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IN THE SUPREME COURT OF THE STATE OF DELAWARE

CHRISTOPHER MILLER, an individual, and CHRISTOPHER MILLER and LINDSAY MILLER as trustees of the C & L MILLER REVOCABLE TRUST, Plaintiffs Below, Appellants, v. HCP TRUMPET INVESTMENTS, LLC; HISPANIA PRIVATE EQUITY II L.P.; HISPANIA INVESTORS II LLC; CARLOS SIGNORET; JASON SHAFER; MARK RUSSELL, and VICTOR MARURI, Defendants Below, Appellees.	No. 107,2018 Court Below: Court of Chancery in the State of Delaware C.A. No. 2017-0291-SG

APPELLANT'S OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF CITATIONS

NATURE OF THE PROCEEDINGS

Plaintiff Christopher Miller and other early investors of Trumpet Search, LLC ("**Trumpet**") built Trumpet from nothing into one of the leading companies in the autism treatment industry. As is the case with many young companies, Trumpet took on private equity financing; here from HCP Trumpet Investments, LLC and an affiliate (together, the "**HCP Owners**"). In exchange for the investment, Trumpet gave the HCP Owners the first fruits of any sale until they received double their investment—before the other early investors (such as Miller) would participate in sale proceeds. Trumpet also gave the HCP Owners control over Trumpet's board of managers ("**Board**")[1] and gave the Board authority to require all of Trumpet's members to consent to a sale that it approved. The Second Amended and Restated Operating Agreement (the "**Agreement**") does not expressly address how the Board would conduct a market check to know whether it was obtaining the best price reasonably available under the circumstances for Trumpet and its members. But in exercising the discretion granted, the Agreement requires that HCP comply with Delaware's implied covenant of good faith and fair dealing.

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[1] HCP Trumpet Investments, LLC and the four Board members it installed are collectively referred to as "**HCP**."

Notwithstanding the implied covenant, and the reasonable expectations held by the early Trumpet investors that HCP would endeavor to obtain a reasonable market value in a change of control transaction, HCP did just the opposite. It forced a below-market sale of Trumpet by engaging only one suitor even though it had no evidence that it had obtained a fair market offer. But even worse, HCP actively sabotaged attempts to obtain a superior proposal from another potential buyer. The early Trumpet investors allowed HCP's preferred 2x return because they believed in the substantial value of Trumpet—betting that Trumpet's value would provide HCP's handsome return and *also* benefit Trumpet's other members. They did not reasonably expect at the time they entered into the Agreement that HCP would shun efforts to identify that value and undermine efforts to obtain competitive bids.

All of this is supported by the complaint's well-pleaded allegations. On a Rule 12(b)(6) motion, the Court of Chancery misread the Agreement's terms, misunderstood the nature of Plaintiffs' pre-contract expectations, and improperly weighed the alleged facts. The Court of Chancery's decision should be reversed.

SUMMARY OF ARGUMENT

The Court of Chancery held that the Agreement's express terms gave HCP unfettered discretion to market Trumpet however it wanted, for whatever price it wanted, so long as Trumpet was sold to an independent third party. The Court of Chancery therefore held that Plaintiffs' contrary expectations were unreasonable as a matter of law. These findings were erroneous for three reasons.

First, the Court of Chancery misread the Agreement. Section 8.06(a) of the Agreement addresses what happens *after* a sale is "approved" by the Board, not how the Board obtains offers or negotiates a sale *before* it is "approved." Section 8.06(a) also grants the Board "sole discretion" to determine the manner in which such an "approved" sale will occur—whether as a sale of assets, merger, transfer of membership interests or otherwise. But neither Section 8.06(a) nor any other provision in the Agreement addresses how Trumpet would be marketed or priced beforehand or how the Board would inform itself to know whether it had obtained the best price reasonably available.

Second, the Court of Chancery incorrectly held that, at the time of contracting, Plaintiffs had no reasonable expectations that the Board would pursue a competitive marketing process. This conclusion was principally based on the court's mistaken reading of the Agreement addressed above. But the court committed additional errors too. For example, the court criticized Plaintiffs for not

addressing this issue with express language in the Agreement. In so doing, the court ignored the obvious—that in every implied covenant case the parties could have addressed the disputed issue in writing. That fact is, the issue was not addressed because it was so fundamental that Plaintiffs did not think it was necessary. Filling such gaps is the purpose of the implied covenant. The Court of Chancery also misunderstood the Agreement's waiver of fiduciary duty. Section 3.09 expressly limits that fiduciary duty waiver to conduct that does not also constitute of breach of the implied covenant of good faith.

Third, as the complaint details, HCP's conduct was arbitrary and unreasonable and deprived Plaintiffs of the benefit of their bargain. Not only did HCP refuse to undertake any effort to understand the market's value for Trumpet, HCP actively undermined any attempt to do so. When presented with an indication of interest from a potential buyer for, conservatively, $50 million to $60 million, HCP colluded with its lone suitor to torpedo any further discussions with the competing buyer and force the below-market sale. As a result, Defendants were enriched with a 2x return and other members, including Plaintiffs, were left with almost nothing. Contrary to the Rule 12(b)(6) requirement that it deem these facts true, the Court of Chancery marginalized these well-pleaded facts and improperly substituted its own view.

