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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

APPELLANT MARION COSTER'S REPLY BRIEF

Max B. Walton (Bar No. 3876)
Kyle Evans Gay (Bar No. 5752)
CONNOLLY GALLAGHER LLP
267 East Main Street
Newark, DE 19711
(302) 757-7300
Attorneys for Plaintiff Below, Appellant Marion Coster

Of Counsel:
Michael K. Ross
Serine Consolino
Thomas E. Shakow
AEGIS LAW GROUP LLP
801 Pennsylvania Avenue, NW – Ste. 740
Washington, DC 2000

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INTRODUCTION

The essential facts requiring reversal are not in dispute. In June 2018, UIP's two fifty-percent shareholders deadlocked over the election of directors to replace the holdover Board. Given that deadlock, Coster exercised her statutory right to seek appointment of a custodian to, among other things, serve as "a neutral tie-breaker to facilitate director elections." Op. 25.

Upon filing of the Custodian Action, Schwat and his "good friend[]" Bonnell, Op. 40—two of the three holdover Board members—"worked together to develop the [Stock Sale] plan to moot the Custodian Action and neutralize the threat of Plaintiff controlling the Company." Op. 41. So doing "served [Schwat's] personal interest," Op. 41, by extinguishing Coster's ability to approve a new Board, mooting the Custodian Action, and maintaining his wide-ranging "management power" over UIP. Op. 40. The holdover Board—on which Coster had no representation—thus remained in office, as Schwat and Bonnell intended. *See* Op. 24.

The Board's conduct violates the fundamental principle that management may not "utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office."[1] Delaware law does not countenance such wanton treatment of any stockholder, let alone one with the 50% voting power to approve a

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[1] *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437, 439 (Del. 1971).

new Board and, in the face of a stockholder deadlock, to seek appointment of a custodian under Delaware statute. Where, as here, Board action "interfere[s] with or impede[s] the effective exercise of the shareholder franchise in a contested election for directors, the board must . . . demonstrate a compelling justification for such action . . . ."[2] The Court of Chancery's factual findings as to the timing, intent, and effect of the Stock Sale preclude a determination that any compelling justification existed for it.

Appellees' protestations that the "compelling justification" standard under *Blasius* and *MM Companies* is to be "applied rarely" are misplaced. Appellees' Answering Brief ("Ans. Br.") 25. This case involves a rare set of facts: the holdover Board—controlled by one of two fifty-percent stockholders—admits that it diluted the other fifty-percent shareholder in order "to moot the Custodian Action" and retain its control over the Company. Op. 30. Given its entrenchment purpose, the Court of Chancery should have cancelled the Stock Sale "without regard to the fairness of the price."[3]

Instead, the Court of Chancery erred by holding "that the Stock Sale satisfies the entire fairness standard." Op. 65. The Stock Sale met none of the *Weinberger*[4] fair-process indicia—hardly surprising given that Schwat expressly designed and

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

3 *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769, 776 (Del. Ch. 1967); *see also MM Cos.*, 813 A.2d at 1132.

4 *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

intended it to be unfair to Coster. As the Court of Chancery found, "[b]y placing stock in the hands of his friend, Schwat" eliminated the risk of "surrendering [his] power over UIP to an unknown custodian" and "mitigated any pressure from Plaintiff at the Board level." Op. 41-42.

The utter lack of fair process here should have "weigh[ed] heavily against a finding of [entire] fairness" of the transaction.[5] It did not. Instead, after noting that "price may be the preponderant consideration outweighing other features of the transaction," Op. 43 (internal quotation omitted), the Court of Chancery concluded that the McLean Valuation was enough for Appellees to meet "their burden to show that the Stock Sale satisfies the entire fairness standard." Op. 65.

This Court should reverse the judgment of the Court of Chancery in its entirety, and remand for appointment of a custodian pursuant to 8 *Del. C.* § 226(a)(1).

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[5] *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs*, 2018 WL 3326693, at *38 (Del. Ch. July 6, 2018), *aff'd sub nom. Davenport v. Basho Techs. Holdco B*, 221 A.3d 100 (Del. 2019).

