IN THE

Supreme Court of the State of Delaware

MARION COSTER, an individual,
Plaintiff-Below, Appellant,

v.

UIP COMPANIES, INC., a Delaware corporation; STEVEN SCHWAT, an individual; and SCHWAT REALTY, LLC, a Maryland company
Defendants-Below, Appellees.

NO. 49, 2020
On Appeal from the Court of Chancery of the State of Delaware, C.A. No. 2018-0440-KSJM

[redacted]

APPELLANT MARION COSTER'S OPENING BRIEF

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NATURE OF PROCEEDINGS

This is an appeal from a decision by the Court of Chancery holding that the holdover board of directors of UIP Companies, Inc. ("UIP" or the "Company") did not breach fiduciary duties to Plaintiff Marion Coster ("Coster") in approving a sale of unissued stock to an existing board member—a stock sale that reduced Coster's ownership from fifty percent to one-third, extinguished Coster's power to approve a new board, and kept the holdover board in office.

On June 15, 2018, Coster filed this action in the Court of Chancery seeking appointment of a custodian for UIP under 8 *Del. C.* § 226(a)(1) (the "Custodian Action") because a deadlock existed between the two fifty-percent shareholders—Coster and Defendant Schwat Realty LLC (wholly-owned by Defendant Steven Schwat)—over the election of a new board. In addition to Steven Schwat ("Schwat") and Schwat Realty ("Schwat Realty"), UIP is a Defendant in the Custodian Action.

In response to the Custodian Action, UIP's three-member holdover board—on which Schwat serves as Chairman—unanimously approved a sale of one-third of the Company's authorized but unissued shares to Bonnell Realty, LLC ("Bonnell Realty"), an entity solely owned by holdover Board member Peter Bonnell. Later that same day, Defendants filed an Amended Answer in the Custodian Action proclaiming it "moot" in light of the stock sale.

One week later, Coster filed a new, separate Verified Complaint in the Court of Chancery for Cancellation of Stock Issue or Imposition of Constructive Trust, Case No. 2018-0622, Dkt. No. 1, seeking cancellation of the stock sale to Bonnell Realty as a breach of the board's fiduciary duties (the "Cancellation Action"). The defendants in the Cancellation Action are Schwat, Bonnell, Bonnell Realty, Stephen Cox (the third holdover board member), and UIP.

Upon agreement of all parties, the Court of Chancery consolidated the two summary proceedings, over which Vice Chancellor Glasscock initially presided. On November 1, 2018, the Court transferred the case to Vice Chancellor McCormick.

On April 17 and 18, 2019, the Court of Chancery held a two-day trial on the merits. Following post-trial briefing and oral argument, the Court of Chancery issued an Order on January 28, 2020 (the "Opinion," attached hereto as Ex. A, and hereinafter cited as "Op."), denying all relief sought by Coster. On February 7, 2020, Coster filed a Notice of Appeal.

SUMMARY OF ARGUMENT

1. The Court of Chancery's holding that UIP's conflicted board "did not commit a fiduciary breach" in approving the stock sale to Bonnell should be reversed for numerous reasons. Op. 65 (quotation omitted). As an initial matter, the Court of Chancery failed to require Defendants to prove a "compelling justification" for it. This Court's precedent requires such a showing because the sale was "for the primary purpose of impeding and interfering with the efforts of the stockholders' power to effectively exercise their voting rights in a contested election for directors."[1] The failure to apply the "compelling justification" standard was dispositive, as the Court of Chancery's factual findings demonstrate that no compelling justification existed here. That should have ended the inquiry and invalidated the sale. Instead, the Court of Chancery conducted an "entire fairness" review, and held that the stock sale was entirely fair. That holding, too, was error.

2. In the event this Court holds that the board's approval of the stock sale breached its fiduciary duties, the parties would return to the *status quo ante*: a deadlock between the two fifty-percent owners over appointment of directors. At that time, there was no serious question that appointment of a custodian was proper

[1] *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003).

under 8 *Del. C.* § 226(a)(1).[2] Absent a custodian, Coster will be relegated to "perpetual minority status without remedy or recourse" in a Company for which she is the rightful one-half owner.[3] To remedy this, Coster requests that this Court remand to the Court of Chancery for appointment of a custodian pursuant to 8 *Del. C.* § 226(a)(1), with the scope of the custodian's powers to be determined by the Court of Chancery.

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[2] The statute provides that where "the stockholders are so divided that they have failed to elect successors to directors whose terms have expired" the Court of Chancery "may appoint 1 or more persons to be custodians. . . ." 8 *Del. C.* § 226(a)(1).

[3] *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 240 (Del. 1982).

STATEMENT OF FACTS

A. UIP Companies, Inc. ("UIP" or the "Company")

UIP is a real estate services company formed under Delaware law in 2007 by Wout Coster (Plaintiff's deceased husband), Kees Bruggen, and Defendant Steven Schwat. A393 [PTO ¶ 6].

The Company wholly owns three subsidiaries: UIP Asset Management, Inc. ("UIP AM"), UIP General Contracting, Inc. ("UIP GC"), and UIP Property Management, Inc. ("UIP PM"), which provide, respectively, asset management, general contracting, and property management services to real estate companies. Most of the companies serviced by UIP are special purpose entities ("SPEs") "in which UIP principals invest their own capital alongside third-party equity sponsors." A393 [PTO ¶ 4].

UIP is a substantial company. It has "almost a hundred employees," A462 [Tr. 424:2], and had revenues exceeding [redacted] in 2017. A300 [JX-66 at 7].

Over the years, UIP has allowed several of its officers and employees, in addition to its owners, to invest in SPEs serviced by UIP. A423-24 [Tr. 25:23-26:16]. While investing in those SPEs—often referred to as "promote" companies—has high upside potential, it also carries risk, and typically requires investors to put up capital and personal guarantees in order to participate. *Id.*

B. UIP's Initial Ownership and Board Composition

Upon formation, the Company issued 33 1/3 shares of UIP stock each to entities respectively controlled by Bruggen (Bruggen Realty LLC), Wout Coster (Coster Realty LLC), and Schwat (Schwat Realty LLC). A393 [PTO ¶ 6]. In the same resolution, the Company approved its Bylaws and Wout Coster, Schwat, Bruggen, Bonnell, and Cox were elected to be UIP directors (hereafter, the "Board"). A393 [PTO ¶ 7].

In approximately 2011, Bruggen left UIP. A393 [PTO ¶ 8]. He resigned his board seat and transferred his 33 1/3 shares back to the Company, leaving Wout Coster and Schwat each with one-half ownership. *Id*. Bruggen's vacant board seat was not filled. A394 [PTO ¶ 10].

C. Defendants' Failed Attempt to Buy Out Wout Coster

In early 2014, having been diagnosed with leukemia, Wout Coster began negotiations with Schwat and Bonnell for a buyout of his UIP shares by Bonnell and Heath Wilkinson, then-president of UIP GC. A449-51 [Tr. 323-25].

