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IN THE SUPREME COURT OF THE STATE OF DELAWARE

MARION COSTER, Plaintiff Below, Appellant, v. UIP COMPANIES, INC., STEVEN SCHWAT, and SCHWAT REALTY LLC, Defendants Below, Appellees.	)	C.A. No.: 49,2020 On Appeal from the Court of Chancery of the State of Delaware C.A. No. 2018-0440-KSJM CONSOLIDATED

APPELLEES UIP COMPANIES, INC., STEVEN SCHWAT, AND SCHWAT REALTY LLC'S ANSWERING BRIEF

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TABLE OF CONTENTS

TABLE OF CITATIONS

Page(s)

Cases

Statutes

NATURE OF PROCEEDINGS

This is an appeal from the Court of Chancery's decision in a consolidated action combining a summary action for the appointment of a custodian for Appellee UIP Companies, Inc. ("UIP" or the "Company") under 8 *Del. C.* § 226(a)(1) and a plenary action challenging the validity of the Company's sale of 33 1/3 shares of stock to Appellee Bonnell Realty, LLC for $41,289.67 (the "Stock Sale"). These two consolidated cases were the first of what are now five lawsuits in four courts, and ten books and records demands that Appellant Marion Coster has now served on UIP and its affiliates – all following her unsuccessful efforts to try to force a buyout of the UIP shares she inherited from her late husband.[1] In the Court of Chancery, Mrs. Coster made serious allegations of wrongdoing, all of which the court roundly rejected.

Mrs. Coster's litigation spree began on June 15, 2018, when she filed an action in the Court of Chancery seeking the appointment of a custodian on the basis of an alleged deadlock over a vote to elect the Company's board of directors (the "Board") (the "Custodian Action"). *Coster v. Schwat*, C.A. No. 2018-0622-SG. The two

[1] *See, e.g.,* B071 [JX-331 at MC0069535] (Mrs. Coster's representative asking counsel whether she had "the right to seek dissolution of the business so she can 'cash out'" and observing that, "While this might not be in the long-term best interests of the company, frankly, Marion doesn't care about the long-term best interests of the company.… She cares about receiving the benefits promised her by her husband.").

shareholders each owned 33 1/3 of the Company's 100 authorized shares. On August 15, 2018, the Board approved the Stock Sale of the Company's remaining 33 1/3 authorized shares to Bonnell Realty, LLC; the sale broke the deadlock. The price was based on an independent valuation performed by the McLean Group, and diluted equally the ownership interests of the two "deadlocked" shareholders. On August 22, 2018, Mrs. Coster filed another complaint in the Court of Chancery seeking cancellation of the Stock Sale (the "Cancellation Action"). *Coster v. UIP Companies, Inc., et al.*, C.A. No. 2018-0440-KSJM. Upon the agreement of the parties, the two actions were consolidated.

The Court of Chancery held a two-day trial on April 17-18, 2019. Following briefing and oral argument, the Court of Chancery issued its Memorandum Opinion (hereinafter, cited as "Op.") on January 28, 2020. The Court of Chancery held that the Stock Sale was entirely fair to the Company and its shareholders. The Court of Chancery also declined to appoint a custodian. Mrs. Coster filed a Notice of Appeal on February 7, 2020.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery correctly found that the Stock Sale was valid because it was entirely fair to the Company. The Court of Chancery did not err in failing to apply a "compelling justification" standard for two reasons. First, the trial court's conclusion accords with Delaware precedent holding that the "compelling justification" standard be "rarely applied." And it correctly held that Mrs. Coster failed to prove that the Board's "primary purpose" was to interfere with the exercise of her corporate franchise. (Op. 29-31.) Second, the trial court correctly held that the question of whether the "compelling justification" standard would apply is irrelevant because the transaction nevertheless survived an entire fairness analysis. In so holding, the trial court correctly applied Delaware law in crediting the independent valuation performed by the McLean Group and holding that that the sale of the non-outstanding stock based on the enterprise value of the Company was entirely fair.

2. Denied. In the event this Court were to not only reverse the Court of Chancery's decision, but also hold the Board's approval of the Stock Sale invalid under the "compelling justification" standard on the basis of the record already established, serious questions would remain as to the requested appointment of a custodian. The appointment of a custodian is discretionary and the Court of Chancery credited testimony and evidence showing that the Board rationally

believed the appointment of a third-party custodian would have potentially catastrophic effects on the Company's business. Even if this Court were to invalidate the Stock Sale, it should not mandate the appointment of a custodian but rather remand for further proceedings relating to whether the Court of Chancery should exercise its discretion under 8 *Del. C.* § 226(a)(1).

COUNTERSTATEMENT OF FACTS

A. The Company

UIP was incorporated in Delaware on December 12, 2007, when its then principals, Messrs. Steven Schwat, Wout Coster and Cornelius "Kees" Bruggen, decided to invest together in real estate deals. B162-B164 [Tr. 300:7-302:23.] They implemented a structure common in the industry to facilitate their investments: The properties themselves were each owned through special purpose entities, or "SPEs," with the three principals typically investing alongside a major equity source. B167-B169 [Tr. 306:9-308:18.] The ability to control the management and development of the properties was important to the principals because, among other reasons, they typically had to personally guarantee the performance of the properties to their lenders. B170-B172 [Tr. 309:5-311:18.] They, therefore, created the Company as a holding company to operate subsidiary companies that would provide property management, asset/development management, and, as needed, construction services, to the projects the owners had invested in. *Id.*

In terms of corporate formalities, the Certificate of Incorporation authorized the Company to issue 100 shares of stock at a par value of $1.00 per share. B023 [JX-1.] In an initial resolution, the then-sole director of the Company, Steven Schwat, approved the issuance of 100 shares of the Company's stock, 33 1/3 shares to be sold at par value to each of Schwat Realty, LLC, Coster Realty, LLC, and

Bruggen Realty, LLC. B058 [JX-30 at UIP_0000043.] The initial resolution also approved the Company's Bylaws and appointed Steven Schwat, Wout Coster, Kees Bruggen, Peter Bonnell, and Stephen Cox to the Company's Board. B056 [JX-30 at UIP_0000041.] On January 1, 2011, Mr. Bruggen resigned and tendered his stock back to the Company. B064-B066 [JX-30 at UIP_0000049-51]; B166 [Tr. 305:3-21.] While he retained his ownership in certain SPEs through which the company's principals invested in properties (and continued to receive distributions from those investments), Mr. Bruggen received no compensation for his 33 1/3 shares of UIP stock. B166-B167 [Tr. 305:18-306:8]; B024-B047 [JX-4.]

The Company's Bylaws provide that "each elected director shall hold office until his successor shall have been duly elected and shall have qualified." B007 [JX-83 § 16.] As a small real estate development firm, its principals/directors historically worked together in the same office and debated issues face to face on a real-time basis, but for better or worse, they did not hew to some corporate formalities and did not hold annual meetings and, thus, no replacements were elected upon Mr. Bruggen's retirement and Mr. Coster's death. B175-B176 [Tr. 318:8-319:13.]