ARGUMENT

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

Appellees offer a slew of flawed arguments as to why the "compelling justification" standard under *Blasius/MM Companies* should not apply to the Stock Sale. Not only are Appellees' arguments contrary to Delaware precedent, but, if accepted, they would fundamentally alter "the proper balance in the allocation of power between the stockholders' right to elect directors and the board of directors' right to manage the corporation . . . ."[6]

Equally flawed are Appellees' arguments concerning entire fairness. If the egregious facts surrounding the Stock Sale survive entire-fairness scrutiny, it becomes difficult to envision a transaction that would not. Allowing the Court of Chancery's ruling to stand thus would erode the "ideological underpinning" of decades of Delaware case law: the need to protect the "stockholder franchise" from interference by an incumbent board seeking to keep itself in office.[7]

1. The Court of Chancery Erred By Not Requiring Defendants to Show a Compelling Justification for the Stock Sale

As the Court of Chancery Opinion recognized, the appointment of a custodian under 8 *Del. C.* § 226(a) necessarily removes control from the incumbent board of directors. Op. 41-42. Without the availability of § 226(a) as a remedy, a

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[6] *MM Cos.*, 813 A.2d at 1127.

[7] *Id.* at 1126 (quoting *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988)).

shareholder deadlock leaves the incumbent board in "perpetual control" of the Company.[8]

To intentionally deprive a fifty-percent shareholder of her statutory right to seek the appointment of a custodian to serve as "a neutral tie-breaker to facilitate director elections," Op. 25, following a contested and deadlocked vote over election of directors is thus, *ipso facto*, an act undertaken to preserve directors' control and entrench the incumbent board. That conduct should be reviewed under *Blasius/MM Companies*, and the Court of Chancery erred by not doing so.

a. The Application of *Blasius/MM Companies* Does Not Require "All Shareholders" To Be Affected

Appellees' threshold argument—that *Blasius* review is only triggered when shareholders are affected "as a single class" (Ans. Br. at 26)—is contrary to Delaware law and is incorrect.

Appellees argue, incorrectly, that *Blasius* review applies exclusively to board conduct affecting "all shareholders' interests," and not to board conduct affecting only the "shareholder whose action may be thwarted." Ans. Br. at 23. To the contrary, Delaware courts apply *Blasius* to board actions which interfere with the rights of a *specific group* of shareholders to elect their preferred

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

directors—including *Blasius* itself.[9] As these cases illustrate, the prototypical *Blasius* trigger occurs when a group of shareholders attempt to replace an incumbent board, and in response, the incumbent board—usually controlled by a different group of shareholders—thwarts the vote of those shareholders who seek to replace it.

Appellees' gloss on *Blasius* is thus incongruous with the purpose of its enhanced standard of review: to protect the "stockholders' power" to elect directors of their choosing.[10] Contrary to Appellees' erroneous suggestion, the right to elect directors is a right belonging to *each* shareholder, and does not depend on whether the board also has interfered with the voting rights of the other shareholders.[11]

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[9] *See, e.g.*, *Blasius*, 564 A.2d at 663 (invalidating board action directed against 9% shareholder); *MM Cos.*, 813 A.2d at 1132 (invaliding board action directed against 7% shareholder); *WNH Investments, LLC v. Batzel*, 1995 WL 262248, at *1 (Del. Ch. Aug. 28, 1995) (invalidating board action directed against 38% shareholder).

[10] *See MM Cos.*, 813 A.2d at 1126-27 ("[I]f the stockholders are not satisfied with the management or actions of their elected representatives on the board of directors, the power of corporate democracy is available to the stockholders to replace the incumbent directors when they stand for re-election."); *see also EMAK Worldwide, Inc. v. Kurz*, 50 A.3d 429, 433 (Del. 2012) ("Shareholder voting rights are sacrosanct. The fundamental governance right possessed by shareholders is the ability to vote for the directors the shareholder wants to oversee the firm. Without that right, a shareholder would more closely resemble a creditor than an owner.").