In April 2014, Wout Coster, Bonnell, Schwat, and Wilkinson signed a term sheet for the sale of Wout Coster's shares (the "Term Sheet"). A42-48 [JX-11]. The Term Sheet stipulated that "the value of [UIP] is $4,250,000 on today's date," and provided for, *inter alia*, the transfer of Wout Coster's fifty-percent ownership to Bonnell and Wilkinson for a payment to Wout Coster of $2.125 million. *Id.*

The nonbinding Term Sheet was subject to "definitive agreements," and the final agreement and corresponding sale of stock were to be completed by May 31, 2014. *Id.* at 1-2.

Almost immediately after signing, it became clear that the transaction contemplated by the Term Sheet would have to be overhauled for tax reasons, and over the next several months, the parties discussed various possible deal structures. A452-455 [Tr. 335:19-338:11]. Meanwhile, Wout Coster became increasingly ill. A414-16; A430-33 [Tr. 8:12-10:6, 133:24-136:8].

As the months passed, Schwat and Bonnell began pushing Wout Coster to agree to deal terms that were unacceptable to him. Wout Coster frequently objected that the proposed deal did not sufficiently compensate him for his shares. A433-34 [Tr. 135:11-136:2], A50 [JX-173 at 2].

Ultimately, no definitive agreements were signed—or even prepared—and thus no deal was ever completed. *See* A62-76 [JX-208] (Schwat noting just days after Wout Coster's death that his widow was now in the position "to complete the deal the way we all envisioned . . . ."); *see also* Op. 12.

D. Coster Inherits Her Husband's UIP Stock

Wout Coster died on April 8, 2015. A393 [PTO ¶ 9]. The following day, Schwat approached Coster's attorney about purchasing what was now Coster's fifty-percent interest in UIP. A58-61 [JX-33].

Coster—suddenly in a precarious financial position—agreed to discuss with Schwat and Bonnell a possible sale of her shares, in the hopes of negotiating either a lump-sum buyout or a steady income distribution stream from UIP. A434-41, A447 [Tr. 136-43, 211]. Bereft and struggling to understand her husband's business affairs, Coster enlisted a friend, Michael Pace, to assist her. A420-22, A77-78 [Tr. 16:4-18:13, JX-214].

Throughout the negotiations, Schwat and Bonnell told Coster she was entitled to no profit distributions, and that her fifty-percent ownership was essentially worthless because UIP was unprofitable. A79-84 [JX-219 at 2-3]. They also claimed that Wout Coster, on his deathbed, had called Bonnell and told him that he was now willing to transfer his UIP shares for no payment. A463 [Tr. 461:1-5]. Pressed about why Wout Coster, who had insisted on receiving money for his shares, would suddenly agree to forgo payment for his UIP stock, Bonnell claimed Wout Coster did so in "consideration [of] my promise to Wout that I would protect Marion's interest [in the SPE investments] from [mistreatment by] Steve Schwat." A427 [Tr. 40:12-24].

As the months passed, Bonnell continued to press Coster to relinquish her shares for no payment. During a meeting in the summer of 2016, Bonnell went so far as to threaten to fraudulently transfer all of UIP's assets. A428 [Tr. 41:2-22]. Bonnell stated that, if Coster continued to insist on payment for her stock, he and

Schwat could simply "create a new corporation and transfer all [UIP's] assets into the new corporation." A428 [Tr. 41:15-17].

With the parties at an impasse over the value of her stock, Coster commissioned a "Calculation of Value" from a consultant. Bonnell provided the consultant with UIP financial information. A161-63 [JX-43]. The consultant calculated the fair market value of UIP and its wholly-owned subsidiaries on a controlling interest basis to be [redacted]. A429; A363-65; A86, A113, and A136 [Tr. 55:21-24; Scott Dep. Tr. at 72-73; JX-225 at pp. 2, 29, and 52].[4] That calculation of value did not budge Defendants from their position that Coster's UIP shares were worthless. A460 [Tr. 388:20-22].

E. Coster Calls a Series of Shareholder Meetings in an Effort To Obtain Representation on UIP's Board of Directors

In the spring of 2017, with the negotiations over, Coster (through counsel) served requests for books and records on UIP and several promote entities. A164-90, A202-237 [JX-231, 234]. Despite repeated follow-up over the next six months, Defendants provided only partial responses to Coster's requests. A457-59; A242-63, A191-92, A238-39, and A240-41 [Tr. 380-82; JX-82, JX-232, JX-236, and JX-237]; *see also* Op. 20 n.125.

[4] The Schedule of Evidence included all deposition transcripts. Op. 2 (citing C.A. No. 2018-0440-KSJM, Dkt. 155).

Settlement discussions then resumed, through counsel. A201 [JX-195 at 3]; Op. at 19. The impasse, however, continued. *Id.* Meanwhile, in the three years since her husband's death, Coster had received no income or distributions from UIP, had no board representation, and had no visibility into the Company's affairs. A425-426, A429 [Tr. 28:23-29:2, 55:14-20].

Facing a perpetual freeze-out with no relief in sight, Coster called the first of a series of shareholder meetings in an effort to obtain representation on UIP's Board.[5] A394-97 [PTO ¶¶ 11-23]. On April 4, 2018, Coster requested a special meeting of UIP's two stockholders—Schwat Realty and Coster—to elect a new board of directors. A394 [PTO ¶ 13].

On May 11, 2018, UIP issued a notice of special meeting of stockholders "[t]o vote on the election of directors of the Corporation." A394 [PTO ¶ 14]. The stockholder meeting occurred on May 22, 2018. *Id.* A partner of Pillsbury LLP ("Pillsbury")—representing UIP, the Board, and Schwat—served as secretary and inspector of elections. A264 [JX-50 at 1].

At the May 22 stockholder meeting, Coster's proxy holder (her counsel) proposed a motion that the number of directors be changed to four, and voted for

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[5] UIP's bylaws provide that special meetings of the stockholders may be called upon by the written request of stockholders holding more than 25% of the voting stock of the Company. A394 [PTO ¶ 12]. Coster is the record owner of the 33 1/3 shares of UIP stock that formerly belonged to Coster Realty, LLC. A393 [PTO ¶ 9].

the motion. Schwat, representing Schwat Realty, voted against it. Because the Bylaws required a majority vote of stockholders, Coster's proposal failed. A394 [PTO ¶ 15].

Coster's proxy holder then proposed that Brian Henderson and Veronica Hall—each a relative of Coster and a successful professional—be appointed to fill the two empty board seats. A442; A395 [Tr. 146:9-17; PTO ¶ 16]. Coster's proxy holder voted for the motion, but Schwat voted against it. A395 [PTO ¶ 16].

Coster's proxy holder then moved that a vote be held to fill all five board seats, with Henderson, Hall, Coster, Schwat, and Bonnell. A395 [PTO ¶ 17]. Schwat objected to the proposal and refused to allow the vote. *Id.* He adjourned the meeting, and said the Company would consider a request for another special meeting to vote on a full five-member board. *Id.*

Later that same day, Coster (through counsel) called for another meeting to elect a board. A395 [PTO ¶ 18]. The Company's counsel (Pillsbury), while agreeing to the meeting, announced, without explanation, that the Company's holdover directors had chosen to reduce the number of board seats from five to three. *Id.*

The ensuing meeting (termed an "annual meeting" by the Company) occurred on June 4, 2018, with the Pillsbury partner again serving as secretary and inspector of elections. A266 [JX-52 at 2]. Votes were held on three motions.