For all these reasons, the Court of Chancery's judgment should be reversed.

STATEMENT OF FACTS

Plaintiff Christopher Miller co-founded Trumpet, which provides clinical services to individuals with autism and other developmental disabilities through its subsidiary Trumpet Behavioral Health. (App. at A-9 to A-10, ¶¶ 16-17.) By May 2016, Trumpet had become a leading company in its field. (*Id.* at A-10, ¶ 18.)

The HCP Owners owned membership interests in Trumpet and had the power to appoint a controlling majority of Trumpet's seven-member Board. The HCP Owners installed Carlos Signoret, Jason Shafer, Mark Russell, and Victor Maruri (together, the "**HCP Board Members**") as members of Trumpet's Board. (*Id.* at A-14, ¶¶ 29-30.) HCP Trumpet Investments, LLC and the HCP Board Members are referred to herein as "**HCP**." The other three Board members—Mr. Miller, Franklin "Lani" Fritts, and Leslie Margolin—are not affiliated with HCP. (*Id.* at A-15, ¶ 31.) Defendants Hispania Private Equity II L.P. and Hispania Investors II LLC (together, the "**HCP Affiliates**") are affiliates of the HCP Owners.[2] The HCP Owners and HCP Affiliates are private equity companies.

The HCP Owners made investments in Trumpet, culminating in a final round of investment in May 2016. At that time, Trumpet's members entered into

[2] The complaint's caption included HCP & Company and HCP Pachyderm Investments, Inc. HCP & Company was dismissed voluntarily because it could not be located. HCP Pachyderm Investments, Inc. also was dismissed voluntarily because it was merged into a MTS-affiliated entity when the Trumpet sale was closed.

the Agreement. (*Id.* at A-7, ¶ 23.) The Agreement provides for a "waterfall" method of distributing the proceeds of any sale. This means the Agreement creates nine different levels of membership interests which receive distributions of sale proceeds only after previous levels have been satisfied. (*Id.* at A-7 to A-9, ¶ 24.) As relevant here, the HCP Owners held the vast majority of the first two levels—Class E and Class D interests. (*Id.*) The Class E and Class D interests are entitled to a preferred 2x payout of their investment before any other members receive distributions. (*Id.*) Because the HCP Owners had invested approximately $14 million, this structure means that the HCP Owners would receive almost all of the first $28 million of any sale before other members in lower levels on the waterfall would receive any distributions.[3] (*Id.*) The Plaintiffs owned membership interests in the second, third, sixth, seventh, eighth, and ninth levels of the waterfall.

The Agreement provides no terms regarding whether or how the Board would conduct a market check. (*Id.* at A-80, § 8.06.) Instead, the Agreement addresses the procedures for completing a sale *after* the Board has decided to sell Trumpet to a buyer on specified terms. (*Id.*) Those procedures include a provision

[3] Some units in Classes D and E were owned by others, meaning the HCP Owners would receive their full $28 million distribution if the company sold for approximately $30 million or more. (*Id.*)

requiring the Board to notify the members of the approved sale terms, and giving discretion to the Board over the form the sale would take:

> If the Board approves a sale of all of the Membership Interests or equity interests in the LLC to any independent third party (each such transaction referred to as an "Approved Sale"), the Board shall notify the Members in writing of such Approved Sale and provide a description of the Approved Sale setting forth the reasonable details, terms, and conditions thereof. Subject to the remainder of this Section 8.06, the Board shall determine in its sole discretion the manner in which such an Approved Sale shall occur, whether as a sale of assets, merger, transfer of Membership Interests or otherwise.

(*Id.*, § 8.06(a).) Section 8.06(a) is part of the larger Section 8.06 which contains the Agreement's "Drag Along" rights. These "Drag Along" rights require the members to consent to a Board-approved sale and includes provisions to force the sale on behalf of members who do not consent as required. (*Id.* at A-80 to A-81, § 8.06.)

Within nine months after the Agreement was executed, the HCP Board Members decided to sell Trumpet. (*Id.* at A-17, ¶ 40.) Without doing any sort of market check, HCP announced at a December 16, 2016 Board meeting that they intended to sell Trumpet to MTS Health Partners, L.P. ("**MTS**") for an effective purchase price of only $31 million. (*Id.* at A-18, ¶ 41). This effective purchase price would be just enough for the 2x payout to the Class D and E members

(including the HCP Owners). (*Id.* at A-11 to A-13, ¶ 24.) But it would leave the rest of the members with nothing. (*Id.*)

The non-HCP Board members objected and asked that the Board pursue an appropriate price by testing the market. (*Id.* at A-18, ¶ 41.) Signaling that HCP was acting in bad faith to sell Trumpet below its market value, HCP Board Member Signoret replied that "he had no fiduciary duty under the Agreement." (*Id.* ¶¶ 42-43.) Without gathering any reliable evidence that it had obtained a fair market offer, HCP demanded the other Board members approve the sale at that price and that the sale close quickly. (*Id.* at A-19, ¶ 44.) After further objection, HCP allowed only five days during the week before Christmas to obtain a better offer. (*Id.*) But HCP still refused to present Trumpet to the market. Instead, HCP allowed Trumpet's CEO Fritts to speak to only two designated companies, instead of permitting him to go out to the market to solicit offers. (*Id.*)