[11] Notably, numerous cases in which Delaware courts have applied *Blasius* have been brought by shareholders individually and not derivatively. *See, e.g.*, *MM Cos.*, 813 A.2d at 1123; *WNH Investments, LLC*, 1995 WL 262248, at *1; *Chesapeake Corp. v. Shore*, 771 A.2d 293, 297 (Del. Ch. 2000).

b. The Court of Chancery's Factual Findings Establish That the Board's "Primary Purpose" of the Dilutive Stock Sale Was To Moot the Custodian Action

Appellees also contend that *Blasius/MM Companies* do not apply because the Court of Chancery "explicitly reject[ed] Mrs. Coster's contention that the 'Stock Sale's primary purpose was to disenfranchise her.'" Ans. Br. at 26-27 (internal quotation omitted). Appellees' contention is wrong. Although the Court of Chancery did not use the phrase "primary purpose" in its factual findings—not surprising given that it did not engage in a *Blasius* analysis—the trial court's findings leave no doubt that the Board's purpose in approving the Stock Sale was to interfere with Coster's powers as a fifty-percent owner to approve a new Board and, in the wake of the stockholder deadlock, to seek appointment of a custodian to serve as "a neutral tie-breaker to facilitate director elections." Op. 25.

Specifically, the Court of Chancery found that the Stock Sale was "*significantly motivated* by a desire to moot the Custodian Action" in order to "eliminate Plaintiff's ability to block stockholder action, *including the election of directors*, and the leverage that accompanied those rights." Op. 29-30 (emphasis added). The Court of Chancery also found that, in response to Coster filing the Custodian Action, Schwat and Bonnell "worked together to develop the plan to moot the Custodian Action and *neutralize the threat of Plaintiff controlling the Company.*" Op. 41 (emphasis added). "By placing stock in the hands of his

friend," the Court found, Schwat eliminated the risk of "surrendering [his] power over UIP to an unknown custodian" and "*mitigated any pressure from Plaintiff at the Board level.*" Op. 41-42 (emphasis added). These factual findings—none of which Appellees contest—foreclose any suggestion that mooting the Custodian Action was anything other than the Board's chief motive in approving the Stock Sale.

The timing of a board's action is also relevant to the question of purpose. In *MM Companies*, this Court held that because the "incumbent Board timed its utilization of [] 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," its purpose was "inequitable."[12]

Here, the Court of Chancery similarly found that the "timing of the sale . . . make[s] clear that the Stock Sale was significantly motivated by a desire to moot the Custodian Action." Op. 29-30. Indeed, Appellees concede this fact. *See* Ans. Br. at 16 (admitting that "the timing of the transaction was certainly driven in large

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[12] *MM Cos.*, 813 A.2d at 1132 (quoting *Schnell*, 285 A.2d at 439); *see also Blasius*, 564 A.2d at 656 (invalidating board action because "[t]he timing of these events is . . . consistent only with the conclusion that Mr. Weaver and Mr. Masinter originated, and the board immediately endorsed, the notion of adding these competent, friendly individuals to the board, not because the board felt an urgent need to get them on the board immediately for reasons relating to the operation of Atlas' business, but because to do so would, for the moment, preclude a majority of shareholders from electing eight new board members selected by Blasius.").

measure by the Custodian Action"). Only after Coster filed the Custodian Action did Schwat and Bonnell "work[] together to develop the [Stock Sale] plan to moot the Custodian Action and neutralize the threat of Plaintiff controlling the Company." Op. 41. The Board then filed its Amended Answer—in which claimed the Custodian Action was now "moot"—within hours of the Stock Sale's execution. Op. 29. Given these findings, the "timing and effect of the dilutive issuance was [not] coincidental" and "compel the conclusion that the purpose of the dilutive issuance was to defeat the challenge to the board's control."[13]

That the Court of Chancery made additional factual findings about the Board's other, purported incidental motivations for the Stock Sale—does not remove the Board's conduct from the purview of *Blasius/MM Companies.* Even if the stock issuance was motivated, in part, by other considerations, the trial court's factual findings make clear that the Board's primary objective was to moot the Custodian Action so that it could remain in office and in control of UIP. As held in *Condec Corp. v. Lunkenheimer Co.*, "where [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 . . . is merely incidental to its primary business objective."[14]

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13 *WNH Investments*, 1995 WL 262248, at *6.

