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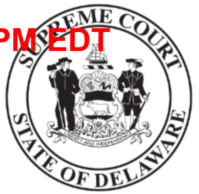

IN THE
Supreme Court of the State of Delaware

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
Appellees-Below, Appellees.

PUBLIC VERSION FILED: AUGUST 25, 2022
NO. 163,2022
On Appeal from the Court of Chancery of the State of Delaware, C.A. No. 2018-0440-KSJM

APPELLANT MARION COSTER'S REPLY BRIEF

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INTRODUCTION

Appellees' Answering Brief largely ignores the principal factual finding that requires reversal under *Schnell v. Chris-Craft Indus. Inc.*[1] ("*Schnell*"). Specifically, the Court of Chancery explicitly found on remand that one of the Board's purposes in undertaking the Stock Sale "was inequitable"—namely, "the UIP board's desire to eliminate Plaintiff's ability to block stockholder action, including the election of directors, and the leverage that accompanied those rights."[2]

This finding of inequitable purpose alone requires reversal of the Stock Sale under *Schnell* because, as this Court held in reversing the First Opinion (hereinafter the "Appellate Decision"), "[i]f the board approved the Stock Sale for inequitable reasons, the Court of Chancery should have cancelled the Stock Sale [under *Schnell*]."[3] Yet, the Court of Chancery did not cancel the Stock Sale as required by the Appellate Decision, even though on remand it again found that the Board's

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1 285 A.2d 437 (Del. 1971); *Coster v. UIP Cos.*, 255 A.3d 952, 962 (Del. 2021).

2 Second Opinion ("Second Op.") at 21. A copy of the First and Second Opinions are attached as Exhibits A and B to Coster's Opening Brief.

3 *Coster,* 255 A.3d at 953; *see also id.* at 963 ("Coster alleged that an interested board approved the Stock Sale intending to interfere with her voting rights as a 50% stockholder and to entrench themselves in office by thwarting the Custodian Action. If that is the case, under *Schnell*, the court need not go any further to find a breach of fiduciary duty.").

"multiple reasons"[4] for the Stock Sale included "problematic purposes that the [First Opinion] identified and the Appellate Decision collected."[5] Instead of adhering to this Court's instructions on remand, the Court of Chancery reached the novel conclusion that *Schnell*'s inequitable-purpose rule "does not apply in this case"[6] because the Board "did not totally lack a good faith basis" for the Stock Sale.[7] That conclusion, in light of the Court's finding of inequitable purposes, constitutes legal error. It is contrary to *Schnell* and it should be reversed.

The Court of Chancery's holding that *Schnell* applies only in "the limited scenario"[8] in which a board takes action "exclusively for an inequitable purpose"[9] finds no support under Delaware law and effectively reads *Schnell* out of existence. It places an extraordinarily heavy burden on Plaintiffs to disprove every proffered business reason when disenfranchising board action is challenged. A modicum of good faith should not be allowed to excuse a board's inequitable action that harms the voting rights of a stockholder—here, Coster's "ability to block stockholder action, including the election of directors, and the leverage that accompanied those

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4 Second Op. 21; *see also id.* at 10-11 (noting that Appellees' "genuine motivations for their actions that stood alongside the more problematic purposes that the [First Opinion] identified and the Appellate Decision collected").

5 *Id.* at 11.

6 *Id.* at 22.

7 *Id.* at 21.

8 *Id.* at 19.

9 *Id.* at 22.

rights."[10] Instead, this Court should reaffirm the continuing validity of Chancellor Allen's *Blasius* reasoning by holding that disenfranchising action by a conflicted board violates *Schnell*—and thus constitutes a breach of fiduciary duties without resort to *Blasius*'s "compelling justification" test—if motivated "in any important respect" by the board's self-interest.[11]

Appellees' contention that "if *Schnell* applies as Coster argues it does, *Blasius* would be superfluous"[12] is demonstrably wrong. Coster does not contend that all board "action intended to impede shareholder voting rights"[13] is invalid under *Schnell*. Rather, Coster contends that board action that interferes with a stockholder's voting rights is invalid under *Schnell* if motivated in any important respect by the board's self interest, as is the case here with respect to the Stock Sale. If, and only if, no such self-interested motive exists, then the board has acted in good faith and the challenged action is *thereafter* subjected to the *Blasius* "compelling justification" review. In no way does Coster's reading of *Schnell* and its progeny render *Blasius* "superfluous."[14]