Signaling that the MTS offer was significantly below market, Mr. Fritts obtained a hastily prepared letter of intent within those five days to purchase Trumpet for an additional $5 million, or a total of about $36 million. (*Id.* at A-20, ¶ 48.) Almost immediately, MTS increased its offer to an effective price of $39 million, further evidencing that Trumpet was being sold well below its value. (*Id.* ¶ 49.) But HCP still refused to engage in any activity to determine the fair market value of Trumpet. For example, HCP refused to allow any additional time

or processes in which a competing bidder could emerge, such as issuing a press release announcing the deal and inviting competing bids, soliciting additional bids from any other suitors, or hiring an investment bank to help test the market. (*Id.* ¶ 50.) Even after Mr. Miller received an unsolicited expression of interest from a viable buyer called FFL Partners, LLC ("**FFL**") valuing the company between $50 million to $60 million conservatively, HCP refused to pursue FFL and refused to inform itself as to the reasonableness of the MTS offer. (*Id.* at A-22 to A-23, ¶¶ 58-60.)

To the contrary, instead of pursuing the FFL interest, HCP actively undermined and attacked any attempt to deal with FFL. (*Id.* at A-23 to A-24, ¶¶ 61-64.) Without the knowledge of others at Trumpet, two HCP Board Members called and colluded with MTS about the FFL offer. (*Id.* at A-23, ¶ 62.) The very next day, MTS groundlessly accused Trumpet of violating an exclusivity clause by even considering a deal with FFL. (*Id.* at A-23 to A-24, ¶ 63.) After Trumpet confirmed to MTS that its exclusivity claims were baseless, MTS increased its offer one more time, to an effective offer of $41 million. (*Id.* at A-26, ¶¶ 72-73, A-28, ¶ 78.) By this time, because of: (1) HCP's refusal to make any effort to conduct a market check; (2) HCP's acts to undermine any efforts to engage with FFL or other potential suitors; and (3) HCP's intimidation and coercion of non-HCP Board members, HCP argued that the MTS offer must be accepted because it

was the only one on the table. (*Id.* at A-26, ¶ 73.) The HCP-controlled board then voted to accept the MTS offer, and closed the transaction.

Plaintiffs brought this action against HCP for breach of the implied covenant of good faith and fair dealing, asserting that HCP breached that duty by actively undermining any attempts to test whether the MTS offer was the best price reasonably available for Trumpet and its members. (*Id.* at A-29 to A-32, ¶¶ 83-95.) Plaintiffs also alleged that the HCP Affiliates aided and abetted the breach, that they tortiously interfered with the Agreement, and that all Defendants were liable under a theory of civil conspiracy. (*Id.* at A-32 to A-36, ¶¶ 96-114.)

Defendants moved to dismiss the complaint, arguing that the implied covenant of good faith and fair dealing could not apply to HCP's conduct. They argued that the Agreement's express terms did not leave a "gap" to be filled by the implied covenant of good faith. They argued that even if there was such a gap, the parties would not have reasonably expected HCP's conduct to be proscribed. (*Id.* at A-162 to A-173.) The Court of Chancery agreed with HCP. It held that the Agreement "does not contain a gap as to how Trumpet could be marketed and sold." Opinion 26. The court held that the Agreement "explicitly vests the Board with sole discretion" over the marketing of Trumpet, with the sole limitation that the company cannot be sold to an insider. *Id.* The court also held that even if the Agreement "contains a gap as to how Trumpet could be sold," the claim fails

because Plaintiffs' "reasonable expectations were [not] frustrated by the Defendants' conduct during the sales process." *Id.* at 29-30. The court reasoned that the terms of the Agreement reveal the parties "contemplated that Trumpet might be sold through private negotiation." *Id.* at 30. Finally, the court determined on its view of the facts alleged in the complaint that the Board did not act arbitrarily or unreasonably because it took "the offer in hand [the MTS offer] . . . over the one in the bush [the FFL expression of interest]." *Id.* at 34. The Court of Chancery therefore granted the motion and dismissed all the claims in the complaint.[4] *Id.* at 36. This appeal followed.

[4] The Court of Chancery dismissed the other claims solely because those claims depend on the claim for breach of the implied duty of good faith and fair dealing. Reversal of the court's order will necessarily reverse those holdings as well.

ARGUMENT

I. The Court of Chancery erred in holding that the Agreement's express terms left no room for application of the implied covenant of good faith and fair dealing.

A. Question presented.

Does the Agreement leave room for the implied covenant of good faith and fair dealing to supply implied terms addressing how Trumpet would be marketed for sale and how a sale price would be determined?

This question was preserved before the Court of Chancery at Appendix pages A-201 to A-208.