14 *Condec Corp.*, 230 A.2d at 776; *see also Packer v. Yampol*, 1986 WL 4748 (Del. Ch. Apr. 18, 1986) ("An inequitable purpose can be inferred where the

To be sure, if the Board's motivating concern in diluting Coster's voting power truly was that appointment of a custodian would harm the Company—and the contemporaneous emails between Appellees and their counsel indicate that it was not[15]—Schwat could have worked with Coster to find a mutually-agreeable slate of directors. It is risible to suggest that Schwat's only recourse was to dilute Coster's voting power so that she no longer had power to approve a new Board.

Finally, Appellees erroneously contend that Coster failed to meet her "burden" of proving that Defendants' "primary purpose" was to moot the Custodian Action. *See* Ans. Br. at 27. According to Appellees, Coster "failed to show an improper motivation triggering the compelling justification standard in the first place." Ans. Br. 28 (emphasis removed). Here, Appellees conflate the Board's "purpose" with its "justification"—"two separate analyses that must remain distinct."[16] As the Court of Chancery found, Schwat and Bonnell

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directors' conduct has the effect of being unnecessary under the circumstances, of thwarting shareholder opposition, and of perpetuating management in office.").

[15] 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 break the existing shareholder deadlock over election of directors. A305 [JX-59 at 2]. The document by which the Board approved the Stock Sale—the Unanimous Written Consent of the Board of Directors of UIP—similarly makes no mention of any concern over the "deleterious" effects of a custodian. *See* A358-360 [JX-68].

[16] *State of Wisconsin Inv. Bd. v. Peerless Systems Corp.*, 2000 WL 1805376, at *11 (Del. Ch. Dec. 4, 2000) ("[I]nquiries into *purpose* as opposed to *justification* are two separate analyses that must remain distinct. The question of *purpose* asks for what ultimate ends were the acts committed. Purpose is defined as '[a]n

concocted the Stock Sale "plan" in order "to moot the Custodian Action." Op. 41. By executing on that plan, they averted appointment of a custodian to serve as "a neutral tie-breaker to facilitate director elections," Op. 25, thus maintaining the holdover Board in office and "neutraliz[ing] the threat of Plaintiff controlling the Company." Op. 41.

Once it found that the Board's *purpose* was "to moot the Custodian Action," *see* Op. 41, the Court of Chancery should have shifted the burden—which is a "heavy" one—to Appellees to prove that their purported *justifications* for the Stock Sale were "compelling."[17] As detailed in Coster's Opening Brief, each of Appellees' two proffered justifications—(1) that the appointment of a custodian would be "deleterious" to the Company, and (2) a sudden need to keep a supposed promise to Bonnell made four years prior—falls far short of "compelling" under these facts. *See* Opening Br. 26-28. Instead of holding Appellees to their "heavy burden" under *Blasius* and *MM Companies*,[18] the Court of Chancery got it backwards by concluding that Coster "did not succeed in proving" that each of Appellees' proffered justifications for the Stock Sale was pretextual. Op. 32.

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objective, goal, or end.' The concept of *justification* concerns the rationale behind the search for that end. *Justification* is defined as "[a] lawful or sufficient reason for one's acts or omissions.'").