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[10] *Id.* at 21.
[11] *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 658 (Del. Ch. 1988).
[12] Answering Br. 29.
[13] *Id.*
[14] *Id.*

Even if Appellees' inequitable conduct here could be excused under *Schnell*, the Court committed legal error in its application of the *Blasius* "compelling justification" test. The Court of Chancery improperly relied on legally impermissible considerations, such as Wout Coster's purported wishes and Coster's supposed motive in filing the Custodian Action. In addition, the ruling impermissibly undermines § 226(a)(1) by allowing Appellees, via self help, to usurp the Court of Chancery's role under § 226(a)(1). No exigent circumstances existed with respect to the two "compelling justifications" identified by the Court of Chancery for the Stock Sale: (1) potential termination of UIP contracts by

counterparties, and (2) a desire to reward Bonnell with UIP equity.[15] Even if *Blasius* controls, the Court of Chancery's decision should be reversed.[16]

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[15] Second Op. 26-27.

[16] The Answering Brief repeatedly references other litigation between the parties outside of Delaware. Answering Br. 1, 11, and 11 n.31. But those cases are not part of the record below, were not mentioned or relied upon by the Court of Chancery, and arise out of wrongful conduct by Appellees towards Coster with respect to entities other than UIP. They have nothing to do with the issues presented in this appeal. *See Coster v. Schwat*, *et al.*, Civil Action No. 18-CV-1995 (D.D.C.) (asserting, among other claims, fraud with respect to Schwat and Bonnell surreptitiously selling a $29.4 million parcel of commercial property to themselves for just $12.5 million, depriving co-investor Coster of several million dollars of profit); *Coster Realty, et al. v. Schwat, et al.*, Case No. 2020 CA 001430 B (D.C Super. Ct.) (alleging improper diversion of profit distributions to Bonnell that rightfully were owed to Coster); *Coster Realty v. Schwat Realty, et al.*, Case No. 481393-V (Montgomery Co. Cir. Ct.) (same, plus allegation that Schwat and Bonnell wrongfully deducted hundreds of thousands of dollars from distribution payments made to Coster); *Coster Realty v. Schwat, et al.*, Case No. 2022 CA 003108 B (D.C. Super. Ct.) (alleging that Schwat and Bonnell, without Coster's knowledge or consent, purported to amend an LLC operating agreement to which Coster was a party to extinguish her "promote" interest potentially worth millions of dollars in major commercial development project currently underway in Washington, D.C.).

ARGUMENT

I. HAVING FOUND THAT THE BOARD ACTED WITH INEQUITABLE PURPOSES, THE COURT OF CHANCERY SHOULD HAVE CANCELLED THE STOCK SALE UNDER *SCHNELL*

In both its First and Second Opinions, the Court of Chancery found that the Board acted with inequitable purposes in orchestrating and approving the Stock Sale.[17] Yet, in the Second Opinion, the Court of Chancery rewrote Delaware law—including this Court's Appellate Decision—by holding that *Schnell* "does not apply in this case"[18] because the Board did not act "exclusively for an inequitable purpose."[19] As detailed in Coster's Opening Brief, that exceedingly narrow reading of *Schnell* constitutes legal error.[20] This Court should reverse and expressly hold that a breach of fiduciary duty occurs under *Schnell* where, as here, disenfranchising action is taken against a stockholder (or group of stockholders) by a board of directors motivated "in any important respect" by the board's self-interest.[21] Only

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[17] Second Op. 21 ("the board's desire to eliminate Plaintiff's ability to block stockholder action, including the election of directors and the leverage that accompanied those rights was inequitable.") (internal quotation omitted); *id.* ("UIP board had multiple reasons for approving the Stock Sale. Some were problematic."); [*id.* at 10-11 (defendants' "genuine motivations for their actions . . . stood alongside the more problematic purposes that the [First Opinion] identified and the Appellate Decision collected.").]

[18] *Id.* at 22.

[19] *Id.*

[20] Opening Brief ("Opening Br.") 17-30.

[21] *Blasius*, 564 A.2d at 658.

if no such self-interested motive exists has the board acted with the good faith required to trigger *Blasius* review instead of cancellation under *Schnell*.