The Company has no employees, and it primarily operates through its three subsidiaries: UIP General Contracting ("UIPGC"), UIP Property Management ("UIPPM"), and UIP Asset Management ("UIPAM") (collectively, the "Operating

Companies.") B162-B165 [Tr. 300:16-303:5.] From 2008 on, the Operating Companies have, as intended, provided services to the SPEs that owned real estate development projects. *Id.* Each SPE hires the various Operating Companies to develop, operate, and manage properties. *Id.* When these SPEs contract with one or more of the Operating Companies, the large equity investors (who have much leverage) typically negotiate and often dictate the terms and fees governing the agreements. B173-B174 [Tr. 312:23-313:16.] Services provided to third-party clients represent a tiny fraction of the Operating Companies' revenue. B210 [Tr. 492:1-19]; B216-B217 [Tr. 500:12-501:12.] Historically, the Company has never made distributions to its owners from it or its Operating Companies' profits. B193-B194 [Tr. 354:2-355:6.]

B. The Negotiations for a Succession Plan

Mr. Bonnell had been with UIP since shortly after the Company's inception. B162-B164 [Tr. 300:7-302:13.] Over those years, Mr. Coster and Mr. Schwat had several times promised Mr. Bonnell that he would become a principal of the Company and begin receiving significant percentages of promote interests related to projects he had worked on, in addition to becoming a full partner on new deals: signing required recourse, raising money, and being included proportionately in the promote entities; but neither Mr. Bonnell nor the principals had ever memorialized

those promises in writing. B177-B178 [Tr. 322:18-323:6]; B202-B203 [Tr. 427:9-428:4.]

In early 2014, Mr. Coster disclosed to Messrs. Schwat and Bonnell that he had leukemia and would need to begin to reduce his involvement in the day to day operations of the Company. B203 [Tr. 428:5-23.] At the same time, Heath Wilkinson—the executive then running UIPGC—had resigned and Mr. Bonnell, unsure of whether the principals' promises would ever come to fruition, also began exploring other opportunities. *Id*; B048 [JX-10 at UIP_0003166.]

Alarmed that the departure of key operational personnel at a time when Mr. Coster's future ability to participate in the management of the Company was uncertain could compromise the Operating Companies' viability, the principals began to negotiate a "succession plan" with Mr. Bonnell and Mr. Wilkinson that would provide for Mr. Schwat, Mr. Bonnell, and Mr. Wilkinson to eventually become equal 1/3 shareholders of the Company's outstanding stock, with Mr. Coster effectively being bought out. B179-B184 [Tr. 326:15-331:11.]

To that end, on April 11, 2014, Messrs. Schwat, Coster, Bonnell, and Wilkinson executed a "FINAL Term Sheet" (the "Term Sheet"). A42-A48 [JX-11.] While the Term Sheet was subject to the review of the respective parties' tax counsel and tasked the parties to select counsel to draft definitive agreements, it provided that upon the execution of affirmative agreements, Messrs. Coster and Schwat would

assign 15% of the promotes earned on deals already completed to each of Mr. Bonnell and Mr. Wilkinson, respectively, and would transition ownership of some of Mr. Schwat's and all of Mr. Coster's interest in the Company to Mr. Bonnell and Mr. Wilkinson over three years. A42 [JX-11 at UIP_0003365.]

After executing the term sheet, the parties asked the Company's then-corporate accountant, Michael Rinaldi, and Michael Sloan, an attorney with Davis, Wright, and Tremaine LLP hired to represent the Company, to review the proposed deal and identify any tax implications. A452-A453 [Tr. 335:19-336:2.] Messrs. Rinaldi and Sloan realized that the proposed deal was extremely tax inefficient. (*Id*.) In short, once the promote assignments to Messrs. Bonnell and Wilkinson were taxed and the note to Mr. Coster was repaid, Mr. Bonnell and Mr. Wilkinson would lose money. B204-B205 [Tr. 432:3-433:15.] Throughout the summer and fall of 2014, the parties to the Term Sheet kept trying to make progress on a simplified, more tax efficient, agreement whereby Mr. Coster would effectively be paid for his goodwill in the Company by means of a note equaling his salary on a declining basis over the next five years. *See generally*, B052-B055 [JX-14.]

While final documents had not been drafted, the parties agreed to start implementing certain aspects of what they had agreed to. B185-B189 [Tr. 343:10-347:3.] Messrs. Bonnell and Wilkinson were announced as principals of the Company. B209 [Tr. 459:14-22.] Mr. Schwat and Mr. Coster agreed to each begin

assigning 11% of past promote payments to Mr. Bonnell and Mr. Wilkinson and approved promote distributions reflecting this new allocation. B187-B189 [Tr. 345:17-347:3.] Mr. Coster also agreed to reduce his salary to $300,000 in June 2014, consistent with the parties' agreement. *Id.* In addition, all the deals that closed after April 11, 2014, and until Mr. Coster's death reflected the promote split agreed upon in the Term Sheet. *Id.* Despite the implementation of these aspects of the agreement, however, the parties to the Term Sheet were not able to agree on the terms for the sale of Mr. Coster's shares in the Company. B187 [Tr. 345:5-16.]

C. Mr. Coster's Death and Subsequent Negotiations with Plaintiff and Mr. Coster's Estate

On April 7, 2015, with Mr. Coster's health deteriorating, Robert Gottlieb, an attorney representing Mr. Coster and the Wout Coster Family Trust (the "Trust"), emailed the parties to the Term Sheet to reiterate Mr. Coster's request to finalize definitive agreements. B189-B190 [Tr. 347:11-348:3.]

The next day, April 8, 2015, Mr. Coster died. B187 [Tr. 345:6-16.] Mr. Schwat emailed Plaintiff and offered to meet with her to explain the terms of the deal that he believed that Mr. Coster had intended to memorialize. B190 [Tr. 348:4-22.] On June 2, 2015, Mr. Gottlieb emailed Mr. Schwat to inform him that "[t]he Estate is prepared to move forward with the reorganization." B190-B192 [Tr. 348:23-350:12.]

In the summer of 2016, after Mrs. Coster expressed concerns over the lack of predictable income associated with payments stemming from her promote interests, Michael Pace, a retired attorney whose wife was the executor of Mr. Coster's estate, volunteered to help Mrs. Coster understand the legal issues relevant to the estate. B140-B142 [Tr. 28:13-30:22.] Mr. Pace offered to negotiate a "global solution" encompassing both Marion's promote interests and the shares in the Company that she had inherited from Mr. Coster. *Id.* The solution was intended to "take Marion and the estate completely out of the businesses." *Id.*

While Messrs. Schwat and Bonnell voluntarily shared the Company's financial records with Mrs. Coster and her advisors so as to allow them to secure independent valuations of the Company, B147 [Tr. 51:15-24], both Mrs. Coster and Mr. Pace testified that neither of them sought to review or understand the financial information provided. B159 [Tr. 155:5-18 (Mrs. Coster)]; B148-B149 [Tr. 69:11-70:1 (Mr. Pace).] Mr. Pace, however, testified that he relied on the representations of Mr. Rinaldi that the Operating Companies were "generating significant revenues," which Mr. Pace apparently conflated with profits in concluding that representations from Mr. Bonnell that the Operating Companies "were essentially breaking even" were misleading. B143-B144 [Tr. 35:11-36:4]; B073-B078 [JX-219.]

