Series B holders have no performance obligations; they are passive investors. And for many years the Company paid every dividend, so there was no problem for the holders to investigate in any event. Once the instrument stopped performing — amidst evolving public disclosures and confusion about the Company's view of its obligations, *see* Br. 13 — the largest holder (Plaintiff), [REDACTED] investigated, identified the issue, and filed suit within the limitations period. [REDACTED] *see* SBS 13-15, [REDACTED] Indeed, [REDACTED] *See* Br. 13. Ultimately, [REDACTED] decision by the Company that the genesis of this lawsuit lies.

ARGUMENT IN RESPONSE TO CROSS-APPEAL

IV. IF THE LANGUAGE IS AMBIGUOUS, *KAISER* CONTROLS.

A. Question Presented: If the Certificate is ambiguous, should it be construed in favor of Plaintiff? This question was raised below, *see* A795-803; A1333-38; A2274-79; A2322-33, but the Court of Chancery did not resolve it.

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

Plaintiff demonstrated in its opening brief that if the Certificate is ambiguous, the rule of *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996), requires its construction against the Company. *See* Br. 33-34. The Company argues that the rule against presuming into existence an unexpressed stock preference, as stated in cases such as *Rothschild Int'l Corp. v. Liggett Grp. Inc.*, 474 A.2d 133 (Del. 1984), should be applied instead. *See* SBS 40-45. The Company's argument is without merit.

1. The *Rothschild* rule follows from the principle that the special rights granted to the preferred are "contractual in nature" and therefore must be granted through "express provisions" of the contract. *See Rothschild*, 474 A.2d at 136; *see also* 8 *Del. C.* § 151(a). That is, a preference right "will not be presumed,"

Rothschild, 474 A.2d at 136, and cannot, for example, be read into existence through reliance upon a general reservation clause that does not actually mention the claimed preference, *see Waggoner v. Laster*, 581 A.2d 1127, 1135 (Del. 1990). As this Court has noted, however, this is not a rule of "strict construction," but instead a straightforward requirement that the preference actually be stated in the contract. *Elliott Assocs., L.P. v. Avatex Corp.*, 715 A.2d 843, 853 n.46 (Del. 1998). Thus, so long as the right is stated expressly in the contract, and not presumed or implied, the *Rothschild* rule is satisfied.

Kaiser applies where the language of an instrument creating public investor rights is ambiguous. *Kaiser* requires that such ambiguity, if it could have been avoided through alternate drafting, be construed against the issuer. *See Kaiser*, 681 A.2d at 398-99. This approach serves to protect the "reasonable expectations" of public investors, *see id.*, who may interpret the contract language in a way that, while different from the issuer's interpretation, is nonetheless reasonable.

2. The Company's argument that *Kaiser*'s *contra proferentem* rule does not apply to preference rights, *see* SBS 43-45, ignores *Kaiser* itself, in which the language concerned conversion rights, which are preferences. *See, e.g.*, *Waggoner*, 581 A.2d at 1133 (referencing "stock preferences, including . . . conversion rights . . ."). Further, the Company's attempt to undermine *Kaiser* by suggesting that the reason it did not address *Rothschild* was that it was an "expedited appeal," *see* SBS

44, n.8, is well off the mark. This Court reaffirmed the continuing vitality of *Kaiser* just last year. *See Commerzbank*, 65 A.3d at 551-52. The reason *Rothschild* was not discussed in *Kaiser* is simpler: it was not relevant, as there was no dispute that the preference was expressly stated in the contract.

3. Then-Chancellor Strine's examination of the relationship between these cases in *Shiftan v. Morgan Joseph Holdings, Inc.*, 57 A.3d 928, 937-38 (Del. Ch. 2012), dispels the notion that the *Kaiser* rule contains the gaping exception the Company suggests. In *Shiftan*, the Court of Chancery posed a hypothetical involving a "very particular" situation in which the ambiguity in the certificate goes to whether any preference was created in the first place, *i.e.*, where the certificate could "be read to either give special rights to the preferred stock or not to do so," such that both the *Kaiser* rule (concerning ambiguities in public investor instruments) and the *Rothschild* rule (requiring that a preference be expressly stated in the contract rather than presumed) potentially would apply. *See Shiftan*, 57 A.3d at 937-38 & n.28. If the Company were correct that *Kaiser* does not apply to preference rights, there would have been no need to reconcile the two rules — the court simply would have applied the *Rothschild* rule. It is precisely because *Kaiser* does apply to ambiguous preference language that the two rules would come into "direct conflict" in the *Shiftan* hypothetical.