A396 [PTO ¶ 19]. The first sought approval of "the election of Steven Schwat, Peter Bonnell and [Stephen] Cox to serve as directors until the Corporation's next Annual Meeting or until their successors are duly elected and qualified." A396; A268 [PTO ¶ 20; JX-52 at 3]. Schwat voted for the motion, and Coster's proxy holder voted against it, so it failed to pass. *Id.*

The second motion sought to increase the size of UIP's board to five seats and to elect Henderson, Hall, Coster, Schwat and Bonnell "to serve as directors until the Corporation's next Annual Meeting or until their successors are duly elected and qualified." A396; A268 [PTO ¶ 21; JX-52 at 3]. Coster's proxy holder voted for the motion. Schwat voted against the motion, causing it to fail. *Id.*

The third and final motion sought to elect Henderson, Hall, and Schwat "to serve as directors until the Corporation's next Annual Meeting or until their successors are duly elected and qualified." A396; A268 [PTO ¶ 22; JX-52 at 3]. Coster's proxy holder voted for the motion, and Schwat against it. *Id.* It thus failed.

The Company's board of directors thus continued to comprise three holdover directors appointed in 2007: Schwat, Bonnell, and Cox (the "Board"). A397; A268 [PTO ¶ 23; JX-52 at 3].

F. Coster Files the Custodian Action and Defendants Delay in Answering

On June 15, 2018, Coster filed the Custodian Action seeking appointment of a custodian over UIP pursuant to 8 *Del. C.* § 226(a)(1) to end the deadlock and resulting entrenchment of UIP's holdover board. A397 [PTO ¶ 24].

Thereafter, on July 3, 2018, counsel for Defendants requested from Coster's counsel and received a courtesy extension—until July 20, 2018—to file a responsive pleading, purportedly due to defense counsel's other obligations. A269-71 [JX-242].

G. The McLean Group Valuation

Prior to Defendants' deadline to answer, UIP's accounting firm, at Schwat's direction, reached out to Andy Smith of the McLean Group to inquire whether he could perform a valuation of UIP. A276-280, A397 [JX-57, PTO ¶ 25]. Three days later—before the McLean Group was even retained—Smith emailed Schwat: "Steve, FYI I had lunch with Jason Smolen yesterday . . . I casually mentioned the valuation issue of related party companies (not mentioning UIP or you, of course), he totally gets it and agrees that there is no value [to UIP]." A272-275; A466-67 [JX-56; Tr. 539-40]. Schwat—co-founder and one-half owner of UIP—replied, "Awesome." *Id.*

Thereafter, UIP formally engaged the McLean Group. A276-80; A467 [JX57; Tr. 540:5-9]. Defendants then requested a further extension of Defendants'

answer deadline, again citing the press of other work. A281-82 [JX-257 at 1-2]. Coster's counsel agreed to further extend the deadline until July 27, 2018. *Id.*

On July 25, 2018, Deborah Baum of Pillsbury—Defendants' lead litigation attorney—emailed Defendants asking, "Where are we with the valuation? We have an answer date of this Friday and can not [sic] get more time so we need to respond (and probably should have a second counsel answer for the company) if the share issuance and purchase isn't complete by Friday." A287-88 [JX-58].

Later that day, Baum emailed Defendants: "All: I think it is a fair assumption that the stock issuance is not going to be achievable by this Friday, which is the due date for our response to Mrs. Coster's Complaint . . . . [W]e can amend as soon as the transaction is done." A289-290 [JX-59 at 1-2]. She added, "I don't want you to have to hire separate counsel to represent the company if we are just going to fix the problem [of the Custodian Action] via stock issuance." A290 [JX-59 at 2].

On August 14, 2018, Smith sent Schwat the final version of the valuation (the "McLean Valuation"), which concluded that the estimated fair market value of a 100.0% equity interest in UIP was $123,869. A297 [JX-66 at 4]. Later that same day, Schwat sent the McLean Valuation to Bonnell and offered to sell him the 33 1/3 unissued shares of UIP for one-third of the valuation: $41,289.67. A292-93 [JX-288].

H. Defendants Dilute Coster's Ownership Interest

The next day, August 15, 2018—without a Board meeting and without notice to Coster—the Board adopted a Unanimous Written Consent approving the sale of the 33 1/3 shares to Bonnell for $41,289.67 (the "Stock Sale"). A397; A443; A358-360 [PTO ¶ 27; Tr. 149:1-17; JX-68].

The Board claimed in its Unanimous Consent that the Stock Sale's purpose was to effectuate the non-binding Term Sheet signed in 2014. A358-60 [JX-68]. Notably, however, the Unanimous Consent made no mention of effectuating another key provision of the Term Sheet: that Bonnell and Wilkinson would pay Wout Coster $2.125 million for his UIP shares. A358-60 [JX-68]. And, contrary to Defendants' proffered justification for the Stock Sale at trial, the Unanimous Consent made no mention of the Custodian Action, or that the sale was necessary to avoid harm to UIP from appointment of a custodian. A358-60 [JX-68].

Within hours of the Board's approval of the Stock Sale, Defendants filed an Amended Answer in the Custodian Action, which stated: "in light of the issuance of additional shares . . . there is no deadlock, and Plaintiff is not a 50% shareholder." A397-98 [Dkt. No. 12 at 3, PTO ¶ 28]. The Amended Answer thus claimed that "[t]he Complaint is moot." A397-98 [Dkt. No. 12 at 25, PTO ¶ 28].

A week later, on August 22, 2018, Coster filed the Cancellation Action. A398 [PTO ¶ 29]. Upon stipulation of the parties, the Court consolidated the

Cancellation Action with the previously-filed Custodian Action. A398 [Dkt. No. 16, PTO ¶ 29].

I. The Court of Chancery's Opinion

Following a two-day hearing in April 2019, and completion of post-trial briefing, the Court of Chancery issued its decision on January 28, 2020. That decision concluded that "Defendants have met their burden to show that the Stock Sale satisfies the entire fairness standard" and thus the Board did not breach its fiduciary duties in approving it. Op. 64-65. The Court of Chancery thus refused to "assume that the stockholders are currently deadlocked," and declined to appoint a custodian. Op. 65.

ARGUMENT

I. THE BOARD BREACHED ITS FIDUCIARY DUTIES TO COSTER BY APPROVING THE STOCK SALE

A. Question Presented

Did the Court below err in holding that the conflicted Board did not breach its fiduciary duties to Coster by approving the Stock Sale, which purportedly reduced Coster's ownership interest from one-half to one-third, extinguished her ability to approve board appointments, mooted the Custodian Action filed by Coster in the Court of Chancery, and maintained the holdover Board in office?[6]

B. Standard and Scope of Review

The Court's ruling in favor of Defendants on Coster's claim for cancellation of the Stock Sale is a mixed question of law and fact. The Court's legal conclusions are reviewed *de novo*, its factual findings are reviewed for clear error.[7]

C. Merits

The Court of Chancery's holding that the conflicted Board "did not commit a fiduciary breach" in approving the Stock Sale should be reversed for numerous reasons. Op. 65. At the threshold, the Court failed to require Defendants to prove a "compelling justification" for the Stock Sale. This Court's precedents require such a showing because the Board approved the Stock Sale "for the primary

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[6] Plaintiff preserved this question below in Plaintiff's Opening Post-Trial Brief (A494-519 [pp. 17-42]) and in Plaintiff's Post-Trial Answering Brief. (A490-504 [pp. 13-27]).