Mrs. Coster's advisors were in possession of information concerning the value of her interests that they did not intend to share with Messrs. Schwat and Bonnell.

B153-B156 [Tr. 74:21-77:3.] Mr. Pace further testified that while there was a discussion at some point about having Mr. Rinaldi perform a valuation of the Company, the plan was discarded because "[i]t would not be helpful to [Marion] for [UIP] to have a low valuation in hand because they will use it to justify a low offer." B145-B146 [Tr. 44:12-45:14]; B157-B158 [Tr. 88-6-89:13]; B079 [JX-40.] Mrs. Coster had also received information from the Estate's attorneys and their retained valuation firm concurring that the operating entities that together comprise UIP had little to no independent value. B155 [Tr. 76:3-24.]

Asked to propose a buyout solution that would compensate Mrs. Coster for all of her interests (including both the Operating Companies and the SPEs), Mr. Bonnell emailed Mrs. Coster on September 25, 2016. B206-B208 [Tr. 448:22-450:16.] Although Mrs. Coster has claimed in these proceedings, including to this Court, that the Defendants leaned on her to sell them her interests at deeply discounted (and unfair) values, in fact, the evidence showed that they did just the opposite. *Id.*

On April 4, 2018, Mrs. Coster (through her lawyer) demanded a shareholder meeting for the election of directors. B195 [Tr. 356:2-8.] A special meeting of the stockholders of the Company was held promptly on May 22, 2018. *Id.* Mrs. Coster's proxy (her lawyer) presented a proposal for Mrs. Coster's daughter-in-law and son-in-law to be elected to vacant seats on the five-person Board. A264-A265 [JX-50];

B195-B196 [Tr. 356:9-357:9.] Neither that nor another proposal achieved a majority. *Id*. At trial, Mrs. Coster admitted that neither her daughter-in-law nor her son-in-law had any relevant experience in real estate development and that, despite being informed that the Defendants would consider candidates for the Board with relevant experience, Mrs. Coster did not provide any alternative candidates. B160 [Tr. 157:1-9.]

On June 1, 2018, by a Unanimous Consent of the Board, the Company's Bylaws were amended to reduce the size of the Board to three. B080-B082 [JX-51.] On June 4, 2018, the Company held an annual meeting of the shareholders, and Mr. Schwat presented a proposal to re-elect Mr. Schwat, Mr. Bonnell, and Mr. Cox to the Board. A266-A268 [JX-52.] Mr. Schwat also presented two proposals submitted by Mrs. Coster to increase the size of the Board to five seats, and to elect Mrs. Coster, her daughter-in-law, and her son-in-law to the Board. *Id.* None of the proposals was approved by a majority of the shareholders and, under the Bylaws, Mr. Schwat, Mr. Bonnell, and Mr. Cox consequently continued to serve as holdover directors. *Id.* Just over two weeks later, on June 22, 2018, Plaintiff filed the Custodian Action seeking the appointment of a custodian to break the "deadlock." B083-B097 [JX-54.]

D. The Stock Sale to Bonnell Realty

Concerned about keeping the Company together, both in terms of the potential impact of the Custodian Action on the Company's operations, the need to keep Mr. Bonnell motivated to continue to stay at the Company (the promise of equity interest in the Company that he had been promised years ago had never been fulfilled), and the potential for a devastating exodus of approximately 100 employees of the Company due to fears around this litigation, Mr. Schwat, assisted by counsel, retained the McLean Group on behalf of the Company to perform an independent valuation. B196-B195 [Tr. 357:19-359:23.] In a July 27, 2018 email, Mr. Schwat instructed Andy Smith, a Managing Director of the McLean Group, that the Company did "NOT want you to hurry your valuation in any way that would leave you less than 100% confident that you have the correct, fair market value of the company." B199-B201 [Tr. 362:21-364:5.] On August 14, 2018, the McLean Group transmitted the finalized version of its valuation of the Company (the "McLean Valuation"). A294-A357 [JX-66.] Mr. Smith testified at trial regarding the process he used to develop a valuation of the Company: he followed the valuation standards prescribed by the American Institute of CPAs, and considered the appropriate factors bearing on the valuation of a 100% equity interest in the Company, including the Company's expected future cash flows and its line of credit and deficient working capital balance, as well as possible capital expenditures, the

effects of income tax, the specific-industry risk associated with the enterprise, and the "key-person" risk posed by the critical roles of Mr. Schwat and Mr. Bonnell in the business, among other things. B218-B219 [Tr. at 516:12-517:22]; B220-B222 [Tr. 524:7-526:9]; B223 [Tr. 534:3-21.]

Based on that analysis, the McLean Group concluded that the enterprise value of the Company was $1,071,822. A349 [JX-66 at 56.] From that value, as is standard, the McLean Group deducted an amount reflecting the deficiency in working capital and $495,733 reflecting the balance outstanding on the Company's line of credit, which resulted in a net equity value of $123,869 as of June 30, 2018. A297, A303, A349 [JX-66 at 4, 10, 56]; B224 [Tr. 535:11-15.]

At trial, Jeffrey Zell, an accomplished real estate developer and consultant, testified that from a real estate industry perspective, the McLean Valuation was reasonable. B213-B217 [Tr. 497:20-501:23.] He explained that the structure of the Company and the Operating Companies, whereby the Operating Companies service primarily properties affiliated with the principals rather than third-party owners, is common in the industry. B211 [Tr. at 495:1-14]; B211-B212 [Tr. 495:23-496:10.] He went even further to say that, given the risks associated with this particular Company's business model and the reliance on business generation by Mr. Schwat and Mr. Bonnell, he was "not so sure anybody would pay anything for any of these companies." B214-B215 [Tr. at 498:17-499:3]; B217 [Tr. 501:17-23.] Mr. Zell

confirmed what the parties' themselves (including Mr. Coster) had understood for years – the real value of the business was in the SPEs and "promote" entities, not the Company. B213-B217 [Tr. 497:20-501:23.] Illustrating the point, Mr. Schwat testified that Mrs. Coster herself had received between $2.5 million and $2.7 million in distributions from the SPEs since her husband's death. B193-B194 [Tr. 354:2-355:6.]