B. Scope of review.

This Court reviews de novo the grant of a motion to dismiss under Court of Chancery Rule 12(b)(6), determining whether the trial court erred as a matter of law in formulating or applying legal precepts. *Nemec v. Shrader*, 991 A.2d 1120, 1125 (Del. 2010) (quoting *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009)). The order granting dismissal must be overturned if the complaint states a claim "under any 'reasonably conceivable' set of circumstances inferable from the alleged facts." *Winshall v. Viacom Int'l Inc.*, 76 A.3d 808, 813 n.12 (Del. 2013). This Court must "view the complaint in the light most favorable to the non-moving party, accepting as true their well-pled allegations and drawing all reasonable inferences that logically flow from those allegations." *Nemec*, 991 A.2d at 1125 (quotation marks omitted) (quoting *Gantler*, 965 A.2d at 703). The Court reviews

questions of contract interpretation de novo. *E.g.*, *GMG Capital Invs., LLC v. Athenian Venture P'rs I, Ltd. P'ship*, 36 A.3d 776, 779 (Del. 2012).

C. Merits of argument.

The Court of Chancery erroneously ruled that the Agreement left no room for any implied terms about how Trumpet would be marketed for sale.

Applicable law. The implied covenant of good faith and fair dealing serves the important function of upholding the parties' reasonable contractual expectations where the contract's express terms do not fully articulate those expectations. *E.g.*, *Nemec*, 991 A.2d at 1126. To be sure, the implied covenant cannot be used to oppose conduct explicitly authorized by the contract's express language. *Gerber v. Enter. Prods. Hldgs., LLC*, 67 A.3d 400, 419 (Del. 2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 441 (Del. Ch. 2012)) ("Express contractual provisions always supersede the implied covenant . . . ."). But where the contract's express language does not address the conduct at issue, the implied covenant fills the contractual gap. *Id.* at 418. Under these circumstances, the covenant supplies "what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting." *Id.* At the motion to dismiss stage, the Court decides the reasonable expectations of the parties "based on a reading of the terms of the [LLC] agreement and consideration of the

relationship it creates between the . . . investors and managers." *Dieckman v. Regency GP LP*, 155 A.3d 358, 367 (Del. 2017). The Court interprets clear and unambiguous terms according to their ordinary meaning. *GMG Capital Invs.*, 36 A.3d at 779.

There are at least two reasons why parties would reasonably expect a certain term, but fail to expressly include it—either because (1) the unexpressed term was so fundamental to the transaction that the parties did not see the need to express it; or (2) notwithstanding diligent efforts to express all material terms of an agreement, the parties merely failed to anticipate the need for the term. *See Dieckman*, 155 A.3d at 368; *Gerber*, 67 A.3d at 419. In either case, the implied covenant supplies the missing term and thereby protects the claiming party from "arbitrary or unreasonable conduct which has the effect of preventing the . . . party to the contract from receiving the fruits of its bargain." *Gerber*, 67 A.3d at 419 (quoting *ASB Allegiance*, 50 A.3d at 440-42); *see also Nemec*, 991 A.2d at 1126.

Application of the implied covenant must be a "cautious enterprise"; it is not meant to rewrite an otherwise clear contract just because one party made a bad deal. *Nemec*, 991 A.2d at 1126. Instead, it is reserved for cases—like this one—where a party had reasonable expectations at the time of contracting that are consistent with the contract's express language, and where those expectations are frustrated by the opposing party's arbitrary and unreasonable conduct. *Id.* at 1126.

It is reserved for cases—like this case—where it is necessary to protect the fruits of the parties' bargain. *Id.*; *see also Gerber*, 67 A.3d at 419.

Discussion. Plaintiffs allege that HCP breached the implied covenant of good faith when it refused to expose Trumpet to the open market and instead forced a self-serving sale to MTS. The first question the Court must consider, therefore, is whether the Agreement's language expressly addresses how HCP would determine and achieve the fair value of Trumpet if it elected to pursue a sale of the company. Put differently, the first question is whether the Agreement's express terms contain a gap on this issue for the implied covenant to fill.

The Court of Chancery erroneously held that the Agreement contained no such gap. Specifically, the court held that Section 8.06(a) of the Agreement endows the Board with "sole discretion" as to how the company could be marketed and sold. Opinion 26-27. Section 8.06(a)'s plain language does not support the court's conclusion.

1. Section 8.06(a) does not address marketing or pricing of Trumpet.

Section 8.06(a) spans two sentences, and addresses what happens once the Board has *approved* a sale (an "Approved Sale"), not how the Board *markets* or obtains offers for the sale before it is "approved":

> If the Board approves a sale of all of the Membership Interests or equity interests in the LLC to any independent third party (each such transaction referred to

> as an "Approved Sale"), the Board shall notify the Members in writing of such Approved Sale and provide a description of the Approved Sale setting forth the reasonable details, terms, and conditions thereof. Subject to the remainder of this Section 8.06, the Board shall determine in its sole discretion the manner in which such an Approved Sale shall occur, whether as a sale of assets, merger, transfer of Membership Interests or otherwise.

(App. at A-80, § 8.06(a).) Section 8.06(a) is part of the larger Section 8.06 which addresses "Drag Along Rights"—that is, the Board's right to require that members consent to the "Approved Sale."