Appellees' contrary contentions should be rejected for three reasons. First, Court of Chancery's finding that a principal purpose of the Stock Sale "was inequitable" mandates cancellation of the transaction under the command of the Appellate Decision.[22] Second, Appellees are wrong in contending that *Schnell*'s applicability already presupposes "self-interested/inequitable" action by a board.[23] Third, Appellees are equally wrong in suggesting that "if *Schnell* applies as Coster argues it does, *Blasius* would be superfluous."[24]

A. Appellees Ignore the Trial Court's Finding of Inequitable Intent by UIP's Board to Extinguish Coster's Blocking Rights and the Leverage it Provided

At least five times,[25] Coster's Opening Brief cites the Court of Chancery's finding on remand that "the UIP board's desire to eliminate Plaintiff's ability to block stockholder action, including the election of directors and the leverage that accompanied those rights was inequitable."[26] Despite this, Appellees barely

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22 *Coster*, 255 A.3d at 954 ("After remand, if the court decides that the board acted for inequitable purposes . . . it should cancel the Stock Sale and decide whether a custodian should be appointed for UIP").

23 Answering Br. 23.

24 *Id*. at 29.

25 Opening Br. 3, 15, 17, 19, and 30.

26 Second Op. 21 (internal quotation omitted).

acknowledge this critical finding in their Answering Brief.[27] Appellees' failure to address it is especially stark given this Court's framing of the issue requiring an equitable review on remand: "that an interested board approved the Stock Sale to interfere with [Coster's] voting rights and leverage as an equal stockholder."[28]

B. Appellees Are Wrong that Invalidation of Board Action Under *Schnell* Requires Something More than a Finding of a Self-Interested Motive by the Board

Faced with express findings on remand that they acted with "inequitable" purposes in undertaking the Stock Sale,[29] Appellees attempt to minimize the significance of this finding by misstating and misapplying the *Schnell* doctrine. According to Appellees, a finding of a self-interested/inequitable motive for board action is a "necessary" but not "sufficient basis for triggering invalidation under *Schnell*."[30] Appellees are wrong as a matter of law.

As this Court instructed in its Appellate Decision, "if the [trial] court decides [on remand] that the board acted for inequitable purposes . . . it should cancel the

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[27] At one point, the Answering Brief even goes so far as to state the polar opposite of the Court of Chancery's finding. *Compare* Answering Brief ("Answering Br.") 28 Heading 2 "The Court of Chancery Correctly Determined that the Reduction of Coster's Leverage as a 50% Shareholder Was Not Inequitable") *with* Second Op. 21 ("the UIP board's desire to eliminate [Coster's] ability to block stockholder action, including the election of directors, and leverage that accompanied those rights was inequitable") (internal quotation omitted).

[28] *Coster,* 255 A.3d at 963; *see also id*. at 960.

[29] Second Op. 21.

[30] Answering Br. 23.

Stock Sale and decide whether a custodian should be appointed for UIP."[31] No additional showing is required. Only if, on remand, the trial court "finds that the board acted in good faith when it approved the Stock Sale"—that is, ***without an inequitable purpose***,—is a compelling-justification review under *Blasius* necessary.[32]

As to the quantum of self-interest required to invalidate board action under *Schnell* as inequitable, *Blasius* provides the answer. There, Chancellor Allen observed that board action that interferes with stockholder voting rights is inequitable if motivated by the board's self-interest "in any important respect."[33] Should such self-interested motive be found, the court does "not need to inquire further. The action taken would constitute a breach of [fiduciary] duty" under *Schnell*.[34] If no such selfish motive existed, then the board acted in "good faith," and the challenged action is subject to *Blasius* review for determination of whether a compelling justification existed for it.[35]

Here, the trial court's findings establish that the Board indeed had two self-interested motives: (1) "the Stock Sale most effectively served [Schwat's] personal

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[31] *Coster,* 255 A.3d at 954.
[32] *Id*.
[33] *Blasius*, 564 A.2d at 658.
[34] *Id*.
[35] *Id.*

interest,"[36] and (2) the Board's desire to maintain its incumbency.[37] Consequently, the trial court should have cancelled the Stock Sale under *Schnell* irrespective of whether a compelling justification existed under *Blasius*.[38]