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

18 *Id.*

c. *Blasius/MM Companies* Applies to Stock Sales

Third, and finally, Appellees attempt to avoid the application of *Blasius* and *MM Companies* by characterizing the dilutive stock sale as a "transaction" as opposed to an "action." *See* Ans. Br. at 31. This purported distinction is found nowhere in *Blasius* or its progeny. As this Court has made clear, the relevant inquiry is solely whether "the defensive action taken by an incumbent board of directors [was] for the primary purpose of interfering with and impeding the effectiveness of the shareholder franchise in electing successor directors."[19] *Blasius* itself held that the enhanced "compelling justification" standard applies to cases dealing with the question of "who should comprise the board of directors."[20]

In support of their argument that the *Blasius* standard of review does not apply to "transactions," Appellees imply that no Delaware case has ever applied *Blasius* review to a stock sale. *See* Ans. Br. at 31. Appellees are mistaken. In *WNH Investments, LLC v. Batzel*, the Court of Chancery applied *Blasius* to a cancel a stock sale where the "true purpose [of the board's dilutive issuance] was to defeat plaintiff's challenge to their control."[21] There, the Court of Chancery affirmed the principle that a stock issuance made "for the primary purpose of

19 *MM Cos.*, 813 A.2d at 1131.
20 *Blasius*, 564 A.2d at 663.
21 1995 WL 262248, at *8.

keeping control" must be set aside under *Blasius*.[22] And, although they pre-date *Blasius*, at least two other Delaware decisions, both cited by *Blasius*, have invalidated stock issuances by boards whose "primary purpose" was to retain control.[23]

Next, Appellees selectively quote *Mercier v. Inter-Tel* to argue that *Blasius* does not apply to "garden variety" matters such as the Board's stock sale here. *See* Ans. Br. at 30. In fact, the *Mercier* court specifically distinguished "garden variety" matters from those "*touching on matters of corporate control*," observing that *Blasius* appropriately applies to the latter.[24] A dilutive stock sale whose purpose is to thwart a fifty-percent shareholder's attempt to unseat an incumbent board is no "garden variety" stock sale, but rather one that unquestionably "touch[es] on matters of corporate control."[25] To contend otherwise ignores the Court's own findings that the Stock Sale was "significantly motivated" by the

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22 *See id.*

23 *See Condec Corp.*, 230 A.2d at 775 ("I have reached the conclusion that the primary purpose of the issuance of such shares was to prevent control of Lunkenheimer from passing to Condec and to cause such control to pass into the hands of U.S. Industries."); *Phillips v. Insituform of North America, Inc*., 1987 WL 16285, at *8 (Del. Ch. Aug. 27, 1987) (quoting *Canada Southern Oils, Ltd. v. Manabi Exploration Co.*, 96 A.2d 810 (Del. Ch. 1953) ("When the undisputed facts are viewed cumulatively, I find it reasonable to infer that the primary purpose behind the sale of these shares was to deprive plaintiff of the majority voting control.").

24 *Mercier v. Iner-Tel (Del.) Inc.*, 929 A.2d 786, 811 (Del. Ch. 2007) (emphasis added).

25 *Id.*

Board's desire to maintain control of the Company—as well as Appellees' own admission that it was motivated to "break" the deadlock. *See* Op. 29-30; *see also* Ans. Br. at 43 ("In this case, there was a means to break the deadlock, and the Company took advantage of it."). Indeed, the Court of Chancery's own Opinion characterizes the parties' entire dispute as one over the "control and ownership" of UIP. *See* Op. 1. Appellees' attempt to attach the meaningless label of "transaction" to the Stock Sale to avoid *Blasius* is without merit.

Lastly, Appellees cite *Keyser v. Curtis*[26]—wherein the Court of Chancery applied the "entire fairness" standard rather than *Blasius* to review a dilutive stock sale—to support their argument that *Blasius* does not apply to stock sales. *See* Ans. Br. at 31. Appellees' citation does not withstand scrutiny. In *Keyser*, the company's sole director sold himself stock "at a bargain price" in order to prevent the company's shareholders from removing him from office.[27] Although the Court of Chancery reviewed the Stock Sale under the "entire fairness" standard, it did so because the Stock Sale was—in addition to being preclusive—a self-interested transaction. The clear implication of the Court of Chancery's holding is that the director's conduct failed *both* the entire fairness and *Blasius* standards of review: indeed, the court described the director's conduct—"issuing stock in order to prevent [plaintiff] and his allies from electing a new Board"—as the

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26 2012 WL 3115453 (Del. Ch. July 21, 2012).