4. Further, when the Company suggests that this case presents the "very particular" situation hypothesized in *Shiftan*, *see* SBS 42, it is wrong. There is no ambiguity as to whether the Certificate establishes a preference here. The Company itself concedes that "the VRTE provision . . . *is itself a preferential right*." SBS 44 (emphasis added). The dispute concerns instead the construction of what all parties agree is expressly stated preference language.[10] If that language is ambiguous, *Kaiser* controls.

5. The Company also argues that it would be bad policy to apply *Kaiser* here, because preferred investors are sophisticated and preference rights exist in derogation of the common, such that the preferred should not be granted rights beyond those in the contract. *See* SBS 45-47. But this argument is misdirected. Plaintiff seeks only to vindicate its contract rights, not to obtain additional rights.

Further, the Company's proposed exception to the *Kaiser* rule, requiring rejection of a public investor's reasonable contract-based expectations whenever a competing reasonable interpretation of the language can be identified by the issuer, would create the wrong incentives and introduce unwarranted uncertainty into Delaware's contract enforcement paradigm.

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[10] The Company's alternate argument, that this case is about the "creation" of "additional preferences," *see* SBS 42-43, is merely another means to arrive at the same incorrect result. If construction in favor of the preferred of language that expressly states a preference but is otherwise ambiguous is re-characterized as "creating" an "additional preference," *Kaiser* would never apply.

6. Finally, as the facts triggering *Kaiser* — that the Series B was offered for sale to and is still held by public investors — are not in dispute, and the Company on appeal does not argue that other facts are relevant, Plaintiff only briefly addresses two further factual assertions raised by the Company.

First, Plaintiff did not draft the Certificate. The Company obscures this fact (and other facts) through its use of the vague term "Lehman." *See, e.g.*, SBS 7. The entity that acted as underwriter to the 2003 transaction was LBI, a former affiliate of Plaintiff that has not been under common control with Plaintiff for over five years. *See* A2329. Further, even LBI was not negotiating in contemplation of its own investment, and 100% of the Series A (precursor to the Series B) purchased by LBI was immediately placed with financial institutions, none of which were affiliates of LBI (or Plaintiff). *See* A1753-54.

Second, the ambiguity is to be construed against the issuer even where it was not the drafter because, among other reasons, the issuer is "better able to clarify unclear bond contract terms in advance" than a public investor who purchases after the fact. *Kaiser*, 681 A.2d at 398-99 (quotation marks and citations omitted). Here, [redacted]

[redacted] *See* A1757. Plaintiff, on the other hand, had no involvement in drafting, and the Series B also has been acquired by numerous other public investors with no involvement in the drafting.

V. EXPECTATION DAMAGES ARE NOT EQUITABLE RELIEF.

A. <u>Question Presented:</u> Are the damages sought here by Plaintiff a form of legal relief? This question was raised below, *see* A2295, and considered by the Court of Chancery, *see* Op. 19-21.

B. <u>Scope 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>

The Company suggests that Plaintiff seeks specific performance here, in particular that the Company's Board be "compel[led] . . . to declare and pay a dividend." SBS 48-49. That is not so. Plaintiff had a contractual expectation that a VRTE would be cured prior to the incurrence of new debt; damages measured by Plaintiff's expectations under the Certificate are not equitable relief. *See Duncan v. Theratx, Inc.*, 775 A.2d 1019, 1022 (Del. 2001) ("The standard remedy for breach of contract is based on the reasonable expectations of the parties *ex ante*."). Further, as the Court of Chancery observed, Plaintiff has other damage theories, including the consent fee theory recognized in Delaware. *See* Op. 21. The Company's suggestion that it might seek equitable relief to clarify that it need not pay both expectation damages and deferred dividends does not change the nature of the relief Plaintiff actually is seeking here.

Finally, the Company's citation of cases concerning director discretion to pay dividends, *see* SBS 48 n.49, is well off the mark. This is not an action for breach of fiduciary duty; it is an action for breach of contract. The Certificate imposed specific contractual obligations on the Company, including the dividend obligation and debt incurrence restrictions. It is the breach of those contract obligations for which Plaintiff seeks expectation damages.

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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