Appellees accuse Coster of "ignor[ing] other language in *Blasius*, as noted by this Court [in its Appellate Decision], that *Schnell* does not apply when the board acts in good faith, even with a self-interested, inequitable motive."[39] According to Appellees, such language is found on page 962 of the Appellate Decision.[40] But nothing on page 962—or anywhere else in this Court's Appellate Decision or in *Blasius*—supports Appellees' self-contradicting assertion. If a board acts "with a self-interested, inequitable motive,"[41] by definition it has not acted with the good faith required to avoid cancellation under *Schnell*.[42]

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[36] First Op. 41. The Answering Brief attempts to downplay this finding by suggesting that it is merely Coster's gloss on the trial court's findings, not its actual findings. *See* Answering Br. 26 ("as to Coster's contention that the Stock Sale furthered Schwat's 'personal interests...'"). In its First Opinion, the trial court explicitly found that "the Stock Sale most effectively served [Schwat's] personal interest." First Op. 41.

[37] *See* Opening Br. 26-28; First Op. 39-42.

[38] *Coster,* 255 A.3d at 954.

[39] Answering Br. 23.

[40] Answering Br. 23 n. 70 (citing *Coster*, 255 A.3d at 962).

[41] Answering Br. 23.

[42] *See Blasius*, 564 A.2d at 658 (board action motivated "in any important respect" by self-interest constitutes a breach of fiduciary duty under *Schnell*).

In sum, in finding that the Board's desire to extinguishing Coster's equal voting power and its accompanying leverage "was inequitable,"[43] the Court of Chancery necessarily found that the Board acted partially out of self-interest—and thus with some bad faith—in approving the Stock Sale. The Court of Chancery acknowledged as much in concluding that Board "did not totally lack a good faith basis" for the Stock Sale.[44] The trial court's findings establish that the Board in fact had at least two self-interested motives: (1) "the Stock Sale most effectively served [Schwat's] personal interest,"[45] and (2) even if not its primary purpose, the Stock Sale was motivated in part by the Board's desire to maintain its incumbency.[46] These findings alone require cancellation of the stock sale under *Schnell* because a modicum of good faith cannot overcome the Board's inequitable purposes. As this Court previously held, "[i]f the board approved the Stock Sale for inequitable reasons, the Court of Chancery should have cancelled the Stock Sale."[47]

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[43] Second Op. 21.

[44] *Id.*

[45] First Op. 41. The Answering Brief attempts to downplay this finding by erroneously suggesting that it is merely Coster's gloss on the trial court's findings, not its actual findings. *See* Answering Br. 26 ("as to Coster's contention that the Stock Sale furthered Schwat's 'personal interests...'"). But in its First Opinion, the Court explicitly found that "the Stock Sale most effectively served [Schwat's] personal interest." First Op. 41.

[46] *See* Opening Br. 26-28; Second Op. 30.

[47] *Coster,* 255 A.3d at 954.

C. Appellees Improperly Distort Coster's *Schnell* Argument to Suggest It Renders *Blasius* "Superfluous"

Appellees contend that "if *Schnell* applies as Coster argues it does, *Blasius* would be superfluous."[48] According to Appellees, "[i]f any action intended to impede shareholder voting rights were invalid under *Schnell* solely because it deprives a person of a clear right, then *Schnell* would invalidate every board action that could possibly be subject to *Blasius* review."[49]

Appellees are wrong. Coster does not argue that all board "action intended to impede shareholder voting rights" is invalid under *Schnell*. Instead, board action that interferes with stockholder voting rights is invalid under *Schnell* if motivated in any important respect by the board's self interest, as was the case here regarding the Stock Sale. If, and only if, no such self-interested motive exists, then the board has acted in good faith and, rather than being cancelled under *Schnell*, the challenged action is subjected to *Blasius* "compelling justification" review. *Schnell* and *Blasius* are easily reconciled under this proper application of those longstanding precedents, which in no way renders *Blasius* "superfluous."[50] It is Appellees, not Coster, who

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48 Answering Br. 29.

49 *Id.*

50 *Id.*

misapprehend the distinction between the two tests made by Chancellor Allen in *Blasius*.[51]

Appellees rely on *Alabama By-Products Corp. v. Neal*[52] for the proposition that invalidation of board action under *Schnell* "should be reserved for those instances that threaten the fabric of law, or which by an improper manipulation of the law, would deprive a person of a clear right."[53] The instant case also meets that standard for a pair of reasons.