27 *Id.* at *13.

"quintessential *Blasius* trigger."[28] The court thus did not avoid subjecting the director's conduct to *Blasius*-type scrutiny; instead, the court applied the enhanced scrutiny of *Blasius within* its "entire fairness" review, concluding that:

> Where . . . a corporation's sole director issues corporate stock to himself at a bargain price 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. **The only way that showing might be made would be if it could be proved that the director had a very powerful justification for issuing the stock.**[29]

In sum, *Keyser* does not, as Appellees claim, obviate the compelling justification standard established in *Blasius/MM Companies.*

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

Having found that Schwat's very purpose in orchestrating the Stock Sale was "to mitigate any pressure from Plaintiff at the Board level" resulting from her fifty-percent ownership interest, Op. 41, the Court of Chancery should have

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[28] *See id.* at *12.

[29] *Id.* at *13 (emphasis added). The Court of Chancery in *Keyser* further observed that "[a] similar application of the entire fairness doctrine has been advocated by a member of this Court, although not in a judicial opinion. *See* Leo E. Strine, Jr., et al, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 Geo. L.J. 629, 676 n.174 (2010) ("In our view, one might consider *Blasius* as involving a specialized form of the entire fairness doctrine, whereby even if directors are acting in subjective good faith, they cannot act to prevent their own unseating without demonstrating a very powerful justification for their self-serving conduct."). *Id.* at *13 n.129.

invalidated the Stock Sale "without regard to the fairness of the price" under this Court's precedents.[30] Instead, the Court of Chancery went on to review the Stock Sale for entire fairness, erroneously concluding that it was "[e]ntirely [f]air." Op. 64.

a. Appellees Ignore the *Weinberger* Fair-Process Indicia, None of Which Were Present Here

As the Court of Chancery found, the process of the Stock Sale was "by no means optimal." Op. 48. Coster's opening brief demonstrates that "[n]one of the traditional [*Weinberger*][31] indicia of fairness were present" with regard to the Stock Sale. Op. Br. at 35. Strikingly, Appellees do not challenge this assertion. Nowhere does the Answering Brief even attempt to argue that the circumstances of the Stock Sale satisfied the *Weinberger* indicia of fair process. Nor could they - the Stock Sale was expressly designed to extinguish Coster's ability to approve a new Board, to moot the Custodian Action, and to keep the holdover Board in office and Schwat's firmly in control of UIP. Op. 29-30, 41-42. The transaction was inherently unfair to Coster, as intended by Appellees.

Rather than address the *Weinberger* factors—which weigh decidedly against a finding of fair process—Appellees chide Coster for supposedly ignoring that

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30 *Condec Corp.*, 230 A.2d at 776; *see also MM Cos.*, 813 A.2d at 1132; *Blasius*, 564 A.2d at 658 (citing *Schnell v. Chris Craft Industries, Inc.*, 285 A.2d 437 (Del. 1971) and *Giuricich v. Emtrol Corp.*, 449 A.2d 232 (1982)).

31 *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

Schwat caused the Company to engage "the McLean Group to conduct an independent valuation of the Company." Ans. Br. at 34. Aside from the obvious—that the McLean Valuation relates to the fair price component of "entire fairness" review, not to fair process—the McLean Valuation, hurriedly completed without Coster's knowledge after she filed the Custodian Action, only underscores the abject lack of fair process here. Even before being engaged or reviewing any Company records, the McLean Valuation's author, Andy Smith, eagerly reported to Schwat that a lunch companion also believed "that there is no value [to UIP]," to which Schwat replied, "Awesome." A283-286; A480-81 [JX-56; Tr. 539-40].[32]