On August 15, 2018, pursuant to a Unanimous Consent of the Board, the Company sold the 33 1/3 shares of authorized, non-outstanding stock to Bonnell Realty for 1/3 of the Company's equity value established in the McLean Valuation—or $41,289.67. A258-A360 [JX-68.] The Board noted that the transaction was intended to effectuate the purpose of the Term Sheet signed in April of 2014 so that Mr. Bonnell would have an equity interest in the Company. B198 [Tr. 359:7-18.] Defendants readily acknowledge that, while the purpose of the transaction was, as reflected on the Unanimous Consent, to effect the long-desired transition of ownership to Mr. Bonnell, the timing of the transaction was certainly driven in large measure by the Custodian Action. B198 [Tr. 359:19-23.] As Mr. Schwat explained, the imposition of a custodian on the Company could have serious implications for the Company's on-going business, and he felt it was his obligation to try to avoid that if possible. B196-B197 [Tr. 357:19-358:7.] On August 22, 2018, Mrs. Coster

filed the Cancellation Action in the Court of Chancery seeking to cancel the Stock Sale.

E. The Court of Chancery's Opinion

After a two-day trial and post-trial briefing by the parties, the Court of Chancery issued its 66-page Opinion on January 28, 2020. (Op. 1.) Although the Court of Chancery considered the issues "largely moot" in light of its evaluation of the Stock Sale under the entire fairness standard, (*id*. at 29), it made factual findings that although the Board's decision to authorize the Stock Sale "was significantly motivated by a desire to moot the Custodian Action," (*id*. at 29, 30), the Defendants had "further demonstrate[d] that the Custodian Action was deleterious to UIP for reasons unrelated to the Plaintiff." (*Id.*) The trial court credited testimony from Messrs. Cox and Schwat that they had approved the Stock Sale to Mr. Bonnell because it "effectuated the purpose of the Term Sheet" and "had promised" Mr. Bonnell that he would be a full partner in the Company. (*Id.*) Finally, the trial court found that Mr. Schwat had long considered Mr. Bonnell "essential to the Company's survival." (*Id.*)

When the Court of Chancery turned to the parties' legal contentions, it addressed first the challenges to the Stock Sale, and then addressed the "ramifications of those rulings" on the remaining claim seeking the appointment of a custodian. (Op. 33.) The trial court first held that because the Stock Sale would

be subjected to an entire fairness review—"Delaware's most onerous standard of review"— it would not reach "Plaintiff's alternative argument[]" that the Stock Sale must meet the "compelling justification" standard. (*Id*. at 36.) The trial court explained that entire fairness review applied because it found that a majority of the Board that approved the transaction (i.e., Messrs. Bonnell and Schwat) were interested in the transaction. (*Id*. at 37-42.)

The Court of Chancery then evaluated the Stock Sale under the entire fairness rubric. On the question of fair dealing, the trial court first addressed Plaintiff's arguments that "several defects in process … compel a finding of unfairness." (Op. 43.) The trial court rejected each objection, finding no defect in process was evident from: (1) the timing of the Stock Sale (*id*. at 44); (2) the failure to conduct a "market check" in the face of evidence that there was no external market for the shares (*id.*); and (3) the failure to hold an official Board meeting to approve the Stock Sale. (*Id.* at 44.) Finally, the trial court rejected Mrs. Coster's attacks on the independence and credibility of Andy Smith and the McLean Group, who performed the independent valuation used to determine the sale price in the Stock Sale, finding that "[Mrs. Coster's] attempts to impugn the process by portraying Smith as biased miss the mark." (*Id.* at 48.) While the trial court noted that the process was not "optimal" it found that Mrs. Coster's fair dealing arguments did not prove that the price reached was unfair. (*Id.* at 49.)

The Court of Chancery next considered the "fair price" prong of the entire fairness analysis. (Op. 48-65.) The trial court noted that while the Company had proffered the McLean Valuation as accurately valuing the Company (and therefore, the stock sold), Mrs. Coster did not offer her own valuation and instead presented an expert who "did not review any materials or evidence in the record other than the McLean Valuation itself" in his attempt to discredit the valuation. (*Id.* at 50.) The trial court first summarized the "capitalized cash flow" analysis employed by the McLean Valuation that reported a final equity value for the Company of $123,869. (*Id.* at 50-53.) It then rejected the criticisms of the valuation offered by Mrs. Coster's expert, (*id.* at 54-64), before holding the McLean Valuation to be "the most reliable indicator of the fair value of UIP as of the date of the Stock Sale" and consequently holding that: (1) "Defendants have carried their burden of proving that the price of the Stock Sale based on the McLean Valuation falls within a reasonable range of values," (*id*. at 64); (2) the Stock Sale satisfied the entire fairness standard, (*id*.); and (3) Defendants "did not commit a fiduciary breach." (*Id.* at 65.) Finally, the trial court concluded that because the Stock Sale was valid, it could not assume the stockholders in the Company were currently deadlocked and consequently declined to appoint a custodian. (*Id.*) Nor did the trial court find any other valid basis in any of Mrs. Coster's other attempts at arguments in support of the appointment of a custodian. (*Id.* at 65-66.)

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY DETERMINED THAT THE BOARD BREACHED NO FIDUCIARY DUTIES IN APPROVING THE STOCK SALE BECAUSE THE SALE SATISFIED ENTIRE FAIRNESS REVIEW.

A. Question Presented

Did the Court of Chancery correctly apply Delaware law when it found that the Stock Sale was a self-interested transaction that was nevertheless valid by virtue of being entirely fair to the Company and its shareholders? (Op. 64-65.)

B. Scope of Review

The Court of Chancery's finding that the Stock Sale was valid is a mixed question of law and fact. While the Court's legal conclusions are reviewed *de novo*, its factual findings are disregarded only where there is clear error. *DV Realty Advisors LLC v. Policemen's Annuity & Benefit Fund of Chi., Ill.*, 75 A.3d 101, 108 (Del. 2013). "The factual findings of a trial judge can be based upon physical evidence, documentary evidence, testimonial evidence, or inferences from those sources jointly or severally." *Cede & Co., v. Technicolor, Inc.*, 758 A.2d 485, 491 (Del. 2000). "The fact that the appellant disagrees with the court's factual determinations is not a basis for reversal. Factual findings will not be disturbed on appeal unless they are clearly erroneous." *Brennan v. Abrams*, 215 A.3d 1283, 2019 WL 3883733, at *1 (Del. Aug. 16, 2019) (Table). Under that standard, a trial court's

factual findings may not be reversed so long as they are plausible in light of the record viewed in its entirety. *Banther v. State*, 823 A.2d 467, 483 (Del. 2003).

C. Merits of Argument

Mrs. Coster's challenges to the Court of Chancery's holding that the Board "did not commit a fiduciary breach" in approving the Stock Sale (Op. 65) are without merit. At the outset, Mrs. Coster argues that the trial court erred in failing to apply the *Blasius* standard, which would require Defendants to establish a "compelling justification" for the Stock Sale. (AOB at 21-24)[2]; *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). But for the *Blasius* standard to apply, Mrs. Coster had to prove that the Board's motivation for the Stock Sale was "for the primary purpose of impeding and interfering" with her power to "effectively exercise [her] voting rights in a contested election for directors." *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003). The trial court explicitly found that Mrs. Coster failed to meet this burden, and therefore was correct in declining to apply the *Blasius* standard to the Stock Sale. (Op. 29-31.)

