EFiled: Feb 13 2015 04:38PM EST
Transaction ID 56775341
Case No. 9770-CB

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROBERT STROUGO, on behalf of himself and all others similarly situated, Plaintiff, v. AARON P. HOLLANDER, STANLEY J. HILL, JOSEPH J. LHOTA, ITSIK MAARAVI, and FIRST AVIATION SERVICES, INC., Defendants.	C.A. No. 9770-CB

PLAINTIFF'S REPLY BRIEF IN SUPPORT OF PLAINTIFF'S MOTION FOR PARTIAL JUDGMENT ON THE PLEADINGS

Dated: February 13, 2015

MONTGOMERY McCRACKEN WALKER & RHOADS, LLP
Sidney S. Liebesman (DE #3702)
Lisa Zwally Brown (DE #4328)
1105 N. Market St., 15th Floor
Wilmington, DE 19801
Tel. (302) 504-7800
Fax: (302) 504-7820

Attorneys for Plaintiff

OF COUNSEL:

POMERANTZ LLP
Gustavo F. Bruckner
Alla Zayenchik
600 Third Avenue
New York, NY 10016
(212) 661-1100

Table of Contents

INTRODUCTION 1

ISSUES PRESENTED.....3

ARGUMENT 4

I. A Ruling in Plaintiff's Favor Would Not be Contrary to Delaware Law.....4

II. Plaintiff's Position is Not Inconsistent with Delaware's Rejection of the Vested Rights Doctrine.....6

III. Plaintiff's Position is Not Inconsistent with the Supreme Court's Ruling in ATP 7

IV. Plaintiff's Position is Not Inconsistent with Plaintiff's Ability to Bring a Direct Suit 10

V. There Is No Danger of Varying and Inconsistent Bylaws Applying to Various Groups of Stockholders.....13

VI. Plaintiff Did Not Voluntarily Sell His Shares and Divest Himself of the Right to Amend and Repeal Bylaws.....15

VII. The Fee-Shifting Bylaw Affects Plaintiff's Substantive Rights 16

VIII. The Court Should Find That the Fee-Shifting Bylaw Cannot Apply to Former Stockholders.....18

i. The Timing of the Adoption of the Fee-Shifting Bylaw Violates the Implied Covenant of Good Faith & Fair Dealing.....18

ii. The Timing of the Adoption of the Fee-Shifting Bylaw is Plainly Inequitable 19

CONCLUSION.....22

Table of Authorities

Cases

Airgas Inc. v. Air Products & Chems., Inc,
8 A.3d 1182 (Del. 2010) 19
ATP Tour, Inc. v. Deutscher Tennis Bund
91 A.3d 554 (Del. 2014) 7, 8, 9
Aveta Inc. v. Cavallieri
23 A.3d 157 (Del. Ch. 2010) 10
Bear Sterns Mortgage Funding Trust v. EMC Mortgage, LLC
C.A. No. 7701–VCL 2015 WL 139731 (Del. Ch. Jan. 12, 2015) 17
Beard Research, Inc. v. Kates
8 A.3d 573 (Del. Ch. 2010) 10
Boilermakers Local 154 Retirement Fund v. Chevron Corp.
73 A.3d 934 (Del. Ch. 2013) 17
Carsanaro v. Bloodhound Techs., Inc.
65 A.3d 618 (Del. Ch. 2013) 20
Cavalier Oil Corp. v. Harnett
564 A.2d 1137 (Del. 1989) 12
City of Providence v. First Citizens Bancshares Inc.
99 A.3d 229 (Del. Ch. 2014) 5
Cobb v. Ironwood Country Club
C.A. No.G050446, 2015 WL 358794 (Cal. App. 4th. January 28, 2015).....5
Kidsco, Inc. v. Dinsmore
674 A.2d 483 (Del. Ch. 1995.....4
Kramer v. Western Pacific Industries, Inc.
546 A.2d 348 (Del. 1988) 12
Kuroda v. SPJS Holdings, L.L.C.
971 A.2d 872 (Del. Ch. 2009) 18
Sample v. Morgan
914 A.d 647 (Del. Ch. 2007) 20
Seaport Village Ltd v. Seaport Village Operating Co.
C.A. No. 8841-VCL, 2014 WL 4782817 (Del. Ch. September 24, 2014).....11
Sinchareonkul v. Fahnemann
C.A. No. 10543-VCL, 2015 WL 292314 (Del. Ch. January 22, 2015).....20