Next, Appellees conflate the Vice Chancellor's findings regarding the length of time it took Smith to complete his valuation (approximately two weeks, Op. 44) with the timing of the Stock Sale transaction. *See* Ans. Br. at 35 (citing Op. 44, which notes that "Smith arrived at his valuation over a span of approximately two weeks."). It is the latter—the timing of the Stock Sale—that matters under *Weinberger*,[33] and it is undisputed that Appellees timed the Stock Sale in order to "moot the Custodian Action and neutralize the threat of Plaintiff controlling the

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[32] Appellees quote a July 27, 2018 email from Schwat to Smith purporting to instruct him not "to hurry your valuation . . . ." Ans. Br. at 14. Notably, however, Schwat sent this self-serving email only after having accidentally sent a non-privileged email to Smith (on which he copied Appellees' litigation counsel) admonishing him that UIP was "in a rush for the valuation" given the impending answer deadline in the Custodian Action. A287-288 [JX-58 at 1].

[33] *Weinberger*, 457 A.2d at 711.

Company." Op. 41; *see also* Ans. Br. at 16 (conceding that "the timing of the transaction was certainly driven in large measure by the Custodian Action").

Lastly, Appellees cite the Vice Chancellor's conclusion that their failure to offer the stock sold to Bonnell to anyone else was "not a process defect." Ans. Br. at 35 (citing Op. 44). But whether a market check was performed pertains to the issue of fair price, not fair process; it is not among the fair-process indicia identified in *Weinberger*.[34]

In sum, given the abject lack of fair process, the Court of Chancery erred in concluding that "[t]he Stock Sale [i]s [e]ntirely [f]air." Op. 64.[35] While Appellees are correct that "the test for [entire] fairness is not a bifurcated one as between fair dealing and price," it is also true that where, as here, "the process was decidedly unfair," the fair-process component "weighs heavily against a finding of [entire] fairness" of the transaction.[36]

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[34] *Id*.

[35] Appellees' citation to *In re Trados Inc. Shareholder Litigation*, 73 A.3d 17, 78 (Del. Ch. 2013) is unavailing. There, the Court of Chancery found that the price received by the common stockholders in a merger was fair because the company "did not have a realistic chance of generating a sufficient return to escape the gravitational pull of the large liquidation preference and cumulative dividend," and therefore, the common stock "had no economic value before the [m]erger." *Id*. at 77-78. "In light of this reality," despite employing an unfair process, the court held that the directors had established that the merger was entirely fair—and specifically distinguished the "circumstances of [that] case" from situations where "an unfair process can infect the price." *Id.* at 78.

[36] *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs*, 2018 WL 3326693, at *36, *38 (Del. Ch. July 6, 2018), *aff'd sub nom. Davenport v. Basho*

b. Because the McLean Valuation Valued the Defendant Bonnell's Shares On a Noncontrolling Basis, the Court Erred in Holding that Defendants Met Their Burden to Show Fair Price

As detailed in the Opening Brief, the Court of Chancery erred in holding that the McLean Valuation "falls within a range of reasonable value," Op. 64, because it improperly valued Bonnell's shares on a non-controlling basis.[37]

In response, Appellees insist "the price paid by Mr. Bonnell did not reflect a minority discount for lack of control." Ans. Br. at 36. That statement is directly contradicted by both the Court of Chancery's factual findings (Op. 28) as well as *Appellees' own expert*, who unambiguously testified that the McLean Valuation valued Bonnell's shares on a "noncontrolling" basis. A406 [Smith March Dep. Tr. 114]. Appellees' expert also conceded at trial that control of the Company may be worth well more than $41,289.67 to Schwat, Bonnell, or Coster. A468-69 [Tr. 541-42]. Appellees fail to address these facts in their Answering Brief, presumably because they cannot.

Techs. Holdco B, 221 A.3d 100 (Del. 2019); *see also Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 467 (Del. Ch. 2011) ("A strong record of fair dealing can influence the fair price inquiry, reinforcing the unitary nature of the entire fairness test. The converse is equally true: process can infect price") (citing *Bomarko, Inc. v. Int'l Telecharge Inc.*, 94 A.2d 1161, 1183 (Del. Ch. 1999) ("[T]he unfairness of the process also infects the fairness of the price."), *aff'd*, 766 A.2d 437 (Del. 2000)).