First, the Stock Sale deprived Coster of a clear right by "eliminat[ing her] ability to block stockholder action, including the election of directors, and the leverage that accompanied those rights,"[54] which the trial court found "was inequitable" to Coster.[55]

Second, Coster had a clear right under Delaware statute to file the Custodian Action seeking appointment of a custodian in the wake of the stockholder deadlock to elect a new board.[56] As the trial court found on remand, Appellees undertook the

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51 *Blasius*, 564 A.2d at 658 (disenfranchising board action invalid under *Schnell* if board acts "out of a self-interested motive in any important respect").

52 588 A.2d 255 (Del. 1991).

53 Answering Br. 22 n. 66 (quoting *Ala. By-Prods Corp.*, 588 A.2d at 258).

54 *Id.* at 21.

55 *Id*. at 22 n. 66 (quoting *Ala. By-Prods Corp.*, 588 A.2d at 258).

56 8 *Del. C.* § 226(a)(1); *accord Saxon Indus.v. NKFW P'rs*, 488 A.2d 1298, 1301 (Del. 1984) (noting plaintiff's "clear right" to seek relief under the DGCL).

Stock Sale "for the primary purpose of mooting the Custodian Action."[57] The Board deliberately deprived Coster of her clear statutory right to seek appointment of a custodian.

* * * *

In sum, this Court should reverse the Court of Chancery's holding that *Schnell* "does not apply in this case"[58] because "the UIP's board's decision did not totally lack a good faith basis."[59] The Court of Chancery found on remand that UIP's conflicted Board "had multiple reasons for approving the Stock Sale. Some were problematic."[60] And the Court of Chancery explicitly found that one of those reasons—to extinguish Coster's blocking rights and their accompanying leverage—"was inequitable."[61] Given these findings of inequitable purpose, the Court of Chancery should have cancelled the Stock Sale under *Schnell* because the Board acted selfishly in two important respects when approving it: (1) Schwat sought to further his personal interests in maintaining his operational control over UIP, and (2) the Board sought to maintain its incumbency.[62] The Court of Chancery's novel

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57 Second Op. 23 ("this decision finds that the Stock Sale was for the primary purpose of mooting the Custodian Action").

58 *Id.* at 22.

59 *Id.* at 21.

60 *Id.*

61 *Id.*

62 *Id*. at 30.

holding that *any* good faith justification, even in the face of inequitable purposes by the board, overcomes *Schnell* and allows a dilutive stock sale that extinguished Coster's power as a 50% owner, should be reversed as contrary to Delaware law.

II. THE COURT ERRED IN NOT CANCELLING THE STOCK SALE UNDER *BLASIUS*

Although no previous Delaware court has apparently done so, the Court of Chancery on remand held that Appellees had "met the onerous burden [under *Blasius*] of demonstrating a compelling justification for the Stock Sale."[63] The Court of Chancery committed reversible error in so doing because it relied on legally impermissible considerations, such as Wout Coster's wishes and Coster's supposed motive in filing the Custodian Action. The ruling also impermissibly undermines § 226(a)(1) by creating a comparatively easy self-help measure that, absent reversal, holdover boards can and will employ to moot § 226(a)(1) actions instead of allowing the Court of Chancery to adjudicate them.

Appellees make four principal arguments attempting to justify the Court of Chancery's decision. Each argument is unpersuasive, and the Court of Chancery's *Blasius* analysis should be reversed.

A. No Exigency Existed to Warrant Appellees Mooting the Custodian Action Instead of Allowing the Court of Chancery to Adjudicate It

According to Appellees, they "appropriately acted to moot [the Custodian Action] and were under no obligation" to wait to allow the Court of Chancery to consider Coster's requested relief.[64] Appellees are mistaken. It was improper for

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[63] *Id*. at 26.
[64] Answering Br. 5.

Appellees to usurp the Court of Chancery's role under § 226(a)(1) on the ground that the court ***might*** rule in Coster's favor. No exigent circumstances existed with respect to the two "compelling justifications" identified by the Court of Chancery for the Stock Sale: (1) potential termination of UIP contracts by counterparties, and (2) a desire to reward Bonnell with UIP equity.[65]

Appellees do not dispute an important factual point made in the Opening Brief: there is no evidence at all—zero—that, in the two months between filing of the Custodian Action (June 15, 2018) and the Stock Sale (August 15, 2018), any UIP counterparty ***actually*** threatened to terminate a contract due to the pendency of the Custodian Action. Nor do Appellees dispute that, as the Opening Brief noted, "many, if not most, of the third-party contracts relied upon by Appellees [appear to be] contracts between UIP and SPEs owned and controlled by Schwat and Bonnell."[66] Unable to cite evidence of actual termination threats by counterparties, Appellees point to the Court of Chancery's determination that "appointment of a custodian ***could*** trigger broad termination provisions . . . ."[67] But this mere theoretical threat, without evidence of any actual or imminent threat, is nothing more

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[65] Second Op. 29 (noting potential contract terminations and "chancing Bonnell's departure" as the "business risks" justifying the Stock Sale).