[7] *RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 849 (Del. 2015).

purpose of impeding and interfering with the efforts of the stockholders' power to effectively exercise their voting rights in a contested election for directors."[8] The failure to apply the "compelling justification" standard was dispositive, for the Court of Chancery's factual findings demonstrate that no compelling justification existed here. That should have ended the inquiry and invalidated the Stock Sale. Instead, the Court of Chancery conducted an "entire fairness" review of the Stock Sale, and held that it was entirely fair. That holding, too, was error.

1. The Court of Chancery Erred By Failing to Require Defendants to Show a Compelling Justification for the Board's Interference With Coster's Voting Power So the Board Could Remain in Office

It is a bedrock principle of Delaware corporate law that the ability of stockholders to vote for directors of their choosing is a "fundamental governance right."[9] Consequently, "[t]his Court and the Court of Chancery have remained assiduous in carefully reviewing any board actions designed to interfere with or impede the effective exercise of corporate democracy by shareholders, especially in an election of directors."[10]

Just such a board action occurred here. The Court of Chancery found that the Stock Sale "served [Schwat's] personal interest," because "[b]y placing stock in the hands of his friend [Bonnell], Schwat quashed any risk [from] the Custodian

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8 *MM Cos., Inc. v. Liquid Audio*, 813 A.2d 1118, 1132 (Del. 2003).
9 *EMAK Worldwide, Inc. v. Kurz*, 50 A.3d 429, 433 (Del. 2012).
10 *MM Cos.*, 813 A.2d at 1127.

Action and mitigated any pressure from Plaintiff at the Board level" given the majority vote needed to appoint directors. Op. 41-42. Having so found, the Court of Chancery erred in not requiring Defendants to prove a compelling justification for the Stock Sale.

a. Schwat Orchestrated the Stock Sale With the Primary Purpose of Eliminating Coster's Ability to Approve a Successor Board or Seek Appointment of a Custodian

At the outset, the Court of Chancery correctly characterized this case as a dispute over "control and ownership" of UIP. Op. 1. Coster first requested a stockholder meeting to elect a new board on April 4, 2018. While Coster had no representation on the holdover Board, Schwat served at its Chairman. A456 [Tr. 379:5-7]. His "good friend[]" Bonnell also was on the Board. Op. 40. Cox, a UIP employee who reported to Schwat, was the remaining Board member. Op. 42; *see also* Op. 24. In short, Schwat's plenary power over UIP was the mirror-image of Coster's utter lack of power. Op. 40 (noting that "Plaintiff could not reduce Schwat's control, terminate his employment, or effect change to any member of Schwat's team").

The successive stockholder meetings produced a deadlock between the two fifty-percent owners over the election of a successor board. As a result, "the Board continued to comprise three holdover directors appointed in 2007: Schwat, Bonnell, and Cox." Op. 24.

The stockholder deadlock pleased Schwat and Bonnell. Each readily acknowledged at trial his desire to keep the holdover Board in office in the face of Coster's attempts to elect a new board. A461 [Tr. 400:10-11] (Schwat: "I was satisfied with the current board"; A478 [Tr. 464:15-16] (Bonnell: He and Schwat "discussed how the company is operating just fine with the board that it has.").

Facing a perpetual freeze-out from representation on UIP's board, Coster filed the Custodian Action. Schwat saw the Custodian Action as a threat because it could result in him "surrendering power over UIP to an unknown custodian." Op. 41. So did the other Board members. As the Court of Chancery found, "Defendants obviously desired to eliminate Plaintiff's ability to block stockholder action, ***including the election of directors***, and the leverage that accompanied those rights." Op. 29 (emphasis supplied).

In response, Schwat and Bonnell "worked together to develop the [Stock Sale] plan to moot the Custodian Action and neutralize the threat of Plaintiff controlling the Company." Op. 41. The Court of Chancery found that Cox, too, "was an officer and an employee of UIP and thus was inclined to favor the status quo threatened by the Custodian Action." Op. 42.

Schwat, in particular, benefitted from the Stock Sale. It "served [Schwat's] personal interest" by eliminating any risk to his control over UIP. Op. 41. As the Vice Chancellor explained, "[b]y placing stock in the hands of his friend [Bonnell],

Schwat quashed any risk, however minimal, of this Court ordering the expansive relief Plaintiff sought in the Custodian Action ***and mitigated any pressure from Plaintiff at the Board level***" from Coster having equal voting power over the appointment of directors. Op. 41-42 (emphasis added).

b. The "Compelling Justification" Standard Applies Because the Board Purposely Impaired Coster's Voting Power

The Court of Chancery's factual findings bring this case squarely within the four corners of Chancellor Allen's landmark opinion in *Blasius* and this Court's decision in *MM Companies* endorsing it.[11]

Blasius presented the question of whether a "board, even if it *is* acting in subjective good faith . . . may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors."[12] After canvassing Delaware case law, "the Chancellor concluded that such situations required enhanced judicial scrutiny, pursuant to which the board of directors 'bears the heavy burden of demonstrating a compelling justification for such action.'"[13]

The corporate governance precept undergirding *Blasius* is that while a board may be better positioned than the stockholders to determine what is best for the company on most matters, the board's opinion "is irrelevant . . . when the question

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[11] *See Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988); *MM Cos.*, 813 A.2d at 1127-1132.

[12] *Blasius*, 564 A.2d at 658 (emphasis in original).

[13] *MM Cos.*, 813 A.2d at 1128 (quoting *Blasius*, 564 A.2d at 661).

is who should comprise the board of directors. The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters."[14]

The Court of Chancery's findings as to the genesis and purpose of the Stock Sale—to moot the Custodian Action and to "mitigate[] any pressure from Plaintiff at the Board level," Op. 41-42—trigger application of the "compelling justification" standard under *Blasius/MM Companies*. Here, as in *MM Companies*, the Stock Sale "was a defensive action taken by an incumbent board of directors for the primary purpose of interfering with and impeding the effectiveness of the shareholder franchise in electing successor directors."[15] The Court of Chancery thus erred in not requiring Defendants to carry their "heavy burden of demonstrating a compelling justification for such action."[16]

c. Entire-Fairness Review Does Not Obviate the Requirement to Prove a Compelling Justification Under *Blasius/MM Companies*

In the post-trial briefing, Coster argued that Defendants had failed to meet their burden under *Blasius* and *MM Companies* to show a "compelling justification" for the Stock Sale. A495-96 [pp. 18-19], A558-63, 72 [pp. 13-18, 27]. The Court of Chancery did not apply that test. Instead, after finding that "a

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14 *Blasius*, 564 A.2d at 663.

15 *MM Cos.*, 813 A.2d at 1131.

16 *Id.* at 1128 (quoting *Blasius*, 564 A.2d at 661).

majority of the Board was interested in the Stock Sale," the Court of Chancery applied only the "entire fairness standard of review." Op. 42. The Court of Chancery concluded that, "[b]ecause the Stock Sale satisfied Delaware's most onerous standard of review, this decision does not reach Plaintiff's alternative arguments." Op. 36.