By its plain, unambiguous terms, Section 8.06(a) addresses what happens once the Board has already "approved" a sale. It says *nothing* about how the Board would market Trumpet for sale, how the Board would find and select potential buyers, how the Board would negotiate the transaction, or how the Board would determine what Trumpet was worth before it decided to approve the sale. No other provision of the Agreement addresses these topics either. Indeed, only *after* these steps have occurred (marketing, pricing, negotiating) could a sale be "approved" by the Board pursuant to Section 8.06(a) and disclosed to the members. Section 8.06(a)'s plain language does not contemplate HCP's bad-faith conduct before the MTS sale was "approved"—that is, HCP's refusal to shop Trumpet more openly to obtain the best price reasonably available; its refusal to consider the FFL indication of interest; its decision to join MTS in actively

interfering with the FFL opportunity; and its decision to force the approval of the MTS transaction.

The only way to support the Court of Chancery's reading of Section 8.06(a) is to add words relating to conduct that occurs *before* approval of a sale, such as "marketing" or "pricing" or "negotiating." These words do not exist in Section 8.06(a). Neither Section 8.06(a) nor any other provision of the Agreement addresses how HCP would get the best price reasonably available for Trumpet. Accordingly, the implied terms Plaintiffs advance about the method of marketing and pricing the company are not contrary to the Agreement's express terms.

2. Section 8.06(a) grants "sole discretion" over the form of transaction, not how Trumpet would test the market.

Section 8.06(a) indeed provides the Board with "sole discretion," but that "sole discretion" is not over marketing, pricing, or any other pre-*approval* market check activities. Instead, the clear language of Section 8.06(a) limits that "sole discretion" to the "manner" or form the Approved Sale will take:

> Subject to the remainder of this Section 8.06(a), the Board shall determine in its sole discretion the manner in which such an Approved Sale shall occur, *whether as a sale of assets, merger, transfer of Membership Interests or otherwise*.

(App. at A-80, ¶8.06(a) (emphasis added).) This language says nothing about marketing or pricing the company before the Board can enter into a change of control transaction; it merely provides discretion over the manner of sale, which is

defined "as a sale of assets, merger, transfer or Membership interests or otherwise." (*Id.*) The last phrase modifies and limits the prior phrase granting discretion over the manner in which the sale would occur. It was included to define the word "manner." *See, e.g.*, *Butler v. Butler*, 222 A.2d 269, 271 (Del. 1966) ("[T]he meaning of doubtful words or phrases may be determined by reference to their association with other associated words and phrases.").

The Court of Chancery brushed this defining language aside, reasoning that the language was included to signal that, in addition to its other broad discretion over all aspects of marketing and selling the company, the board's discretion "*includes* decisions about the form of the transaction." Opinion 27. The court's reading is unsupportable. There are no textual clues that would lead an ordinary reader to believe that the list was intended to be illustrative of only *some* types of discretionary choices. For example, the list is not introduced by the word "including" or any other signal that it does not limit the definition of "manner." *Cf. Pauls v. State*, 554 A.2d 1125 (Del. 1989) (holding the word "includes" indicates a list is illustrative and not exclusive). Moreover, if the definition of "manner" includes all aspects of the marketing and sale of the company, then the list of examples would serve no purpose. *See Kuhn Constr., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396-97 (Del. 2010) ("We will read a contract as a whole and we will give each provision and term effect, so as not to render any part of the

contract mere surplusage.”). The more natural reading of the phrase is that the list provides examples to define the “manner” of the sale over which the Board has sole discretion.

3. Requiring that an “Approved Sale” be to an “independent third party” neither expands the scope of Section 8.06(a) nor prevents bad-faith conduct.

On page 29 of the Opinion, the Court of Chancery asserts that the parties “filled” any remaining “gap” by requiring that any “Approved Sale” be to an “independent third party,” thus preventing the potential for a self-dealing insider transaction. This assertion is incorrect for two reasons. First, as already explained, the “sole discretion” granted to the Board in Section 8.06(a) is limited and does not expand to the marketing or pricing of Trumpet. Second, while the “independent third party” requirement prohibits self-*dealing* insider transactions, it does not prohibit self-s*erving* third-party transactions. In other words, it leaves a tremendous gap on the good faith front. For example, HCP could comply with the “independent third party” rule by walking outside, finding an independent third party walking down the street, and selling Trumpet to that party for $10.00. While such a sale would not be to an insider, it would certainly violate the parties’ reasonable expectations about how Trumpet would be marketed.

Therefore, the Court of Chancery erred in holding that the Agreement's express terms left no room for application of the implied covenant of good faith and fair dealing.

II. The Court of Chancery erred in rejecting Plaintiff's reasonable expectations that the Board would undertake at least some level of market check, and that HCP would not seek to undermine efforts to obtain a fair price for Trumpet.