[66] Opening Br. 35.

[67] Second Op. 26.

than an argument against appointment of a custodian, which Appellees could and should have made in the Custodian Action.

In addition, the Appellees concede that there was nothing exigent about a sale of equity to Bonnell. According to Appellees, it "did not need to be exigent to establish a compelling justification for the [Stock Sale]."[68] Not so. With no urgency to it, there was no reason 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 interest. It did not justify Appellees exercising self-help by mooting the Custodian Action rather than allowing the Court of Chancery to adjudicate it.

The Court of Chancery's holding that Appellees were justified in engaging in self-help by diluting Coster's 50% interest to moot the Custodian Action should be reversed. If it stands, every board facing a stockholder action for appointment of a custodian would have a comparatively easy work-around: moot the proceeding by selling unissued stock to a friendly insider on the ostensible ground that appointment of a custodian would harm the company. Under the Chancellor's reasoning, ***any*** showing of good-faith by a board, no matter how modest, renders *Schnell*

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[68] Answering Br. 37 (internal quotation omitted).

inapplicable, thus triggering *Blasius* review. If the Stock Sale here can survive *Blasius* review—a transaction that permanently reduced Coster's ownership stake and extinguished her valuable power to approve board appointments and other stockholder action—then a whole array of previously suspect transactions also can.[69] The Court of Chancery's reasoning on this issue should be reversed.

B. Appellees Cite No Authority Supporting Their Erroneous Position that the Trial Court Properly Considered Wout Coster's Wishes

Appellees maintain that the Court of Chancery "correctly considered evidence of Wout Coster's views as to the format of the Stock Sale . . . ."[70] To the contrary, the Court of Chancery erred in so doing.

In its Second Opinion, the trial court repeatedly invoked Wout Coster's supposed desire to have Bonnell be a UIP stockholder as a ground justifying the Board diluting his widow from a one-half owner to a one-third owner and extinguishing her valuable voting rights as a 50% owner.[71] Appellees do the same in their Answering Brief, claiming that in late 2013, "Schwat and Wout began

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[69] *See, e.g., State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, 2000 WL 1805376, at *6-9 (Del. Ch. Dec. 4, 2000) (adjourning a stockholder meeting to prevent a stockholder vote); *Blasius*, 564. A.2d at 652-53 (increasing the size of a board by two members).

[70] Answering Br. 5-6.

[71] Second Op. 10 (selling Bonnell stock furthered "the succession plan that Wout and Schwat had developed on a clear day before any deadlock loomed"); 28 (same); and 31 (same).

discussing a succession plan whereby Bonnell and Wilkinson would ultimately succeed to Wout's shares in the Company."[72]

Appellees egregiously misstate what Wout desired. Although it is true that Wout approved of Bonnell eventually owning UIP equity, Wout emphatically wanted Bonnell (and Heath Wilkinson, who left UIP before the instant litigation) ***to purchase*** his fifty-percent interest ***from him*** for a ***seven-figure sum***.[73] Indeed, Coster's uncontroverted trial testimony was that Wout "never" would have approved of the terms of the Stock Sale.[74]

Putting aside these factual distortions, Wout's preferences were simply irrelevant on the date of the Stock Sale. He had died almost 3 ½ years before. The Board owed fiduciary duties to the current stockholders at the time of the Stock Sale, not former ones.[75]

Appellees fail to cite any case law in support of their position that Wout's wishes may control the disposition of Coster's shares three-and-a-half years after his

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72 Answering Br. 9.

73 A486-88 [Tr. 134:16-136:2]; A049-50 [JX-11] at 2-3 ("Total Sale of [UIP] Interest by [Wout Coster] to HW/PB - $2,125,000"); A070-73 [JX-187] ("I consented to [the Term Sheet] when the deal included payment for [his one-half ownership of] the company. That deal doesn't exist anymore. There is no longer a sale going on . . . . In the end I need to get comfortable with the cashflow to me to live off.")