Town of Smyrna v. Kent County Levy Court
C.A. No. 244-K, 2004 WL 2671745 (Del. Ch. November 9, 2004) 11
Underbrink v. Warrior Energy Servs. Corp.
C.A. No. 2982-VCP, 2008 WL 2262316 (Del. Ch. May 30, 2008).....5
United Technologies Corp. v. Treppel
C.A. No. 127, 2014 WL 7662608 (Del. Dec. 23, 2014).....4
Winshall v. Viacom Intern., Inc.
55 A.3d 629, 637 (Del. Ch. 2011) 18

Statutes

DGCL§109(b) 15

Other Authorities

D. Gordon Smith, Matthew Wright, Marcus Kai Hintze,
"Private Ordering With Stockholder Bylaws" 80 Fordham L. Rev. 125, 126 (2011).....16

INTRODUCTION

Defendants[1] would have this Court believe that the application of a bylaw that was unilaterally adopted after Plaintiff's ownership interest was extinguished is a commonplace occurrence. Not so. Defendants fail to cite a single case where a Delaware court has applied a bylaw to a former stockholder whose ownership interest had been extinguished at the time the bylaw was adopted; nor can they. No Delaware court has taken such a stance. It is a well-established tenet of Delaware law that a party cannot be bound to an agreement to which it is no longer a party. All of the cases relied upon by Defendants involve bylaws that were adopted while the stockholder in question held stock in the company.

Here, the effect of the timing of the adoption of the fee-shifting bylaw must be considered in light of the unique facts of the case. While Defendants state that Plaintiff sold his stock, the truth is that *all* of the minority stockholders of First Aviation were involuntarily cashed out through a 10,000 to 1 Reverse Stock Split that became effective on May 30, 2014, leaving only a handful of stockholders eligible to continue their ownership in the Company. *Four days later*, on June 3, 2014, First Aviation amended its bylaws for the purpose of adopting a non-

[1] All capitalized terms, unless otherwise defined, shall have the meaning ascribed to them in Plaintiff's Opening Brief in Support of Motion for Partial Judgment on the Pleadings filed on December 24, 2014.

reciprocal fee-shifting bylaw designed solely to deter stockholder litigation in connection with the Reverse Stock Split.

Defendants mischaracterize Plaintiff's position on the validity of unilateral bylaws adopted after Plaintiff purchased his shares. Defendants argue that a board can unilaterally adopt a bylaw after Plaintiff became a stockholder, and that Plaintiff is not guaranteed the same set of bylaws that were in effect at the time that he purchased his shares. Defendant suggests that Plaintiff's position would contravene Delaware's rejection of the vested rights doctrine by failing to acknowledge the board's right to adopt unilateral bylaws. However, Plaintiff never denied that Defendants had the right to unilaterally adopt bylaws that were binding upon Plaintiff ***after*** Plaintiff purchased his shares and ***before*** Plaintiff was squeezed out by operation of the Reverse Stock Split. Rather, Plaintiff submits that a bylaw adopted after Plaintiff ***ceased*** to be a stockholder cannot apply to him.

Defendants would also have this Court believe that there will be wide-reaching and unsettling implications of accepting Plaintiff's contention that a bylaw that was unilaterally adopted after a stockholder's interest was extinguished cannot be applied to that stockholder. However, as explained below, Defendants' fears are not well-founded. There is no danger of different sets of bylaws applying to different sets of stockholders depending on when the stockholder in question sold their shares in this case. *All* of First Aviation's minority stockholders were

cashed out simultaneously prior to the adoption of the bylaw. Thus, the bylaw does not apply to ***any*** of First Aviation's minority stockholders. To the extent the bylaw does apply, it would only apply to Defendant Hollander and his affiliates.

