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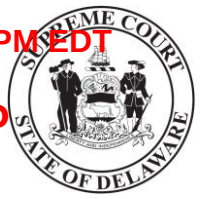

IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

CROSS-APPELLANT'S REPLY BRIEF ON CROSS-APPEAL

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SUMMARY OF ARGUMENT

In Appellee's Answering Brief on Appeal and Cross-Appellant's Opening Brief on Cross-Appeal (the "Cross-Appeal Brief"), SBS[1] demonstrated that the Court of Chancery's summary judgment in favor of SBS should be affirmed for the reasons on which the Court of Chancery relied. But even if the Court were to conclude that those reasons were faulty, it should nevertheless affirm summary judgment in favor of SBS because (1) if the Certificate is ambiguous, Delaware law requires that the ambiguity be resolved in favor of common stock rights and against the Series B Preferred stockholders; and (2) in any case, Lehman seeks equitable relief, and thus laches should be applied to bar Lehman's untimely complaint. As to the former, Lehman argues that SBS's statement of the law leaves a "gaping exception" in the *Kaiser*[2] "doctrine." (Lehman Br. at 31) That is backwards: *Kaiser* is the relatively new and rarely applied exception, limited to its peculiar facts. The broader rule, enshrined in the Delaware General Corporation Law and applied for nearly a century, is that stock preferences do not exist unless they are stated explicitly. And as to the latter, Lehman simply dodges the argument by reiterating its (incorrect) claim to be seeking expectation damages. No matter what terminology is applied, Lehman cannot deny that it is still owed

[1] Undefined capitalized terms carry the meaning assigned in the Cross-Appeal Brief.

[2] *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996).

every unpaid dividend that ever accrued on the Series B Preferred Stock. Thus, any monetary recovery must be accompanied by an equitable reduction in those outstanding dividends, and the relief is, by nature, equitable.

ARGUMENT

I. *KAISER* DID NOT ABROGATE THE LONG-STANDING PRINCIPLE, BASED ON STATUTE, THAT STOCK PREFERENCES DO NOT EXIST UNLESS CLEARLY STATED IN A CERTIFICATE.

In the Cross-Appeal Brief, SBS demonstrated that any rights, preferences and limitations of preferred stock must be clearly and expressly stated in a certificate of incorporation (including a certificate of designations), and may not be presumed or implied. (SBS Br. at 40-47) Ambiguous language is, by definition, not clear and express, and the resolution of ambiguity necessarily involves the application of presumptions and implication. Therefore ambiguous language relating to a stock preference in a certificate of designations can never be resolved in a way that expands the scope of the preference. Lehman has no answer to this argument. Instead, Lehman simply repeats its assertion that *Kaiser* somehow *sub silencio* overturned nearly a century of jurisprudence and the clear statutory command of 8 *Del. C.* § 151. Lehman's argument is meritless. If the Certificate is ambiguous as to when a VRTE occurs giving the Series B Preferred stockholders the right to block new indebtedness and elect two directors, any ambiguity must be resolved in favor of the common stockholders and against expansion of the Series B Preferred Stock's preferential rights.

A. Lehman's Purported Reconciliation Of The *Rothschild* And *Kaiser* Rules Actually Supports SBS's Argument.

In the Cross-Appeal Brief, SBS showed that, pursuant to a long-standing

statutory rule of construction, stock preferences must be stated clearly and with specificity in a certificate of designations, or else do not exist. (SBS Br. at 42-43) Lehman answers that "so long as the right is stated expressly in the contract, and not presumed or implied, the *Rothschild* rule is satisfied." (Lehman Br. at 30) That is an odd concession for Lehman to make, because if the Certificate's VRTE provision is ambiguous (which is the premise of this point on appeal), the right is neither clear nor "stated expressly in the contract," and SBS's interpretation is correct as a matter of law. *See Elliott Assocs., L.P. v. Avatex Corp.*, 715 A.2d 843, 852 (Del. 1998) ("Any rights, preferences and limitations of preferred stock that distinguish that stock from common stock must be expressly and clearly stated, as provided by statute."); *Rothschild Int'l Corp. v. Liggett Grp. Inc.*, 474 A.2d 133, 136 (Del. 1984) ("Preferential rights are contractual in nature and therefore are governed by the express provisions of a company's certificate of incorporation."); *In re Sunstates Corp. S'holder Litig.*, 788 A.2d 530, 535 (Del. Ch. 2001) ("[T]he law of this State has clearly stated for many decades that special rights or preferences of preferred stock must be expressed clearly and that nothing will be presumed in their favor…."); *Sullivan Money Mgmt., Inc. v. FLS Holdings Inc.*, C.A. No. 12731, 1992 WL 345453, at *3 (Del. Ch. Nov. 20, 1992) ("Because rights or preferences over common stock are in derogation of the common law, they 'should be clearly expressed and not presumed'…."), *aff'd*, 628 A.2d 84 (Del.