74 A489 [Tr. 149:12-14].

75 *See* Opening Brief 38 n. 133 (citing cases).

death.[76] Instead, they downplay the Second Opinion's repeated mentioning of Wout's supposed wishes about Bonnell, suggesting that it was "not [e]ssential to the Court of Chancery's findings [u]nder *Blasius*."[77]

Appellees' attempt to minimize the Second Opinion's repeated references to Wout's supposed wishes regarding Bonnell is unavailing. The Court of Chancery clearly gave them considerable weight in resolving the "many close calls" this case presented.[78] Emphasizing the point, the Second Opinion concludes by noting the Chancellor's "solace in knowing that the ultimate solution to the deadlock—the Stock Sale—was consistent with the succession plan that Wout and Schwat devised on a clear day before deadlock emerged."[79] The improper consideration of Wout's purported wishes is reversible error.

C. Appellees Wrongly Dismiss as Dicta the Court of Chancery's Improper Consideration of Coster's Motives for Filing the Custodian Action

The Second Opinion also makes clear that the Court of Chancery relied on another legally improper consideration: that Appellees' purposeful elimination of Coster's "leverage as an equal stockholder" was justified because Coster had used

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76 *Id.*

77 *Id*. at 26.

78 Second Op. 10 (selling Bonnell stock furthered "the succession plan that Wout and Schwat had developed on a clear day before any deadlock loomed"); 28 (same); and 31 (same).

79 *Id.* at 31.

that leverage "to pursue the Custodian Action."[80] The Answering Brief wholly ignores the case law relied upon by Coster in arguing that the trial court erred in considering her motive in filing the Custodian Action.[81] And again, Appellees fail to cite any contrary authority. Appellees instead suggest that the trial court's discussion of Coster's motive is mere *dicta,* and that "it was not a basis for the trial court's *Blasius* analysis."[82]

Appellees' suggestion lacks merit. In its Second Opinion, the Court of Chancery clearly considered Coster's motive in filing the Custodian Action. According to the Second Opinion, it was part of a "legal play" to force a buyout, and therefore justified Appellees' purposeful elimination of Coster's "leverage as an equal stockholder."[83] That holding is reversible error. In *Saxon Industries, Inc. v. NKFW Partners*,[84] this Court held that where, as here, a party has a statutory right to seek relief under the DGCL, the plaintiff's "motive, whatever its inspiration, is immaterial."[85] The Court of Chancery erred as a matter of law by relying on Coster's motive in pursuing the Custodian Action as a component of the decision below

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[80] *Id.* at 23.
[81] Opening Br. 38-42.
[82] Answering Br. 41-42.
[83] Second Op. 23.
[84] 488 A.2d at 1301.
[85] *Id.* Coster made this argument in her post-remand briefing, repeatedly quoting *Saxon Indus*., yet the Court of Chancery did not address it in the Second Opinion. *See* Plaintiff's Post-Remand Answering Brief (A563-64 [pp. 12-13]).

permitting a transaction that the Court of Chancery found, at least in part, "was inequitable."[86]

D. Appellees' Explanation for the Trial Court's Flip-Flop Regarding the Stock Sale's Effects On Schwat Is Contradicted by the Language of the First Opinion

On remand, the Court of Chancery concluded that the Stock Sale was "appropriately tailored" to its ends because, "[a]lthough it is true that the Stock Sale eliminated Plaintiff's ability to use her 50% interest to block stockholder action, the Stock Sale also had that effect on Schwat."[87] The Court of Chancery did so notwithstanding—and without acknowledging—that, in its First Opinion, it had rejected the identical argument as "true in form," but wrong in substance.[88]

Appellees make only a half-hearted defense—relegated to a footnote—of this unexplained about-face.[89] According to Appellees, the Court of Chancery "did not reject this point" in its First Opinion.[90] But that is clearly incorrect. In the First Opinion, the court found as follows:

> Defendants [argue] that Schwat gained no disabling benefit from the Stock Sale, which diluted Schwat's own holdings, harmed his financial interests, and weakened his ability to block stockholder action….***While Defendants' arguments are true in form***, the facts reveal that Schwat in fact had reason to support the [Stock Sale] beyond the beneficial business effects discussed