Mrs. Coster also ignores the extensive Delaware precedent discussing the limited circumstances in which the "compelling justification" standard will be applied in lieu of enhanced *Unocal* scrutiny and/or entire fairness review. *See, e.g.*,

[2] References to Appellant Marion Coster's Opening Brief hereinafter are cited as "AOB at __."

Keyser v. Curtis, 2012 WL 3115453 (Del. Ch. July 21, 2012) (applying entire fairness analysis and not the Blasius standard to self-interested director's issuance of stock intended to defeat an imminent board takeover); *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 811 (Del. Ch. 2007) (noting that the "compelling justification" test should not be used when "more traditional tools are available to police self-dealing or improperly motivated director action"). Indeed, Mrs. Coster fails to note that, in the Opinion, the trial court expressly declined to apply the "compelling justification" standard to a self-interested transaction that would already be subject to entire fairness review. (Op. 36.)

Mrs. Coster's half-hearted challenges to the Court of Chancery's application of the entire fairness analysis are similarly meritless. The trial court found that Mrs. Coster failed to show any facts that the independent discounted cash flow ("DCF") valuation of the Company represented an unfair process or produced an unfair result. (Op. 48-62.) Moreover, Mrs. Coster's assertion that the McLean Group was obligated to impose a "control premium" to its valuation for purposes of the Stock Sale to Mr. Bonnell is a stunning misstatement of Delaware law. (AOB at 36-39.)

1. The Court of Chancery Was Not Required to Apply *Blasius's* "Compelling Justification" Standard

In her opening brief and throughout her briefing in the case below, Mrs. Coster consistently conflates the rights of shareholders as a class with her own purported

right to participate in the management of the Company, despite lacking the requisite shareholder votes to secure such representation. In doing so, Mrs. Coster ignores the wealth of precedent in which myriad defensive actions have been upheld by Delaware courts applying *Unocal Corp. v. Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985), and its progeny. *See also Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 192 (Del. Ch. 2005) (declining to find that directors acted with improper purpose or were self-interested when they approved a convertible stock issuance that diluted the interest of a dissident shareholder who had expressed the desire to control the company and was viewed as "hostile" to management). As these cases make clear, the evaluation of the reasonableness of a Board's defensive action is determined in relation to all shareholders' interests, and not only to the shareholder whose action may be thwarted. *See Unocal*. 493 A.2d at 958 ("The board continues to owe Mesa the duties of due care and loyalty. But in the face of the destructive threat Mesa's tender offer was perceived to pose, the board had a supervening duty to protect the corporate enterprise, which includes the other shareholders, from threatened harm."); *see also Ryan v. Armstrong*, 2017 WL 2062902, at *2 (Del. Ch. May 15, 2017) (finding that *Unocal* enhanced scrutiny is "primarily a tool for this Court to provide equitable relief where defensive measures by directors threaten the stockholders' right to approve a value-enhancing transaction"). But as this Court held in *Unocal*, "[t]here is no obligation of self-sacrifice by a corporation and its

shareholders in the face of such a challenge [to corporate control]." *Unocal*. 493 A.2d at 958.

Thus, in *Blasius*, the Court of Chancery considered whether a board complies with its fiduciary duties when it acts "for the primary purpose of preventing or impeding an unaffiliated majority of shareholders from expanding the board and electing a new majority." *Blasius*, 564 A.2d at 651. The *Blasius* court acknowledged that it was "established in [Delaware] law, that a board may take certain steps — such as the purchase by the corporation of its own stock — that have the effect of defeating a threatened change in corporate control, when those steps are taken advisedly, in good faith pursuit of a corporate interest, and are reasonable in relation to a threat to legitimate corporate interests posed by the proposed change in control." *Id*. at 659. This rule recognized that the exercise of good faith and due care generally immunized the exercise of legal authority that nevertheless had the effect of entrenching the board, so long as the action was not designed "***for the primary purpose of interfering with the effectiveness of a stockholder vote.***" *Id*. (emphasis added). However, the *Blasius* court reasoned that "a board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of the corporation's power over its property, or with respect to its rights or obligations" but rather, "involves allocation, between shareholders as a class and the board, of

effective power with respect to governance of the corporation." *Id*. at 660. In other words, the "compelling justification" standard was designed to evaluate board action that removed the power to determine the composition of the board from the shareholders ***as a class*** and allocated it to management. That was simply not the case here.

The Court of Chancery has explained that *Blasius* is a particularization of a broader concept finding board conduct relating to a shareholder vote to be inequitable when it has the effect of either: (1) "precluding shareholder action," or (2) "snatching victory from an insurgent slate on the eve of [a] noticed meeting." *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 495 (Del. Ch. 1995). This Court has consequently held that the "onerous" compelling justification standard should be "applied rarely" and is "appropriate only where the 'primary purpose' of the board's action [is] to interfere with or impede exercise of the shareholder franchise,' and the stockholders are not given a 'full and fair opportunity to vote.'" *Williams v. Geier*, 671 A.2d 1368, 1376 (Del. 1996) (quoting *Stroud v. Grace*, 606 A.2d 75, 92 (1992)). But Mrs. Coster fails to explain how the Stock Sale, which was effectuated *after* the stockholders were given a "full and fair opportunity to vote" on the election of corporate directors, falls within the *Blasius* framework.

Mrs. Coster was afforded the opportunity to vote for the election of new directors. She failed to have her slate of directors elected to the Board, however,

because she never controlled a majority of shares sufficient to allow her to do so. Having exercised her franchise and failed to elect new directors, Mrs. Coster sought the appointment of a custodian pursuant to 8 *Del. C.* § 226(a)(1). But the appointment of a custodian does not implicate the allocation of power between the Board and the shareholders ***as a single class***. Rather, it implicates the allocation of power between ***different sets of shareholders*** when the shareholders are deadlocked after being afforded the opportunity to exercise the corporate franchise. Indeed, the very basis of the custodian action is premised upon the absence of a majority of shareholders sufficient to elect new directors. Furthermore, the appointment of a custodian over the objection of Mr. Schwat (who owned 50% of the Company's then issued stock) could certainly not be said to have vindicated the rights of the Company's shareholders as a class.[3]

2. The Court of Chancery Correctly Held that Mrs. Coster Had Failed to Show the Board Acted for the "Primary Purpose" of Entrenchment.