1993) (TABLE); *Penington v. Commonwealth Hotel Const. Co.*, 151 A. 228, 234 (Del. Ch. 1930) ("The general rule is that preferred stock enjoys only those preferences which are specifically defined…. While there is no legal objection to the creation of [a preference] right by proper agreement of the parties, yet it would seem that before such exceptional right is recognized it ought to appear clearly that the parties have intended to create it."), *modified sub nom. Penington v. Commonwealth Hotel Const. Corp.*, 155 A. 514 (Del. 1931).

B. Lehman Mischaracterizes *Kaiser* And *Shiftan*.

SBS demonstrated in the Cross-Appeal Brief that *Kaiser* has never been applied to expand the scope of stock preferences. (SBS Br. at 43-44) Lehman claims that in so arguing, SBS "ignores *Kaiser* itself, in which the language concerned conversion rights, which are preferences." (Lehman Br. at 30) But Lehman disregards the Court of Chancery's opinion in *Kaiser*, which was affirmed on appeal. There, the Court of Chancery explicitly acknowledged the long-standing *Rothschild* line of cases but distinguished them on the ground that "[w]e are not really talking about a preference as such." *Matheson v. Kaiser Aluminum Corp.*, C.A. No. 14900, 1996 WL 33167234, at *2 (Del. Ch. Apr. 8, 1996), *aff'd*, *Kaiser*, 681 A.2d 392 (Del. 1996).

Even without reference to the *Kaiser* court's characterization of the issue, there is a clear distinction between the provision at issue in *Kaiser* and the VRTE

provision here. In *Kaiser*, the plaintiff sought injunctive relief to prevent a common stock reclassification, arguing that an anti-dilution provision barred the company from replacing its existing common stock before conversion of the preferred. *See Kaiser*, 681 A.2d at 393-94. But the anti-dilution provision at issue in *Kaiser* did not establish a preference against the common stock, nor did interpretation thereof determine the extent of any preference. Rather, as the Court of Chancery observed, the anti-dilution provision was "a protection against changing a preference." *Matheson*, 1996 WL 33167234, at *2. Here, that is not the case: the VRTE provision at issue affirmatively *grants* the right to exclusively elect two directors, and certain debt-incurrence protections, to the Series B Preferred stockholders – rights that are in derogation of the common-law principle that all shares of a corporation are equal – in certain circumstances. Thus, Lehman's claim that *Kaiser* involved stock preferences is simply wrong. (Lehman Br. at 30) *Kaiser* involved an anti-dilution provision that protected the value of the preferred stock's conversion rights. *Kaiser*, 681 A.2d at 395. The VRTE provision affirmatively grants rights to the Series B Preferred stockholders. (Certificate § 9) Only the latter is a stock preference subject to the *Rothschild* rule.

SBS also established in the Cross-Appeal Brief that *Shiftan v. Morgan Joseph Holdings, Inc.*[3] identified a direct conflict between the *Rothschild* and

[3] 2 A.3d 928 (Del. Ch. 2012).

Kaiser rules, but that the conflict is easily resolved by applying *Kaiser* – as suggested by the Court of Chancery in *Kaiser* itself – only when resolution of the ambiguity will neither create nor expand a preferential right. (SBS Br. at 42-44) In response, Lehman mischaracterizes *Shiftan*, arguing that the "'very particular'" situation identified by then-Chancellor Strine "goes to whether any preference was created in the first place…." (Lehman Br. at 31) In so arguing, Lehman begs the question of what it is to "create" a preference. Whereas in Lehman's argument there is an analytical distinction between the creation of and determination of the extent of stock preferences (*Rothschild* applies to the former but *Kaiser* applies to the latter, according to Lehman's brief), that is not Delaware law. As *Shiftan* itself noted, the *Rothschild* rule constitutes "'the judicial process of analyzing the existence ***and scope*** of the contractual statement of preferences in certificates of incorporation or certificates of designation.'" *Shiftan*, 57 A.3d at 937 n.26 (emphasis added) (quoting *Avatex*, 715 A.2d at 853 n.46).