That is an error of law. This Court's precedents required the Court of Chancery to apply the *Blasius/MM Companies* "compelling justification" requirement ***within*** its entire fairness review of the Stock Sale. As this Court has made clear, the *Blasius* compelling justification test and enhanced judicial review of a transaction "are *not* mutually exclusive."[17]

Dual-review most frequently arises in the context of board action during "a pending takeover bid."[18] In *Unocal*, this Court applied an "enhanced duty" to such board actions.[19] This Court has made clear that, even under enhanced *Unocal* review, the defendants must satisfy both *Unocal* and *Blasius* where, as here, "an incumbent board of directors [takes an action] for the primary purpose of interfering with and impeding the effectiveness of the shareholder franchise in

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17 *MM Cos.*, 813 A.2d at 1130 (emphasis in original); *Stroud v. Grace*, 606 A.2d 75, 92 n.3 (Del. 1992) (challenged board action "necessarily invoked both *Unocal* and *Blasius*").

18 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

19 *Id.*

electing successor directors."[20] In such circumstances, "the *Blasius* compelling justification standard of review [applies] *within* an application of the *Unocal* standard of review."[21]

The Court of Chancery's review of the Stock Sale for "entire fairness" thus did not extinguish Defendants' "heavy burden" to prove a "compelling justification" for the transaction.[22] Given its finding that "Defendants obviously desired to eliminate Coster's ability to block stockholder action, including election of directors," the Court of Chancery should have applied the "compelling justification" standard within its entire fairness review.[23]

To do otherwise—as the Court of Chancery did—creates an illogical and untenable analytical framework under Delaware law. The Court of Chancery applied the "entire fairness" test only after concluding that "a majority of the Board was interested in the Stock Sale." Op. 42. Had a majority of the Board been deemed independent, presumably the Court of Chancery would have applied both *Unocal* and *Blasius*, as this Court's precedents require.[24] It cannot be that an *independent* Board that impedes a shareholder's ability to vote for directors must show a "compelling justification" under *Blasius*, but that a *conflicted* board need

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20 *MM Cos.*, 813 A.2d at 1131.
21 *Id.* at 1132 (emphasis in original).
22 *Id.* at 1128 (quoting *Blasius*, 564 A.2d at 661).
23 Op. 29; *MM Cos.*, 813 A.2d at 1128 (quoting *Blasius*, 564 A.2d at 661).
24 *MM Cos.,* 813 A.2d at 1130.

not. Yet that is what happened here. The Court of Chancery erred by not requiring Defendants to prove a compelling justification for the Stock Sale.

2. No Compelling Justification Existed for the Stock Sale, Which Extinguished Coster's Ability to Approve a New Board and to Seek a Custodian

By design, the compelling justification standard is "quite onerous."[25] That is because "[a] board's unilateral decision to adopt a defensive measure touching 'upon issues of control' that purposefully disenfranchises its shareholders is strongly suspect . . . ."'"[26]

Given the "strongly suspect" nature of the Stock Sale—undertaken in the midst of a deadlock over electing a new board and during the pendency of the Custodian Action—Defendants faced a "heavy burden" to prove a "compelling justification" for it.[27] Yet the Court of Chancery erroneously placed the burden on Coster to prove the falsity of "Defendants' purposes or justifications" for the Stock Sale. Op. 32. The Court of Chancery's error in not requiring Defendants to carry their "heavy burden" to show a "compelling justification"[28] was dispositive for two reasons. First, the Court of Chancery's factual findings establish that no compelling justification existed here. Second, Defendants' proffered explanations

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25 *Williams v. Geier*, 671 A.2d 1368, 1376 (Del. 1996).
26 *MM Cos.*, 813 A.2d at 1130 (quoting *Stroud*, 606 A.2d at 92 n.3).
27 *MM Cos.*, 813 A.2d at 1128 (quoting *Blasius*, 564 A.2d at 661).
28 *MM Cos.*, 813 A.2d at 1128.

at trial for the Stock Sale do not—and cannot—constitute a compelling justification.

a. The Court of Chancery Erred in Placing the Burden of Proof on Coster, not Defendants

Although the Court of Chancery deemed the issue "largely moot," Op. 29, and "somewhat beside the point" given its entire fairness review, Op. 32, it nevertheless examined each of Defendants' proffered justifications for the Stock Sale. But in so doing, the Court of Chancery did not hold Defendants to their "heavy burden" under *Blasius/MM Companies* to prove the "compelling justification" for the "strongly suspect" nature of the Stock Sale.[29] Instead, the Court erroneously placed the burden ***on Coster*** to prove that the Stock Sale had an improper purpose. *See* Op. 32 ("Plaintiff did not succeed in proving her theories regarding Defendants' [improper] purposes or justifications.").

b. No Compelling Justification Existed for the Stock Sale

The Court of Chancery's findings establish that Defendants did not—and could not under these facts—carry their "heavy burden" to prove a "compelling justification" for the Stock Sale.[30]

Most imporant are the Court of Chancery's findings that "Defendants obviously desired to eliminate Plaintiff's ability to block stockholder action,

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29 *Id.* at 1128, 1130 (internal quotations omitted).

30 *MM Cos.*, 813 A.2d at 1128 (internal quotation omitted).

including election of directors," Op. 29, and thus Schwat "place[d] stock in the hands of his friend [Bonnell]" in order to "quash[] any risk" of the Court appointing a custodian" and to "mitigat[e] any pressure from Plaintiff at the Board level." Op. 41-42; *see also* Op. 41 (finding that Schwat and Bonnell "worked together to develop the [Stock Sale] plan to moot the Custodian Action and neutralize the threat of Plaintiff controlling the Company").

These factual findings by the Court of Chancery, applied to this Court's precedents, preclude a finding that a compelling justification existed for the Stock Sale. In *MM Companies*, this Court invalidated a board's increase of its size from five to seven directors as a breach of its fiduciary duties. Even though the Company's bylaws allowed the increase, the Court held that no compelling justification existed because "the incumbent Board timed its utilization of these otherwise valid powers . . . for the primary purpose of impeding and interfering with the efforts of the stockholders' power to effectively exercise their voting rights in a contested election for directors."[31]

Here, too, the Stock Sale cannot have been based on a "compelling justification" because the holdover Board, in approving it, sought to prevent Coster

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[31] *MM Cos.*, 813 A.2d at 1132; *see also Phillips v. Insituform of N. Am. Inc.*, 1987 WL 16285, at *8 (Del. Ch. Aug. 27, 1987) (concluding "that no justification has been shown that would arguably make the extraordinary step of issuance of stock for the admitted purpose of impeding the exercise of stockholder rights reasonable in light of the corporate benefit, if any, sought to be obtained").

from "exercis[ing] [her] voting rights"[32] so it would remain in office. Op. 29 ("Defendants obviously desired to eliminate Plaintiff's ability to block stockholder action, including election of directors"); Op. 42 (finding that Cox "was inclined to favor the status quo threatened by the Custodian Action").