The Court of Chancery's factual findings explicitly reject Mrs. Coster's

[3] To this end, Mrs. Coster seems to misunderstand the court below when she cites to its observation that "Defendants obviously desired to eliminate Plaintiff's ability to block stockholder action, including election of directors," (Op. 42), as an admission that the Stock Sale should trigger *Blasius* scrutiny. But the Court was not observing that ***the Board*** was motivated by a desire to block shareholder action, but rather that it was motivated to oppose ***Mrs. Coster's*** attempt to foreclose the election of directors through the appointment of a custodian.

contention that the "Stock Sale's primary purpose was to disenfranchise her." (Op. 29-32.) While the trial court acknowledged that Messrs. Schwat and Bonnell were "significantly" motivated by a desire to moot the Custodian Action (indeed, Defendants freely conceded as much, at least in as much as the timing of the transaction (as opposed to the fact of the transaction) was concerned), (*id*. at 30), the Court of Chancery explicitly found that "Defendants demonstrate[d] that the Custodian Action was deleterious to UIP for ***reasons unrelated to Plaintiff***." (*Id*.) (emphasis added). Noting that Messrs. Schwat and Bonnell had testified that the appointment of a custodian constituted an event of default under various SPE contracts, the trial court found that "the appointment of a custodian threatened to cut off a substantial portion of UIP's revenue stream." (*Id*. at 30-31.) The Court of Chancery also found that the testimony from Messrs. Cox and Schwat that the Stock Sale was motivated largely by the desire to keep the Company's promises to Mr. Bonnell "rang true" because Mr. Bonnell was "viewed as essential to the Company's survival." (*Id*. at 31.) Thus, the trial court found that Mrs. Coster "did not succeed in proving her theories regarding Defendants' purposes or justifications." (*Id*. at 32.)

Contrary to Mrs. Coster's contention (AOB at 25-26), this finding did not impermissibly shift a burden of proof borne by the Defendants upon her. Under *Blasius*, board members bear the burden to show a compelling justification ***only*** once the plaintiff has established that the board acted with the "primary purpose" of

interfering with a shareholder vote or disenfranchising a fiduciary. *See, e.g., State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, 2000 WL 1805376, at *8 (Del. Ch. Dec. 4, 2000) ("Under [the *Blasius*] test, first the plaintiff must establish that the board acted for the primary purpose of thwarting the exercise of a shareholder vote."); *Williams*, 671 A.2d at 1389. ("If, however, the facts show that the Board's primary purpose was to dilute the franchise of the non-Geier Family shares, then, under *Blasius*, Defendants '[bear] the heavy burden of demonstrating a compelling justification for such action.'") (quoting *Blasius*, 564 A.2d at 661). In finding that Mrs. Coster failed to prove her theories regarding the Board's purposes and justifications, the Court of Chancery was not inappropriately requiring Mrs. Coster to prove that the Defendants lacked a compelling justification for an action otherwise prohibited by *Blasius* and its progeny, but rather that Mrs. Coster ***had failed to show an improper motivation triggering the compelling justification standard in the first place***.

3. The Court of Chancery Did Not Err in Applying the Entire Fairness Standard.

As discussed above, Mrs. Coster failed to meet her burden in showing that the Directors acted for the "primary purpose" of frustrating her exercise of the corporate franchise. But even if Mrs. Coster had met her burden, the trial court's determination that the Stock Sale satisfies entire fairness review would nevertheless establish its validity under Delaware law. While Mrs. Coster contends that the Court of

Chancery's purported failure to apply the "compelling justification" requirement "within its entire fairness review of the Stock Sale" is an "error of law," (AOB at 23), it is her insistence that the Court of Chancery was required to find a "compelling justification" for a transaction that otherwise satisfies an entire fairness analysis that would "create[] an illogical and untenable analytical framework Delaware law." (AOB at 24.)

In Delaware, even a self-interested transaction that has not been approved by the majority of the shareholders will be sustained, provided it is found to be entirely fair to the corporation. *See* 8 *Del. C.* § 144 (providing that no contract between a corporation and one or more self-interested directors is void or voidable so long as "[t]he contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the stockholders" even if the transaction has not been ratified by a majority of the stockholders). Moreover, as the Court of Chancery noted, Delaware courts have held that a corporate board that fails to carry its initial burden sufficient to trigger the business judgment rule under *Unocal* may nevertheless prove its action valid provided because the action satisfies the entire fairness standard. (Op. 36, n.216.)[4]

[4] Citing *Unitrin*, 651 A.2d at 1377 n.18 (holding that a director can pass *Unocal* review by demonstrating that the challenged transaction meets entire fairness because "the directors' failure to carry their initial burden under *Unocal* does not,

As between stockholders and directors, then, Delaware law permits even self-interested directors to unilaterally approve a transaction, even a defensive transaction touching on issues of corporate control, provided that the transaction is entirely fair to the corporation.

As discussed above, the *Blasius* court acknowledged the propriety of a corporate board purchasing its own stock as a defensive, entrenchment measure. It is evident, then, that the *Blasius* court never meant to apply the "compelling justification" standard to the situation where a board exercises its lawful authority to sell the stock it owns as a defensive measure—even to a self-interested insider—provided the transaction is found entirely fair to the corporation. As the Court of Chancery has observed, "[The "compelling justification"] test is a potent one that should not be used in garden variety situations, when more traditional tools are available to police self-dealing or improperly motivated director action." *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 811 (Del. Ch. 2007).

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ipso facto, invalidate the board's actions" and "once the Court of Chancery finds the business judgment rule does not apply, *the burden remains on directors to prove* '*entire fairness*'" (emphasis added)); *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 476 (Del. Ch. 2000) (noting that "a board that fails to meet its *Unocal* burden may still prevail by demonstrating that its actions satisfied the exacting entire fairness test"); *Chesapeake Corp. v. Shore*, 771 A.2d 293, 333 (Del. Ch. 2000) (noting that "under *Unocal*, it putatively remains open to the defendants to demonstrate that the [board action] was 'entirely fair' even though their threat analysis…was inadequate").

The infirmity of Mrs. Coster's argument is further evident from the fact that she cites no caselaw applying the "compelling justification" standard to a *transaction*. While Mrs. Coster cites *MM Cos., Inc. v. Liquid Audio*, 813 A.2d 1118, (Del. 2003), for the proposition that "the *Blasius* compelling justification standard of review [applies] within an application of the *Unocal* standard of review," (AOB at 24), the issues in dispute in *MM Cos.* and in other cases cited by Mrs. Coster were entirely inapposite to those found in the context of a transaction that can be analyzed under the entire fairness standard. In *Blasius* and *MM Cos*., the respective boards authorized amendments allowing incumbent directors to create new board seats and appoint directors of their own choice in the face of an upcoming election for directors. *See Blasius*, 564 A.2d at 654 (incumbent board expanded the board from seven to fifteen members and appointed eight new directors); *MM Cos.*, 813 A.2d at 1120 (incumbent board expanded the board from five to seven members and appointed two new directors). Hence, in both *Blasius* and *MM Cos*., the challenged defensive action was not transactional in nature and hence not amenable to entire fairness review.

Indeed, it is curious that Mrs. Coster cites the Court of Chancery's opinion in *Keyser v. Curtis*, 2012 WL 3115453 (Del. Ch. July 21, 2012), for the proposition that courts may invalidate the sale of securities issued for the sole purpose of preventing a board member from being voted out of office (AOB at 28), yet fails to

note that the court in *Keyser* explicitly found that the issuance of company stock to an insider in order to prevent the plaintiff and his allies from electing new directors, "is not subject to review under *Blasius*; it is subject to review under the standard usually applicable to self-dealing conduct—entire fairness." *Keyser*, 2012 WL 3115453, at *12. In citing *Keyser*, Mrs. Coster also excises that court's observation that, when "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," and ignored that court's holding that a Board could approve such a self-interested transaction, provided the Board could prove it "undertook a considerably robust process" to establish that the Board's actions were entirely fair. *Id.* at *13. As discussed below, Mrs. Coster's cursory attempt to discredit the Court of Chancery's determination that the Stock Sale was entirely fair lacks merit.