Application of the *Rothschild* rule to determine both the existence ***and*** scope of stock preferences makes sense in light of the fact that preferences are a zero-sum game: to the extent a preference is awarded to the preferred, the economic value of that preference is taken from the common. To the extent that the scope of

the preference is expanded, more economic value is taken from the common.[4] Here, Lehman is attempting to impose a new and unreasonable interpretation of the VRTE provision in order to receive more present cash dividends. That sort of extracontractual preference expansion – and the resulting extraction of value from the common stockholders – is precisely what the *Rothschild* rule seeks to prevent.

C. Lehman Seeks Additional Preference Rights.

SBS established in the Cross-Appeal Brief that, because preferences consist of economic value transferred by contract from the common stockholders to holders of preferred stock, good policy (and Delaware law) dictates that the Court's solicitude be extended to the common stockholders, who are less able to defend their rights, and, by extension, the value of their securities. (SBS Br. at 45-47) Lehman now argues that it "seeks only to vindicate its contract rights, not to obtain additional rights." (Lehman Br. at 32) Even if that were true (and it is not), Lehman identifies a distinction without a difference. As established *supra* pp. 7-8 and in prior briefing, the scope of a preference is itself a preference, because an expanded right entails an increased transfer of value from the common stockholders to the preferred. (SBS Br. at 43) Application of that principle here is

[4] Lehman's flippant dismissal of this argument is simply to claim that, if the argument is correct, "*Kaiser* would never apply." (Lehman Br. at 32 n.10) That is incorrect. *Kaiser* applies when resolving ambiguity in certificate provisions that do not create or define stock preferences. *Rothschild* applies when resolving ambiguity relating to preferences. (SBS Br. at 43-45)

simple: under Lehman's interpretation of the Certificate, the preferred stockholders had a right to four cash dividends per year. Under SBS's interpretation, the contract was satisfied and Lehman received all of the yearly cash that it was entitled. Thus, despite Lehman's mischaracterizations, it seeks to establish additional preference rights via adjudication of this action.

II. LEHMAN SEEKS EQUITABLE RELIEF; THEREFORE LACHES BARS ITS CLAIMS.

In the Cross-Appeal Brief, SBS established that any recovery that Lehman could receive in this action would, of necessity, have an equitable component because any award of damages would have to be accompanied by a reduction in the amount of dividends that are currently outstanding on the Series B Preferred Stock. (SBS Br. at 48-49) Lehman's responses miss the mark. For example, Lehman notes the Court of Chancery's recognition of a "consent fee theory" as one potential measure of damages. But the one case that the Court of Chancery cited in support of the "consent fee theory" is inapposite here because that case involved a *mandatory* consent right held by *one* stockholder, which the company at issue *deliberately ignored*. *See Fletcher Int'l, Ltd. v. ION Geophysical Corp.*, C.A. No. 5109-VCP, 2010 WL 1223782, at *3-4 (Del. Ch. Mar. 24, 2010). That is not the case here; among other reasons, Lehman did not offer evidence (and cannot prove) that it was entitled to a consent fee for a VRTE waiver. Moreover, even if Lehman could be entitled to such a consent fee, the Court's ability to craft a legal remedy does not change the fact that the relief sought – an award of all outstanding dividends – is equitable, not legal. (SBS Br. at 48)

In addition, SBS cited a number of cases in the Cross-Appeal Brief for the long-established proposition that Delaware courts may not compel the payment of an undeclared dividend in the absence of fraud, but Lehman's reply misconstrues

the argument. Lehman claims that "this is not an action for breach of fiduciary duty," but SBS never claimed it was – because SBS owes no fiduciary duties to Lehman regarding payment of dividends. *See Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 594 (Del. Ch. 1986) ("[W]ith respect to matters relating to preferences or limitations that distinguish preferred stock from common, the duty of the corporation and its directors is essentially contractual and the scope of the duty is appropriately defined by reference to the specific words evidencing that contract…."). Rather, the point that SBS made – and Lehman ignored – is that Lehman claims that the Certificate was breached because SBS allegedly failed to pay dividends when it should have. (*See* Lehman Br. at 35 ("The Certificate imposed specific contractual obligations … including the dividend obligation….")) Thus, Lehman seeks dividends as the remedy. But in the absence of fraud, the Court cannot award dividend damages. (SBS Br. at 48-49)

CONCLUSION

For all of the foregoing reasons, and as set forth in Appellee's Answering Brief on Appeal and Cross-Appellant's Opening Brief on Cross-Appeal, the judgment below should be affirmed.

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