A. Question presented.

At the time of contracting, Plaintiffs held the expectation that if HCP elected to sell Trumpet, HCP would shop the company to the market in at least some way to achieve a fair price. Plaintiffs also expected that HCP would not actively undermine attempts to engage potential bidders. Under these well-pleaded circumstances, were Plaintiffs' expectations "reasonable" for purposes of the implied covenant of good faith and fair dealing?

This question was preserved before the Court of Chancery at Appendix pages A-201 to A-208.

B. Scope of review.

The scope of review pertaining to this question is the same as set forth in Part I above.

C. Merits of argument.

In Part I, Plaintiffs demonstrated that the Agreement does not expressly address how Trumpet would be marketed and thus the implied covenant of good faith can supply those missing terms. The next step is to determine whether Plaintiffs' expectations about how the marketing and pricing would be handled are reasonable.

Applicable law. The implied covenant of good faith upholds the parties' reasonable expectations when the contract's express terms do not address the particular conduct at issue. *Gerber* 67 A.2d at 421. Whether the expectations are reasonable for purposes of the implied covenant is considered at the time of contracting, not when the alleged breach occurred. *Id.* at 418-19. If the Court determines that defendants' conduct frustrated the reasonable expectations of the parties, then the implied covenant prohibits the conduct. *Id.* at 419 (quoting *ASB Allegiance*, 50 A.3d at 440-42) ("The implied covenant requires that a party refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of its bargain."). When exercising any discretionary right, "a party to the contract *must* exercise its discretion reasonably." *Id.* (emphasis added) (quoting *ASB Allegiance*, 50 A.3d at 440-42).

Discussion. The complaint alleges that, at the time the Agreement was signed, Plaintiffs held the reasonable expectation that if HCP elected to sell Trumpet, it would engage in a process designed to obtain the best price reasonably available. (App. at A-16, ¶ 36, A-19, ¶ 47, A-27, ¶ 75.) The complaint also alleges the reasonable expectation that HCP would not impede and actively undermine attempts to obtain a fair price. (*See id.* at A-23, ¶ 62 to A-25, ¶ 68, A-27, ¶ 75.)

The Court of Chancery rejected the "reasonableness" of Plaintiffs' expectations principally because it misconstrued Section 8.06(a). As demonstrated above, the Agreement does not address how the Board would test the market, or how a sale price would be obtained, thus leaving a gap for the implied covenant to supply those missing terms. Accordingly, when the Agreement is read correctly, much of the Court of Chancery's opposition to the question of "reasonable expectations" evaporates.

The court's three other stated reasons for rejecting Plaintiffs' reasonable expectations are also erroneous.

1. Plaintiffs' expectation that the company would be exposed to the market was so fundamental that the parties did not see the need to address it with express language.

The Court of Chancery reasoned that if the Plaintiffs' pre-contractual expectations were so reasonable, they could have negotiated those terms and expressly included them in the Agreement. Opinion 35-36. This assertion, however, could be made in every implied covenant case. A party always *could have* negotiated for express language addressing the issue. But that is not the point. Sometimes, express terms are omitted because they are so fundamental that the parties did not see the need for them. *See Dieckman*, 155 A.3d at 368 (quoting *In re El Paso Pipeline P'rs, L.P.*, No. 7141-VCL, 2014 Del. Ch. LEXIS 101, at

*53 (Ch. June 12, 2014)) (terms are easily implied where they are "so obvious to the participants that they never think, or see no need, to address them").

Such is the case here. The expectations that the Board (i) would take reasonable steps to test the market and find a fair price for Trumpet, and (ii) would not actively impede attempts to obtain a fair price, are so fundamental that the parties did not think, or see a need, to address them. That is why the Agreement is silent about how the Board would market Trumpet.

No alternative expectations make sense. Under the Agreement's waterfall system of distributing sale proceeds, the first roughly $30 million goes almost exclusively to HCP or its affiliates at a 2x return. And if HCP elected to sell Trumpet, and approved a sale under Section 8.06(a), Plaintiffs and the other members were required to consent. It is not rational to conclude that, Mr. Miller—after co-founding and building Trumpet—would agree to these conditions without the expectation that HCP would shop Trumpet to the marketplace to realize Trumpet's fair value.

Plaintiffs accepted HCP's investment capital and relinquished control over Trumpet not because they trusted in *HCP*, but because they trusted in Trumpet's *value*. They believed that if HCP elected to sell, Trumpet's market value would be high enough to return sale proceeds that would flow over the waterfall levels and benefit everyone. This is the only reasonable view of Plaintiffs' expectations.

Otherwise, one would have to conclude that Plaintiffs gave away important rights to HCP on the belief that Plaintiffs' ownership interests were essentially worthless. Plaintiffs did not expect that HCP would ignore Trumpet's value, refuse to seek that value through the marketplace, and actively impede efforts to realize that value. *See Gerber*, 67 A.3d at 423 ("[Plaintiff] could not fairly be charged with having anticipated that" the defendants in that case would be allowed to carry out the objectionable conduct).

2. The Agreement's waiver of fiduciary duty did not waive any overlapping duties under the implied covenant of good faith and fair dealing.