The reality is that First Aviation adopted a self-serving bylaw that effectively provides First Aviation with a grant of immunity and makes corporate directors and officers unaccountable for serious wrongdoing. First Aviation is attempting to bind former stockholders, whose ownership interest in the corporation was extinguished by the Reverse Stock Split prior to the adoption of the fee-shifting bylaw, to its one-sided terms. There is no support in Delaware corporate or contract law for such an endeavor, nor can Defendants' position find support in other U.S. jurisdictions.

ISSUES PRESENTED

There is only one issue raised by way of Plaintiff's pending motion: whether a fee shifting bylaw that was unilaterally adopted by the Company's board of directors ***after*** a 10,000 to 1 Reverse Stock Split cashed out all of the Company's minority stockholders, in a clear attempt to curtail litigation arising from the Reverse Stock Split, can be applied to a former stockholder whose ownership interest was extinguished prior to the adoption of the fee shifting bylaw?

ARGUMENT

I. A Ruling in Plaintiff's Favor Would Not be Contrary to Delaware Law

Defendants have not cited a single case where a bylaw that was adopted after a stockholder's interest had been extinguished has been found to bind that former stockholder. Rather, Defendants rely on inapposite case law and extrapolate from incongruent precedent the proposition that corporations can continue to bind former stockholders to bylaws adopted after their ownership interests have expired.

The cases relied upon by Defendants feature bylaws that were adopted while the stockholder retained an interest in the corporation. *See Kidsco, Inc. v. Dinsmore*, 674 A.2d 483 (Del. Ch. 1995) (Board of directors amended bylaws to extend time for calling meeting to 60 days. Plaintiffs were stockholders at the time of the amendment.); *United Technologies Corp. v. Treppel*, C.A. No. 127, 2014 WL 7662608 (Del. Dec. 23, 2014) (Company adopted a forum selection bylaw after plaintiff initiated a §220 action for inspection of books and records in Delaware.[2] In dicta, the Court stated that the forum selection bylaw could be enforced against plaintiff in a future action arising out of the §220 action. Plaintiff

[2] *United Technologies Corp. v. Treppel* primarily involved the Court's ability to place restrictions on stockholders' inspection rights in the context of suit brought under 8 Del. C. §220. Following plaintiff's initiation of his 220 action, the company adopted a forum selection bylaw. As a side note to its ruling, the Court mused that the company could move to dismiss if a petitioner filed a future action arising out of the discovery obtained in a 220 action in an improper forum in violation of the forum selection bylaw.

was a stockholder at the time the forum selection bylaw was adopted.); *City of Providence v. First Citizens Bancshares Inc.*, 99 A.3d 229 (Del. Ch. 2014) (Board of directors adopted a forum selection bylaw on the same day as the announcement of the merger agreement. Plaintiff was a stockholder at the time of the bylaw's adoption.). Another case cited by Defendants, *Underbrink v. Warrior Energy Servs. Corp.*, C.A. No. 2982-VCP, 2008 WL 2262316 (Del. Ch. May 30, 2008) (allowing for indemnification of a director for a lawsuit that was originally filed prior to the board's adoption of a mandatory advancement rights provision, but to which the directors in question were only added as parties following the adoption of the amended bylaws), differs from the instant case in several salient aspects. *Underbrink* addresses indemnification of directors, not regulation of stockholder rights. *Underbrink* confers a benefit on the directors, rather than imposing a liability. Further, the director in question was still a director of *Underbrink* at the time the bylaw amendments were adopted.

Indeed, there is no authority for Defendants' position. This unusual attempt by a corporation to bind former stockholders to a bylaw adopted after their interest was extinguished presents an issue of first impression in Delaware. Courts that have had the opportunity to address the question have found it impermissible. *Cobb v. Ironwood Country Club*, C.A. No.G050446, 2015 WL 358794 at *6 (Cal. App. 4th. January 28, 2015) ("the [corporation] further contends that because the

bylaws include a provision allowing [the corporation] to amend them, the members — even *former* members — are deemed to have agreed to *whatever* amendments are made in accordance to that provision. We cannot agree with that former contention.") (emphasis in the original).