Delaware courts have long made clear that "directors may not . . . act[] solely or primarily out of a desire to perpetuate themselves in office."[33] Indeed, "[w]here a board's actions are shown to have been taken for the purpose of entrenchment, they may not be permitted to stand."[34] If a corporate director's approval of stock issuance is "in order to gain control of the corporation and prevent its stockholders from removing him (or those aligned with him) from office, there is little, if any, chance that it would be possible to show that he acted fairly."[35]

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32 *MM Cos.*, 813 A.2d at 1132.

33 *Unocal*, 493 A.2d at 955; *see also Schnell v. Chris-Craft Indus.*, 285 A.2d 437, 439 (Del. 1971) (invalidating board's attempt to move up stockholder meeting date to choose new directors because "management has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office").

34 *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 186 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006); *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769, 776 (Del. Ch. 1967) ("[A]ction by majority stockholders having as its primary purpose the 'freezing out' of a minority interest is actionable without regard to the fairness of the price.").

35 *Keyser v. Curtis*, 2012 WL 3115453, at *13 (Del. Ch. July 31, 2012); *see also WNH Invs, LLC v. Batzel*, 1995 WL 262248, at *7-8 (Del. Ch. Apr. 28, 1995) (setting aside a dilutive stock issuance because "defendants' purported purpose for the dilutive issuance is a pretext and their true purpose was to defeat plaintiff's

Even if the Court of Chancery's factual findings did not foreclose a finding that a compelling justification existed for the Stock Sale—and they do—Defendants still failed at trial to satisfy their burden. Each of Defendants' proffered explanations for the Stock Sale fall far short of carrying Defendants' "heavy burden of demonstrating a compelling justification for such action."[36]

First, the Court of Chancery found "that the Stock Sale was significantly motivated by a desire to moot the Custodian Action . . . . "[because] Defendants viewed the appointment of a custodian as deleterious to UIP . . . ." Op. 29-30. Specifically, Schwat and Bonnell testified that "the appointment of a custodian constituted an event of default under various SPE contracts," thus jeopardizing substantial UIP "revenue streams." Op. 30-31.[37] Defendants pressed this justification at trial even though both the Unanimous Consent and Defendants'

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challenge to their control"); *Packer v. Yampol*, 1986 WL 4748, at *14 (Del. Ch. Apr. 18, 1986) ("In cases where management has wrongfully attempted to perpetuate itself in office by issuing securities that would adversely impact on a shareholder legitimately seeking to obtain majority control or to assert majority control already obtained, this Court has not hesitated to grant appropriate relief against such conduct." (collecting cases)).

[36] *MM Cos.*, 813 A.2d at 1128 (quoting *Blasius*, 564 A.2d at 661).

[37] The Court of Chancery's opinion mistakenly states that "Plaintiff does not dispute the existence of broad termination rights and clauses identifying the appointment of a custodian as a default in various of the Company's service contracts with SPEs." Op. 30 n. 190. In fact, in both her Opening Post-Trial Brief, A531-33 [at 54-56], and in her Post-Trial Answering Brief, A582-587 [at 37-42], Coster vigorously disputed that contention.

contemporaneous correspondence are silent about avoiding harm to UIP from appointment of a custodian. A358-360 [JX-68], A289-91 [JX-59].

In any event, almost by definition, Coster's exercise of her statutory right under 8 *Del. C.* § 226(a)(1) to seek judicial appointment of a custodian cannot constitute a "compelling justification" for diluting Coster's ownership in the midst of deadlock over election of directors. No custodian could be appointed without an order of the Court of Chancery after a hearing on the merits. If Defendants viewed a custodian as harmful to UIP, the proper course was to present those arguments to the Court of Chancery, not to engage in extra-judicial self-help. Were that permissible, every board facing a shareholder petition for appointment of a custodian under § 226(a)(1) could simply defeat the petition by issuing stock to an insider, thereby gutting the statutory remedy enacted by the General Assembly.

Second, the Court of Chancery cited the testimony of Schwat and Cox that, "as much as anything, the Stock Sale was motivated by their desire to keep their promise to Bonnell" to let him buy into UIP, as evidenced by "the Term Sheet." Op. 31.[38] Even if true—and the contemporaneous emails between Defendants and

[38] In invoking the non-binding Term Sheet as the justification for the Stock Sale, Defendants conveniently ignore that the Term Sheet required Bonnell and Wilkinson *to purchase* Coster's UIP shares for $2.125, which never happened. A A43-44 [JX-11] at 2-3 ("Total Sale of [UIP] Interest by [Wout Coster] to HW/PB - $2,125,000".).

their counsel (Pillsbury) indicate that it is not[39]—this justification was not compelling.

Importantly, there was nothing exigent about allowing Bonnell to buy into the Company. Since Coster's death in 2015, Bonnell had not once inquired about the status of the supposed promise to allow him to buy UIP stock. A361-62 [Bonnell Dep. Tr. at 186].[40] There simply was no reason—and certainly not a compelling one—why a stock sale to Bonnell could not wait until appointment of a new board that included directors approved by Coster or, if the Court of Chancery appointed a custodian, by the custodian after he or she determined that such a sale was in UIP's best interests.

Lastly, although the Court of Chancery did not address the issue, Delaware case law instructs that not even a good-faith belief by Defendants that the Stock Sale was in UIP's best interests would satisfy the "compelling justification" standard under *Blasius/MM Companies*. As Chancellor Allen noted in *Blasius*, this Court in *Condec* "implied that not even a good faith dispute over corporate policy

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[39] Those contemporaneous emails show that, in fact, the singular impetus for the Stock Sale was Defendants' desire "to fix the problem" of the Custodian Action by selling stock to Bonnell, and thus purportedly break the existing shareholder deadlock over election of directors. A290 [JX-59 at 2].

[40] Wilkinson also testified that no concrete steps were taken between Wout Coster's death and 2018 to issue stock to Bonnell or Wilkinson A458-a [Tr. 178]; *see also* A445-46 [Tr. 207-08] (Cox noting non-issuance of stock to Bonnell between 2015 and June 2018), A465 [Tr. 481] (Bonnell noting same).

could justify a board in acting for the primary purpose of reducing the voting power of a control shareholder . . . ."[41]

3. The Court of Chancery Erred in Holding that the Stock Sale Passed Entire Fairness Review

Defendants' failure to establish a compelling justification for the Stock Sale as required under *Blasius/MM Companies* should have ended the Court's inquiry, and the transaction should have been declared invalid. Instead, the Court of Chancery went on to hold that, "[a]lthough the procedural process was by no means optimal," Op. 48, "the Stock Sale satisfies the entire fairness standard." Op. 65.

Under the "entire fairness" test, it is the defendant's burden to establish that the transaction was "entirely fair": conflicted directors, such as the Defendants here, "bear the burden to demonstrate that the transaction was entirely fair to the corporation and the minority stockholders, both as to process and price."[42] The Court of Chancery erred in finding that the Defendants met that burden.

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[41] *Blasius*, 564 A.2d at 661; *Condec*, 230 A.2d at 776 ("[w]here, however, the [board's] objective sought in the issuance of stock is not merely the pursual of a business purpose but also to retain control, it has been held to be a mockery to suggest that the 'control' effect of an agreement in litigation is merely incidental to its primary business objective.").