[37] It is perplexing that Appellees insist that Appellant "has it []backwards" in their contention that terms "control premium" and "minority discount" can be considered the inverse. Ans. Br. at 36. Appellant makes this very point in her Opening Brief.

Appellees further cite *Dobler v. Montgomery Cellular Holding Co., Inc.*[38] for the proposition that a DCF analysis needs no normalizing adjustments. But in *Dobler*, the court declined to make normalizing adjustments because valuation in question had "already corrected for [control] of the company by modifying [its] inputs."[39] Here, that did not happen: the McLean Valuation failed to account for the Board's intentional decision to structure the Company to realize "breakeven profits . . . in order for the underlying real estate investments [the SPEs in which Schwat and Bonnell have ownership interests] to realize more profits,"[40] resulting in the improbably low valuation of $123,869 for a Company whose yearly revenues exceed tens of millions of dollars. The Court of Chancery thus erred in concluding that the McLean Valuation enabled Appellees to meet the "burden to show that the Stock Sale satisfies the entire fairness standard." Op. 65.

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38 *Dobler v. Montgomery Cellular Holding Co., Inc.*, 2004 WL 2271592, at *17 (Del. Ch. Oct. 4, 2004) *judgment entered sub nom.* 2004 WL 5382076 (Del. Ch. Oct. 13, 2004), *aff'd in part, rev'd in part sub nom. Montgomery Cellular Holding Co., Inc. v. Dobler*, 880 A.2d 206 (Del. 2005).

39 *See* Op. at 29 (citing the McLean Valuation).

40 *See* Op. at 28 n.180 (draft of McLean Valuation noting that "[b]ased on information provided by management," the Company "is designed to provide breakeven profits"); *see also* A306 [JX-66] (final version of McLean Valuation stating that "[b]ased on information provided by management, the vast majority of profits to the owners have been generated through the SPEs and not the UIP Companies").

II. THE COURT SHOULD REMAND FOR APPOINTMENT OF A CUSTODIAN

In this fight over the "control and ownership" of UIP, Op. 1, the Court of Chancery found that Coster, despite owning fifty percent of the Company, "could not reduce Schwat's control [over UIP], terminate his employment [as president], or effect change to any member of Schwat's team." Op. 40. In order to maintain his iron-grip control over UIP, Schwat voted against each slate of directors proposed by Coster, Op. 21-24, leaving the two shareholders deadlocked over the appointment of a new Board. Op. 24. Given the deadlock, Coster exercised her statutory remedy of seeking appointment of a custodian under 8 *Del. C.* § 226(a)(1).

The situation here is substantively indistinguishable from that in *Giuricich*, another § 226(a)(1) case. As this Court noted in *Giuricich*, a refusal by the Court of Chancery 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."[41]

It cannot reasonably be disputed that the same will occur here if this Court cancels the Stock Sale. The Court of Chancery's factual findings establish beyond peradventure that there is no realistic prospect that Schwat, upon a cancellation of the Stock Sale by this Court, will ever consent to appointment of a new Board

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41 *Giuricich*, 449 A.2d at 240.

approved by Coster. A custodian should be appointed pursuant to 8 *Del. C.* §226(a)(1) to break the deadlock between the two rightful fifty-percent stockholders of UIP.

CONCLUSION

The Opinion of the Court of Chancery should be reversed, and the case remanded for 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.

CONNOLLY GALLAGHER LLP

/s/ Max B. Walton

Max B. Walton (Bar No. 3876)
Kyle Evans Gay (Bar No. 5752)
267 East Main Street
Newark, Delaware 19711
Telephone: (302) 757-7300
Facsimile: (302) 757-7292
mwalton@connollygallagher.com
kgay@connollygallagher.com

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Attorneys for Plaintiff Below, Appellant, Marion Coster