According to the Court of Chancery, the Agreement's waiver of fiduciary duty eroded the reasonableness of Plaintiffs' expectations. Opinion at 24-25. The court reasoned that once fiduciary duties were waived, actions that would violate such duties could have been anticipated. This finding is in error and contrary to the Agreement's express language.

Fiduciary duties and the implied covenant of good faith are distinct legal doctrines. But that does not mean they do not overlap in certain cases to proscribe the same conduct. Put another way, some conduct not only violates a person's fiduciary duty but also their implied duty to act reasonably and in good faith.

Section 3.09 of the Agreement expressly states that when (as here) fiduciary duties and the implied covenant overlap to proscribe the same conduct, the

Managers (i.e., the Board members) remain liable for that conduct under the implied covenant:

> No Managers shall be personally liable to the LLC or to its Members . . . for breach of any fiduciary duty or other duty *that does not involve a breach of the duty to act in accordance with the implied contractual obligation of good faith and fair dealing*.

(App. at A-65, § 3.09 (emphasis added.)[5] Thus, the Board members were placed on notice that even if certain conduct would not be barred by fiduciary duties, that same conduct would be barred if it *also* constituted a breach of the implied covenant of good faith. Therefore, when HCP Board Member Signoret retorted that "he had no fiduciary duty under the Agreement," because he thought the waiver of fiduciary duties allowed HCP to unreasonably market Trumpet, he was wrong. (App. at A-18, ¶¶ 42-43.) The Court of Chancery's contrary implication was mistaken.

3. Section 8.06(a)'s notice requirements do not support the Court of Chancery's finding that the parties contemplated a closed-market sale.

The Court of Chancery reasoned that Section 8.06(a)'s requirement that the Board notify the members about the terms of an "Approved Sale" shows the parties

[5] Defendant HCP Investments is a member of Trumpet, but not a Board member. In Section 2.05 of the Agreement (App. at A-57), fiduciary duties and all other duties are waived as to members like HCP Investments, but only as allowed by law. The implied duty of good faith and fair dealing is not waivable under Delaware law. 6 Del. C. § 18-1101(c).

contemplated selling without exposing Trumpet to the open market. The court presumed that the members would not need such notice if an "open-market process were followed." Opinion 31. The court misunderstood what Plaintiff means by an "open-market process." Plaintiffs did not expect a front-page-news process that no member could possibly miss. Rather, Plaintiffs expected that the Board would (1) inform itself as to the value of Trumpet by reasonably exposing Trumpet to the marketplace; (2) test the market to see what it would bear; and (3) take reasonable steps to solicit competition from potential suitors. That is because such steps would be most likely to realize Trumpet's market value—the value Plaintiffs relied on when they signed the Agreement. Plaintiffs are not advancing a one-and-only way to shop the company. Regardless of how the Board conducted its market check or tested the market, the members would still require notification of an "Approved Sale" so they could comply with Section 8.06's "Drag Along" provisions. Therefore, the Court of Chancery's reasoning was erroneous.

Accordingly, the Court of Chancery erred in denying Plaintiff's reasonable expectations that the Board would inform itself as to the fair value of Trumpet by shopping it to the market in some way, and that HCP would not undermine the non-HCP Board Members' efforts to obtain competing offers for Trumpet.

III. HCP's conduct was arbitrary and unreasonable and deprived Plaintiffs of the fruits of their bargain.

A. Question presented.

After electing to sell Trumpet, HCP refused to shop Trumpet to the marketplace, actively undermined efforts to obtain a fair price, and forced a below-market sale of the company. Under these well-pleaded circumstances, does this conduct breach the implied covenant of good faith and fair dealing?

This question was preserved before the Court of Chancery at Appendix pages A-201 to A-208.

B. Scope of review.

The scope of review for this question presented is the same as set forth above in Parts I and II.

C. Merits of Argument.

Part I demonstrated that the Agreement's express terms left room for the implied covenant of good faith to govern how the Board could market Trumpet. Part II demonstrated that Plaintiffs held reasonable expectations that HCP would present Trumpet to the open market and would not actively undermine attempts to achieve a fair market price for Trumpet. This Part III demonstrates that HCP's conduct as alleged in the complaint was arbitrary and unreasonable, deprived Plaintiffs of the benefit of their bargain, and thus breached the implied covenant of good faith.

1. The complaint alleges arbitrary and unreasonable conduct that deprived Plaintiffs of the fruits of their bargain.

The complaint is replete with allegations of HCP's arbitrary and unreasonable conduct. By way of example only:

- At the time of the conduct alleged in the complaint, Trumpet's prominence in the marketplace had skyrocketed, and Trumpet had become one of the leading companies in its field. (App. at A-10, ¶¶ 17-18.)

- HCP controlled the Board. (*Id.* at A-8, ¶ 6 to A-9, ¶ 10; A-10, ¶ 19 to A-11, ¶ 20.)

- Once the Board approved a sale of Trumpet, the members were required to consent to such sale under the Agreement's "Drag Along" provisions. (*Id.* at A-15, ¶ 33.)

- Given the Agreement's waterfall system of distributing sale proceeds to members, the first roughly $30 million went almost exclusively to HCP or its affiliates at a 200% return on their capital investment. The HCP Owners would receive their full 200% return if Trumpet sold for an effective price of approximately $30 million. (*Id.* at A-11, ¶ 23 to A-14, ¶ 27.)