[42] *Strassburger v. Earley*, 752 A.2d 557, 570 (Del. Ch. 2000) (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983).

a. The Court of Chancery's Factual Findings Demonstrate that the Process of the Stock Sale Was Unfair to Coster

Fair process—often referred to as "fair dealing"—"embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[43] Delaware courts have been particularly concerned where, as here, a transaction occurs in haste without an arm's-length negotiation.[44]

The Court of Chancery's factual findings provide answers to each of the fair-dealing indicia set out in *Weinberger*.[45] As to "how the [Stock Sale] was "timed" and "initiated,"[46] the Vice Chancellor found that, in response to Coster's filing of the Custodian Action, Schwat and Bonnell—both conflicted, entrenched directors—"worked together to develop the [Stock Sale] plan to moot the Custodian Action and neutralize the threat of Plaintiff controlling the Company." Op. 41. They accomplished this by deliberately structuring the Stock Sale "to eliminate Plaintiff's ability to block stockholder action, ***including the election of directors***, and the leverage that accompanied those rights." Op. 29 (emphasis supplied).

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43 *Weinberger*, 457 A.2d at 711.
44 *Id.* at 711-12.
45 *Id.* at 711
46 *Id.*

These factual findings by the Court of Chancery prove the absence of fair dealing under Delaware case law.[47] As for the "negotiation" consideration under *Weinberger*, there was none. The Court of Chancery found that, on the same day the McLean Group sent Schwat its final valuation of UIP, "Schwat forwarded [it] to Bonnell and offered to sell him one-third of UIP's authorized but unissued shares at a price equal to one-third of the valuation. Bonnell agreed, and on August 15, the Board acted by unanimous written consent to sell 33 1/3 shares of UIP stock to Bonnell Realty LLC for $41,289.67 . . . ." Op. 28. The Board thus made no attempt to determine whether Bonnell was willing to pay more than $41,289.67 for the one-third interest in UIP. A300 [JX-66 at 7]. Instead, Schwat "dictated the terms" of the Stock Sale.[48]

The final consideration under *Weinberger*—the process by which "approval[] of the directors and the stockholders [was] obtained"—further demonstrates the abject lack of fair dealing here.[49] As the Court of Chancery

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47 *See, e.g.*, *Strassburger*, 752 A.2d at 576-77 (defendants failed to show fair dealing "because there was no advocate committed to protect the minority's interest, and because the players were either indifferent, or had objectives adverse, to those interests"); *Oliver v. Boston Univ.*, 2006 WL 1064169, at *25 (Del. Ch. Apr. 14, 2006) (no fair dealing where "there was *no* process to protect the interests of the minority shareholders") (emphasis in original).

48 *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs*, 2018 WL 3326693, *38 (Del. Ch. July 6, 2018), *aff'd sub nom. Davenport v. Basho Techs. Holdco B*, 221 A.3d 100 (Del. 2019) (no fair dealing where controlling shareholder "refused to negotiate" a transaction that advanced its own interests).

49 *Weinberger*, 457 A.2d at 711.

found, the entire point of the Stock Sale was for Schwat to "plac[e] stock in the hands of his friend [Bonnell]" in order to "quash[] any risk [from the Custodian Action]" and to "mitigate[e] any pressure from Plaintiff at the Board level" given the majority vote needed to appoint directors—in other words, to thwart the only other shareholder's ability to approve directors. Op. 41-42. Consistent with that objective, Defendants did not give Coster advance notice of the Stock Sale, did not seek her consent, and did not give her an opportunity to buy the one-third interest for an amount greater than $41,289.67 (for the obvious reason that they knew she would buy it).

In sum, "[n]one of the traditional indicia of fairness were present in this case," and thus "[t]he fair process aspect of the entire fairness test weigh[ed] heavily against a finding of fairness."[50] The Court of Chancery erred by not concluding that the Stock Sale's very purpose—keeping the holdover Board in office and Schwat in control of UIP—rendered it invalid "without regard to the fairness of the price."[51]

b. Because the McLean Valuation Used the Wrong Valuation Metric, the Court Erred in Holding that Defendants Met Their Burden to Show Fair Price

By all accounts, UIP was thriving on August 15, 2018—the date of the Stock Sale. It had approximately 100 employees, and enjoyed revenues exceeding [redacted]

50 *Basho Techs. Holdco B*, 2018 WL 3326693 at *38.

51 *Condec Corp.*, 230 A.2d at 776.

[redacted] during calendar year 2017. A300 [JX-66 at 7]. Despite this, the Board approved the sale of one-third of UIP's equity to Bonnell for $41,289.67. That purchase price equaled one-third of UIP's "fair market value" according to the McLean Valuation, hurriedly undertaken shortly after Coster filed the Custodian Action.[52]

Where, as here, board action results in a change of control and is challenged on fiduciary duty grounds, the proper valuation methodology under Delaware law is "fair value," not "fair market value."[53] The Court thus erred in relying on the McLean Valuation, which calculated only UIP's fair market value, as "the most reliable indicator of the fair value of UIP as of the date of the Stock Sale." Op. 64.[54]

In contrast to "fair market value," a "fair value" determination requires application of a control premium to a stock sale that results in a change of control

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[52] Before UIP even retained the McLean Group, Smith emailed Schwat to inform him that he had "had lunch with Jason Smolen yesterday . . . I casually mentioned the valuation issue of related party companies (not mentioning UIP or you, of course), he totally gets it and agrees that there is no value [to UIP]," to which Schwat replied, "Awesome." A283-286 [JX-56].

[53] *See, e.g.*, *Weinberger*, 457 A.2d at 712-14 (fair price measure in fiduciary breach case the same as the fair value standard applied in appraisal cases); *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987) (explaining that fair price measure in a breach of fiduciary duty case "flow[s] from the statutory provisions . . . designed to ensure fair value by an appraisal, 8 *Del. C.* § 262"); *see also* Op. 49.

[54] Although Coster made this argument in her post-trial briefing, A513-15 [Plaintiff's Opening Post-Trial Brief at pp. 36-38] and A569 [Plaintiff's Post-Trial Answering Brief at p. 24], the Court of Chancery did not address it in its Opinion. *See* Op. 48-64.

over the company.[55] Stated differently, the valuation of any minority stake under the "fair value" rubric must accord those shares their the "full proportionate value," which necessarily includes a control premium.[56] Conversely, the failure to apply a control premium to any such valuation improperly applies a *de facto* minority discount, which Delaware fair value rejects.[57]

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[55] *See Paramount Commc'ns Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del. 1994) ("The acquisition of majority status and the consequent privilege of exerting the powers of majority ownership come at a price. That price is usually a control premium . . . ."); s*ee also M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 525 (Del. 1999) ("*any* holding company's ownership of a controlling interest in a subsidiary at the time of the merger is an 'operative reality' and an independent element of value that must be taken into account in determining a fair value for the parent company's stock" (emphasis in original)); *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964) ("[I]t is elementary that a holder of a substantial number of shares would expect to receive the control premium as part of his selling price . . . ").

[56] *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1145 (Del. 1989) ("[T]o fail to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result.").