4. The Court of Chancery Correctly Found the Stock Sale Entirely Fair to the Company

At the outset, Mrs. Coster appears to suggest that the Court of Chancery erred in not declaring the Stock Sale invalid solely on the basis of process because, Mrs. Coster contends, it should be found invalid "without regard to the fairness of the price." (AOB at 35.) But as the Court of Chancery recognized, this Court has held

that "the test for fairness is not a bifurcated one as between fair dealing and price," and in a non-fraudulent transaction, "price may be the preponderant consideration outweighing other features" of a transaction. (Op. 43.)[5] Thus, the Court of Chancery has acknowledged that "the fact that the directors did not follow a fair process does not constitute a separate breach of duty." *In re Trados Inc. S'holder Litig*., 73 A.3d 17, 78 (Del. Ch. 2013).

While the Court of Chancery relied on the unitary nature of the entire fairness analysis to conclude that a fair price could overcome a procedural process that was not "optimal," (Op. 48), it also explicitly rejected the factual basis underlying the vast majority of Mrs. Coster's challenges to the process by which the Stock Sale was achieved, and found that Mrs. Coster's "fair dealing arguments standing alone do not prove that the price reached was unfair." (*Id*.)

a. Fair Process

In arguing that the Company failed to conduct a fair process leading to the Stock Sale, Mrs. Coster simply rehashes her argument that the Board was animated by an improper purpose. (AOB at 33-35.) But as shown above, the Court of Chancery expressly held that, because the appointment of a custodian would be deleterious to UIP for reasons unrelated to Mrs. Coster, Messrs. Schwat and

[5] *Citing Weinberger v. UIP, Inc*., 457 A.2d 701, 711 (Del. 1983).

Bonnell's desire to moot the Custodian Action did not constitute an improper motivation. (Op. 30.)

It is also remarkable that Mrs. Coster alleges that the Board conducted an unfair process leading to the Stock Sale without once mentioning the Board's commission of the McLean Group to conduct an independent valuation of the Company. In faulting the Board for failing to "negotiate" with Mr. Bonnell, Mrs. Coster cites to cases finding that the lack of an advocate or process committed to protecting the interests of minority of shareholders demonstrated a lack of fair dealing, (AOB at 34, n.47), but fails to even acknowledge the process—an independent valuation—the Company employed to assure the Company and its shareholders received fair value.

In contrast, Mrs. Coster's pre-trial and post-trial briefing in the Court of Chancery advanced numerous arguments attacking the integrity and independence of Andy Smith and the McLean Group's valuation.[6] The Court of Chancery, however, concluded that Mrs. Coster's "attempts to impugn the process by portraying Smith as biased miss the mark," and credited his testimony and the McLean Group's valuation. (Op. 48.)

[6] *See, e.g.*, B098-B138 [Pl.'s Pre-Trial Br. at 18-20] [Dkt. 100]; A507-A509 [Pl.'s Post-Trial Opening Br. at 30-32] [Dkt. 143].

Mrs. Coster's remaining arguments in the Court of Chancery alleging a lack of fair dealing fared no better. While Mrs. Coster alleged that the timing of McLean Group valuation amounted to a process defect, the Court of Chancery found that Mrs. Coster "has not cited to evidence that the timing alone detracted from the McLean Valuation's accuracy." (Op. 44.) The Court of Chancery also rejected Mrs. Coster's contention that the Company should have conducted a market check before authorizing the Stock Sale, finding that the Board had presented credible evidence that the Company had little to no value to an independent investor or potential purchaser so that a failure to conduct a market check was not a process defect.[7] (*Id*.)

b. Fair Price

Mrs. Coster is simply incorrect in asserting that the McLean Group Report's determination of the "fair market value" of a 100 percent equity interest in the Company differed in any way from the "fair value" standard applied by Delaware

[7] In her Brief in this Court, Mrs. Coster now faults the Board for not offering her "an opportunity to buy the one-third interest for an amount greater than $41,289.67," because, she contends, "[the Board] knew she would buy it." (AOB at 35.) But Mrs. Coster cites to no evidence in the record—either through documents, her own testimony before the Court of Chancery, or her briefing to that court—arguing that she would have bought an additional interest in the Company. In fact, Defendants presented evidence to the contrary showing that Mrs. Coster had expressed the desire to make a "clean break" from the Company and had confirmed that she was willing to seek dissolution of the Company provided such an action would make her whole. B071 [JX-331 at MC0069535]; B150-B153 [Tr. 71:23-74:18.]

Courts. As this Court has explained, when determining "fair value" under the appraisal statute:

> [T]he company must be first valued as an operating entity by application of traditional value factors, weighted as required, but without regard to post-merger events or other possible business combinations. The dissenting shareholder's proportionate interest is determined only after the company as an entity has been valued. In that determination the Court of Chancery is not required to apply further weighting factors at the shareholder level, such as discounts to minority shares for asserted lack of marketability.

Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1144 (Del. 1989). Thus, under Delaware law, the fair value of a minority interest such as that purchased by Mr. Bonnell is simply the proportional value of his share of the Company's value as whole, which is precisely what Mr. Bonnell paid under the Stock Sale when he purchased a non-controlling, one-third stake in the Company for $41,289.67, which was one-third of the $123,869 final equity value of the Company as a whole, as determined by the McLean Group's DCF analysis. Consequently, the price paid by Mr. Bonnell did not reflect a minority discount for lack of control.

Mrs. Coster, however, argues that the derived value is insufficient because the failure to apply a control premium to any such valuation "improperly applies a *de facto* minority discount, which Delaware fair value rejects." (AOB at 37.) But the very cases Mrs. Coster relies upon for this proposition actually confirm that Mrs. Coster has it precisely backwards. Rather, the "control premium" paid for

controlling blocks of shares in the marketplace simply reflects the lack of the typical "minority discount" that the market applies to blocks of minority shares to account for the lack of control.

For instance, in *Cheff v. Mathes*, this Court recognized that "a substantial block of stock will normally sell at a higher price than that prevailing on the open market, the increment being attributable to a 'control premium.'" 199 A.2d 548, 555 (Del. 1964). In *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd*., this Court explained that because the fair value analysis values "the corporation itself, as distinguished from a specific fraction of its shares as they may exist in the hands of a particular shareholder," the Court of Chancery should not apply a minority discount when there is a controlling stockholder. 77 A.3d 1, 20-21 (Del. 2017). Finally, in *Agranoff v. Miller*, the Court of Chancery acknowledged that a "comparable companies" analysis (as opposed to the DCF analysis employed by the McLean Goup) "generates an equity value that includes an inherent minority trading discount, because the method depends on comparisons to market multiples derived from trading information for minority blocks of the comparable companies." 791 A.2d 880, 892-93 (Del. Ch. 2001). The Court in *Agranoff* went on to note that the terms "'minority discount' and a 'control premium' can be considered the inverse of one another because the term 'minority discount' is generally used to mean the

difference between the value of control shares and the value of a minority share of a public company." 791 A.2d at 897 n.43 (citation omitted).