- At a December 16, 2016 Board meeting—only nine months after the Agreement was signed—Defendant Board member Carlos Signoret abruptly announced that HCP planned to sell Trumpet to MTS for an effective price of $31 million, just enough to collect HCP's 200% return and leave all

downstream members with nothing. (*Id.* at A-18, ¶ 41.) Mr. Signoret demanded that the other board members accept the deal and close on it quickly. (*Id.* at A-19, ¶ 44.)

- When challenged about the price and the lack of an open-market process, Mr. Signoret retorted that he had no fiduciary duties to anyone. (*Id.* at A-18, ¶ 41 to A-19, ¶ 44.) Mr. Signoret's retort reveals that he and the other HCP defendants knew that they were acting unreasonably and believed (incorrectly) they could do whatever they pleased without consequences. (*Id.* at A-18, ¶¶ 42-43.)

- When entreated to pursue a more robust process to obtain a market price, HCP gave Trumpet's CEO five days (the week before Christmas), to contact two designated entities who already had expressed some interest in Trumpet. (*Id.* at A-19, ¶¶ 44-47.)

- Notwithstanding these extreme limitations, Trumpet was able to gather one additional—albeit hastily prepared—Letter of Intent for about $36 million. (*Id.* at A-20, ¶ 48.) Tellingly, once MTS learned of this Letter of Intent, MTS quickly increased its offer from $31 million to effectively $39 million. (*Id.* ¶ 49.)[6]

[6] The price was "effectively" $39 million because any purchase would have to pay off approximately $2 million in debt.

- HCP knew the proposed price remained well below market, and they also knew the waterfall would dry up shortly after they received their 200% return. (*Id.* ¶¶ 50-51). HCP still refused to shop Trumpet to the open market to pursue a fair price. (*Id.*)

- During this time, the Board received a written indication of interest from FFL about pursuing sale discussions. FFL opined that Trumpet was conservatively worth $50 million to $60 million (well above the $39 million offered by MTS). (*Id.* at A-22, ¶ 57.)

- FFL had nearly purchased the industry's largest company (Center for Autism and Related Disorders, or "CARD") until the bidding topped $180 million (300% of revenue). (*Id.* at A-21, ¶ 55.) In the discussions with the FFL representative surrounding the delivery of FFL's indication of interest, the Board learned that FFL (through years of industry research) was aware of Trumpet's role and potential in the industry, that there was great market interest in Trumpet, and that Trumpet's market value was significantly greater than what MTS was offering. (*Id.* at A-21, ¶ 55 to A-22, ¶ 57.)

- Rather than investigating the FFL interest or at least opening up the process to allow the market to determine a fair sale price, HCP did just the opposite. HCP colluded with MTS to attack and undermine the FFL interest and stop any efforts to shop Trumpet to other potential market purchasers

(who remained unaware that Trumpet was even for sale). HCP held secret phone calls with MTS, supported groundless MTS attacks on Mr. Miller and the FFL indication of interest, and coerced and intimidated non-HCP Board Members to comply with HCP's demands—all to force the MTS sale and collect their 200% payout as quickly as possible with no regard to the other Trumpet members. (*Id.* at A-22, ¶ 59 to A-28, ¶ 77.)

- Had HCP shopped Trumpet more openly, a higher sale price could have—and would have—been obtained. A sale price well within the range of FFL's indication of interest would have greatly benefitted Plaintiffs and the other members. (*Id.* at A-28, ¶ 78 to A-29, ¶ 82.)

This egregious conduct, detailed in the complaint, was arbitrary, unreasonable, and directly violative of the parties' reasonable expectations that form the basis for the implied covenant claim.

2. The Court of Chancery ignored these well-pleaded allegations and improperly substituted its own view of the facts.

The Court of Chancery erred by not viewing the complaint in the light most favorable to the Plaintiffs, as required by Rule 12(b)(6). The court's analysis of the implied covenant issue was affected by its improper conclusion that all HCP did was choose to reasonably act in accord with its contractual incentives and take "the offer in hand" (MTS's offer) over "the one in the bush" (FFL's expression of

interest). Opinion 34. Near the end of the opinion, the court took the liberty to "note" that the board "made some effort to increase Trumpet's sale price." *Id.* The court pointed out that despite a few months passing after the initial offer, "no other offers were before the Board." *Id.* All of these observations are contrary to the complaint's well-pleaded allegations and reasonable inferences therefrom. As explained above, there were no other offers in the Board's "hand" because the Board refused to solicit them and in fact actively undermined any attempts to obtain competing offers. The Court of Chancery's weighing of the complaint's well-pleaded facts colored its view of the parties' reasonable expectations and improperly affected its decision.

Therefore, the Court of Chancery's decision that the complaint does not adequately allege a violation by HCP of the implied covenant of good faith and fair dealing should be reversed.

CONCLUSION

For the reasons set forth above, Plaintiffs respectfully request that the Court reverse the Court of Chancery's judgment and remand for further proceedings.

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