[57] *See Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*., 177 A.3d 1, 20-21 (Del. 2017) ("Because the court strives to value the *corporation* itself, as distinguished from a specific fraction of its *shares* as they may exist in the hands of a particular shareholder, the court should not apply a minority discount when there is a controlling stockholder.") (emphasis in original) (quotations omitted); *see also Agranoff v. Miller*, 791 A.2d 880, 897 n. 43 (Del. Ch. 2001) (the terms "'minority discount and a 'control premium' can be considered the inverse of one another because the term 'minority discount' is generally used to mean the difference between the value of control shares and the value of a minority share of a public company" (citations omitted)).

Here, the Court of Chancery found that Schwat and Bonnell "worked together to develop the [Stock Sale] plan to moot the Custodian Action and neutralize the threat of Plaintiff controlling the Company." Op. 41. The Stock Sale conferred to Schwat and his "good friend[]" Bonnell, Op. at 40, control over election of a new board—and thus control over UIP's operations and finances. As the Court of Chancery observed, at its core this case presents "a dispute over the control and ownership of" UIP. Op. 1.

Despite this, the McLean Valuation valued the shares sold to Bonnell on a *non-controlling* basis. *See* A370 [JX-81] at p. 5 (A. Smith Rebuttal Report, stating "we have properly assumed that the subject interest would not be a controlling interest; it would fundamentally be a minority interest that does not have outright control"). Andy Smith—who prepared the McLean Valuation—conceded that his report did not consider what value control over UIP had to Schwat and Bonnell, and he acknowledged that such control may well be worth more than $41,289.67 to Schwat, Bonnell, or Coster. A468-69 [Tr. 541-42]; A406 [Smith March Dep. Tr. 114].

In sum, by engineering the Stock Sale, Schwat and Bonnell appropriated for themselves control over UIP, which for them is worth far more than $41,289.67. It provided them—and them alone—the ability to direct the Company's resources and income in whatever manner they choose, and thus allowed them to continue to

block Coster from receiving any remuneration from the Company.[58] The Court of Chancery erred in concluding that "Defendants have carried their burden of proving that the price of the Stock Sale based on the McLean Valuation falls within a range of reasonable values." Op. 64.

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To summarize, the Court of Chancery erred in failing to require Defendants to prove a compelling justification for the Stock Sale. That error was dispositive, because the Court of Chancery's factual findings as to the Stock Sale's genesis and purpose preclude a conclusion under Delaware law that a compelling justification existed for it. Moreover, the Court's determination that the stock sale satisfied the entire fairness test and its acceptance of the McLean Valuation was in error. This Court should reverse the Court of Chancery's erroneous judgment in favor of Defendants on the validity of the Stock Sale and remand the case for consideration of the attorneys' fees issues raised by Coster below. *See* A538 [Coster's Opening Post-Trial Brief at 61].

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[58] *See In re Marriott Hotel Props. II Ltd. P'ship Unitholders Litig.*, 1996 WL 342040, at *5 (Del. Ch. June 12, 1996) ("[T]he right to direct the management of the firm's assets . . . gives rise to the phenomena of control premia.").

II. IF THE COURT REVERSES ON THE VALIDITY OF THE STOCK SALE, IT SHOULD REMAND FOR APPOINTMENT OF A CUSTODIAN

A. Question Presented

In the event this Court reverses the Court of Chancery's holding that the Stock Sale did not violate the Board's fiduciary duties to Coster, should this case be remanded for appointment of a custodian?[59]

B. Standard and Scope of Review

The Court's ruling in favor of Defendants on Coster's statutory claim for appointment of a Custodian is reviewed for abuse of discretion.[60]

C. Merits

If this Court holds that the Board breached its fiduciary duties in approving the Stock Sale, the parties would return to the *status quo ante*: a deadlock between the two fifty-percent owners (Coster and Schwat Realty) over appointment of directors. Rather than reward Defendants with further delay—delay that benefits Schwat given his current control over UIP (Op. 41-42)—this case should be remanded for appointment of a custodian.

Prior to the Stock Sale, there was no serious question as to whether appointment of a custodian was proper. The language of 8 *Del. C.* § 226(a)(1) is clear: where "the stockholders are so divided that they have failed to elect

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[59] Coster preserved this issue below in her Opening Post-Trial Brief (A519-29 [pp. 42-52]), and in her Post-Trial Answering Brief (A573-587 [pp. 28-42]).

[60] *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 240 (Del. 1982).

successors to directors whose terms have expired," the Court of Chancery "may appoint 1 or more persons to be custodians."[61] Because Coster and Schwat were unable to elect a board of directors, Coster proved her claim to relief under the statute.

This Court's decision in *Giuricich* is instructive, as that case presented shareholder deadlock virtually identical to the one here. In *Giuricich*, the plaintiffs owned fifty percent of a Delaware corporation and sought representation on the board of directors proportional to their interests in the company, having only two of the five board seats.[62] Plaintiffs called a special meeting of stockholders for the election of successor directors.[63] No director received more than 50% of the votes, resulting in a deadlock of stockholders and perpetuating the control of the existing, holdover directors.[64] This Court, noting that § 226(a)(1) requires no showing of "irreparable injury as a prerequisite to obtaining relief," ordered the appointment of a custodian, explaining that the failure to appoint a custodian would "leave the existing directors in perpetual control of the corporate entity, and would relegate the one-half owners of the corporation to a perpetual minority status without remedy or recourse."[65]

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61 8 *Del. C.* § 226(a)(1).
62 *Giuricich*, 449 A.2d at 235.
63 *Id.*
64 *Id.*
65 *Id.* at 237, 240.

Such are the circumstances here: Defendants intend to prolong their complete control of the Company for as long as possible, so they may continue to reap the financial benefits of the Company in the manner they choose. Absent appointment of a Custodian, Coster will be relegated to "perpetual minority status without remedy or recourse" in a Company of which she is the rightful one-half owner.[66]

Appointment of a custodian is the only viable remedy given Schwat's determination, as the Court of Chancery found, to avoid "any pressure from Plaintiff at the Board level." Op. 42. As a rightful fifty-percent owner, Coster has every right—just as much right as Schwat—to vote for directors who will represent her interests.

In sum, this case is the paradigmatic example of when a custodian is warranted. Coster requests that the case be remanded with instructions to appoint a custodian pursuant to § 226(a)(1), with the scope of the custodian's powers to be established by the Court of Chancery after briefing by the parties.[67]

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[66] *Id.* at 240; *see also Bentas v. Haseotes*, 769 A.2d 70, 76 (Del. Ch. 2000) (rejecting status quo because it would "permi[t] control of the corporation to remain indefinitely in the hands of a self-perpetuating board of directors").

[67] In summarizing its ruling, the Court of Chancery remarked that, "[a]t times, Plaintiff appears to argue that Defendants' conduct warrants the appointment of a custodian even absent a deadlock." Op. 65. This is incorrect. Nowhere in Coster's Verified Petition or elsewhere did Coster ever argue a legal basis, other than § 226(a)(1), for appointment of a custodian. Coster's allegations concerning

CONCLUSION

The Opinion of the Court of Chancery should be reversed, and the case remanded for (1) appointment of a custodian pursuant to 8 *Del. C.* § 226(a)(1), with the scope of custodian's powers to be determined by the Court of Chancery, and (2) for consideration of Coster's request below for an award of attorneys' fees.

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self-dealing and oppressive conduct by Defendants related to the *scope* of the custodian's powers, not to the appointment of one.