These Delaware cases clearly recognize that market-based analyses determining the "fair market value" of non-controlling interests in companies must be adjusted because those values are derived from market values for minority shares that have already been discounted ***by the market*** to account for the lack of control. When control shares of corporations are sold at above-market prices, this so-called "control premium" simply reflects the fact that the market had not already applied a "minority discount" to the value of the shares to account for the lack of control, and that the market value thus represents the market's best attempt to determine the full proportionate value of the shares in relation to the company's perceived value on the market. As the *Agranoff* court noted, the control premium and the minority discount are simply the inverse of one another. 791 A.2d at 897 n.43 (citation omitted). Thus, if it is true, as Mrs. Coster contends, that the failure to apply a control premium to the market value of a minority share represents a *de facto* minority discount, it must be equally be true that a proportionate value derived from the determination of the value of the company as a whole that has not been discounted represents a *de facto* control premium ***because it does not reflect the discount for lack of control that would be applied by the market***. Mrs. Coster cites no precedent, nor could she, standing for the proposition that Delaware "fair value" analysis requires the

application of a control premium to derive a value that exceeds the proportional value of the shares as derived from the value of the company as a whole. This is particularly true when the value of the company as a whole has been determined by a DCF analysis, because a DCF analysis necessarily considers all the benefits of control that are inherent to the Company. *See, e.g.*, *Dobler v. Montgomery Cellular Holding Co., Inc.*, 2004 WL 2271592, at *17 (Del. Ch. Sept. 30, 2004), *judgment entered sub nom*. (Del. Ch. 2004), *aff'd in part, rev'd in part sub nom. Montgomery Cellular Holding Co., Inc. v. Dobler,* 880 A.2d 206 (Del. 2005) ("A DCF is a final valuation that does not need any additional correction, such as a control premium.").

II. EVEN IF THE COURT WERE TO CANCEL THE STOCK SALE, IT SHOULD ONLY REMAND TO THE COURT OF CHANCERY FOR A DETERMINATION OF WHETHER THE APPOINTMENT OF A CUSTODIAN IS JUSTIFIED.

A. Question Presented

If, despite the foregoing, this Court were to find the trial court erred, and additionally, conclude based on the record in the court below that the Stock Sale must be declared invalid without further proceedings, should this Court's remand order also direct the Court of Chancery to appoint a custodian or should the remand direct the court below to rule upon whether to exercise its statutory discretion to appoint a custodian?

B. Scope of Review

The Court of Chancery's determination to appoint or decline to appoint a custodian pursuant to 8 *Del. C.* § 226(a)(1) is reviewed for abuse of discretion. *Giuricich v. Emtrol Corp*., 449 A.2d 232, 240 (Del. 1982). Under this standard, "the reviewing court may not substitute its own notions of what is right for those of the trial judge, if [her] judgment was based upon conscience and reason, as opposed to capriciousness or arbitrariness." *Chavin v. Cope*, 243 A.2d 694, 695 (Del. 1968).

C. Merits of Argument

Section 226(a) of Delaware's General Corporation Law provides that in the event of a shareholder deadlock, the Court of Chancery "***may***" appoint a custodian.

Consequently, the Delaware Supreme Court has recognized that "the appointment of a custodian is discretionary under Section 226(a)(1)." 8 *Del. C.* § 226(a); *see also, In re Arthur Treacher's Fish & Chips of Ft. Lauderdale, Inc.*, 386 A.2d 1162, 1166 (Del. Ch. 1978) (finding that legislature's use of the word "may" indicated that relief was discretionary). The legislature could have drafted Section 226(a) to provide that, in the event of a shareholder deadlock, the Court of Chancery "***will"*** or "***must"*** appoint custodian, but instead left such an appointment in the court's discretion.

Mrs. Coster erroneously asserts that "[p]rior to the Stock Sale, there was no serious question as to whether the appointment of a custodian was proper." (AOB at 40.) But Mrs. Coster's argument ignores the trial court's finding that "the appointment of a custodian threatened to cut off a substantial amount of UIP's revenue streams, justifying Defendants' efforts to moot the Custodian Action." (Op. 30-31.) Considering the discretion conferred by the statute and the Court of Chancery's factual findings, it is evident that there were, at least, "serious question[s]" concerning the propriety of the appointment of a custodian even before the consummation of the Stock Sale. Indeed, as the Court of Chancery noted, the Board conceded as much by admitting that the Stock Sale was at least in part motivated by a desire to moot the Custodian Action. (Op. 30.)

In her Brief to this Court, Mrs. Coster faults the Board for engaging in "extra-judicial self-help" by implementing the Stock Sale instead of following the "proper

course" of presenting their concerns to the Court of Chancery within the Custodian Action. (AOB at 30.) But Mrs. Coster cannot have it both ways. If, as Mrs. Coster asserts, the submission of these concerns to the Court of Chancery in the Custodian Action was indeed the "proper course," then any remand to the Court of Chancery must consequently allow for that Court to exercise its statutory discretion to determine whether the appointment of a Custodian is appropriate considering its factual finding that such an appointment "threaten[s] to cut off a substantial amount of UIP's revenue streams."

In further arguing for a remand directing the Court of Chancery to appoint a custodian, Mrs. Coster says that this Court's decision in *Giuricich* is "instructive." (AOB at 41.) It may provide guidance, but not for the appointment of a custodian under these facts. First, the legal question in *Giuricich* was whether the Court of Chancery abused its discretion in denying the request for custodian because it concluded it may only appoint a custodian upon a showing of "irreparable injury." *Giuricich*, 449 A.2d at 236-38. No one here has argued that irreparable injury must be shown. To that extent, *Giuricich* is irrelevant.

More important, however, the Court's basis for appointing a custodian in *Giuricich* highlights the very reason the appointment of a custodian would not be appropriate here. The court in *Giuricich* found, "[t]here [was] no indication that this shareholder-deadlock will be resolved in the foreseeable future, absent judicial

intervention. 449 A.2d at 240. It was the perpetuation of an ***unresolvable*** deadlock that "effectively frustrated" the plaintiffs' right to vote for successor directors. *Id.* at 239. In other words, as the Court of Chancery has observed, the purpose of Section 226(a) is "to prevent the perpetuation of control by ***unelected holdover directors***." *Bentas v. Haseotes*, 769 A.2d 70, 77 (Del. Ch. 2000) (emphasis added). In this case, there was a means to break the deadlock, and the Company took advantage of it. Mrs. Coster may not like the outcome, but that is not the basis for appointment of a custodian.

CONCLUSION

For the reasons set forth above, the Opinion of the Court of Chancery should be sustained.

BAYARD, PA

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