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86 Second Op. 21.
87 *Id*. at 27.
88 First Op. 39-40.
89 Answering Br. 44 n. 132.
90 *Id.*

> [above]. This reasoning starts with an obvious observation: the relief sought in the Custodian Action was invasive from Schwat's perspective. At the time Plaintiff filed the Custodian Action, Plaintiff could not reduce Schwat's control, terminate his employment, or effect change to any member of Schwat's team . . . .[91]

In any event, the Court of Chancery's own findings indicate that the prospect of Bonnell ever aligning with Coster against Schwat is purely notional. The findings in the First Opinion—which both the Court of Chancery and Appellees consider "law of the case"[92]—included the following: (1) that Schwat and Bonnell "are good friends,"[93] (2) so close that their "relationship that can only be described as being similar to [a] marriage,"[94] (3) that Schwat and Bonnell had been aligned against Wout in negotiations with him to buy-out his 50% ownership of UIP,[95] and (4) [b]y placing stock in the hands of his friend [Bonnell] . . . [Schwat] mitigated any pressure from Plaintiff at the board level."[96]

The trial court thus erred in concluding that the Stock Sale was "appropriately tailored to achieve the goal of mooting the Custodian Action" because it "had [the same] effect on Schwat as it did Coster.[97] As the Court's own findings demonstrate,

91 First Op. 39-40 (emphasis supplied).
92 Second Op. 4; Answering Br. 35 n. 106.
93 First Op. 40.
94 *Id.*
95 *Id.* at 41.
96 *Id.*
97 Second Op. 27.

whereas the Stock Sale "was inequitable" to Coster,[98] it furthered Schwat's "personal interest[s]."[99] By extinguishing Coster's 50% voting power, Schwat, together with Bonnell, "mitigat[ed] any pressure from [Coster] at the Board level" by insisting on a new board.[100] At trial, both Schwat and Bonnell acknowledged their desire to maintain their holdover Board in office.[101]

For these reasons, and for the reasons stated in the Opening Brief, even if the *Blasius* standard applies, the Court of Chancery's decision should be reversed.

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98 *Id.* at 21.

99 First Op. 41.

100 *Id.* at 42.

101 A502 [Tr. 400:10-11] (Schwat: "I was satisfied with the current board"; A504 [Tr. 478:15-16] (Bonnell: He and Schwat "discussed how the company is operating just fine with the board that it has.").

III. UPON A CANCELLATION OF THE STOCK SALE, THIS CASE SHOULD BE REMANDED FOR APPOINTMENT OF A CUSTODIAN TO SERVE AS A TIE-BREAKING VOTE

Should this Court cancel 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. A perpetual deadlock over election of a new board—with Schwat's friendly and entrenched Board remaining in place—cannot stand under this Court's decision in *Giuricich* v. *Emtrol Corp*.[102] For this reason, and to help bring this long-running litigation to an end, this Court should remand with instructions that a custodian be appointed pursuant to 8 *Del. C.* § 226(a)(1) with the limited power of casting tiebreaking votes where the stockholders are deadlocked, including with respect to board elections.

[102] 449 A.2d 232, 240 (Del. 1982) (failure to appoint a custodian would "leav[e] 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."); *see also Miller v. Miller,* 2009 WL 554920, at *4 (Del. Ch. Feb. 17, 2009).

CONCLUSION

"One of the most venerable precepts of Delaware's common law corporate jurisprudence is the principle that 'inequitable action does not become permissible simply because it is legally possible.'"[103] If allowed to stand, the decision below turns this venerable principal on its head. The Second Opinion should be reversed under *Schnell* because the Court of Chancery found that the Board acted with inequitable purposes in undertaking the Stock Sale. The Court of Chancery should have cancelled the Stock Sale under *Schnell* irrespective of whether a compelling justification existed for it under *Blasius*.

Even if the *Blasius* compelling justification test applied, the Court of Chancery's application of that test is in error and should be reversed. This Court should cancel the Stock Sale as a breach of the Board's fiduciary duties to Coster and remand the case for appointment of a custodian pursuant to 8 *Del. C.* § 226(a)(1) with the limited power of casting tiebreaking votes where the stockholders are deadlocked, including with respect to approving a new board to replace the holdover Board.

[103] *MM Cos. v. Liquid Audio, Inc.,* 813 A.2d 1118, 1132 (Del. 2003) (quoting, in part, *Schnell*, 285 A.2d at 439).

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