II. Plaintiff's Position is Not Inconsistent with Delaware's Rejection of the Vested Rights Doctrine

Delaware law is well-settled on the point that directors may unilaterally adopt bylaws that are not inconsistent with law or the certificate of incorporation, as long as the charter explicitly allows such unilateral action. Delaware courts have consistently held that a stockholder does not have a vested right to a particular set of bylaws that were in effect at the time the stockholder purchased his shares.

However, contrary to Defendants' allegations, Plaintiff's position is not inconsistent with Delaware's rejection of the vested rights doctrine. Plaintiff does not argue that a bylaw that was adopted after a stockholder purchased shares cannot be applied as to that stockholder or that Plaintiff is entitled to the bylaws in effect at the time that Plaintiff purchased shares. Rather, Plaintiff takes the position that a bylaw that was adopted ***after*** a stockholder's interest was extinguished cannot apply to that ***former*** stockholder. Put another way, Plaintiff submits that Defendants can only purport to bind Plaintiff to a bylaw that was

adopted ***before*** the Reverse Stock Split occurred, when Plaintiff was still a stockholder.

Defendants' arguments that Plaintiff is attempting to resurrect the vested rights doctrine is a mischaracterization of Plaintiff's position. Rather, Plaintiff takes the rational position that the stockholder relationship ends once a stockholder has been divested of its interest in the company. Having eviscerated Plaintiff's interest in the company through the Reverse Share Split, Defendants cannot also claim continued control over Plaintiff through unilaterally adopted amendments to the Company's bylaws. This position is consistent with Delaware corporate and contract law, the reasonable expectation of investors, and with common sense.

III. Plaintiff's Position is Not Inconsistent with the Supreme Court's Ruling in *ATP*

The Delaware Supreme Court's advisory opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014) (hereinafter "*ATP*") involved a non-stock member corporation[3] which adopted a non-reciprocal fee-shifting bylaw substantially similar to the bylaw at issue in the instant case. The fee-shifting provision provided, in relevant part:

> (a) In the event that (i) any [current or prior member or Owner or anyone on their behalf ("Claiming Party")] initiates or asserts any [claim or counterclaim ("Claim")] or joins, offers substantial assistance to or has a

[3] *ATP* has not been explicitly held to apply to stock corporations.

> direct financial interest in any Claim against the League or any member or Owner (including any Claim purportedly filed on behalf of the League or any member), and (ii) the Claiming Party (or the third party that received substantial assistance from the Claiming Party or in whose Claim the Claiming Party had a direct financial interest) does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought, then each Claiming Party shall be obligated jointly and severally to reimburse the League and any such member or Owners for all fees, costs and expenses of every kind and description (including, but not limited to, all reasonable attorneys' fees and other litigation expenses) (collectively, "Litigation Costs") that the parties may incur in connection with such Claim. *ATP* 91 A.3d at 556.

In connection with the *ATP* matter, the United States District Court for the District of Delaware certified four questions of law to the Delaware Supreme Court. Of those four questions, the relevant question on this narrow motion for judgment on the pleadings, which pertains to the timing of the adoption of the fee-shifting provision, reads:

> 4. Is such a bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation's rules "that may be adopted and/or amended from time to time" by the corporation's Board, and where the member was a member at the time that it commenced the lawsuit against the corporation? *Id*. at 557.

The only timing issue that the Court addressed in *ATP* was whether the bylaw was enforceable against a member if it was adopted after the member had joined the corporation. The Court advised that a bylaw is generally enforceable against members who join a corporation before its enactment. The court did not address the question of whether the bylaw is enforceable against former members

of the corporation who were not members at the time of the bylaw's adoption. The Court further qualified its opinion by stating that the bylaw would only be upheld "[a]ssuming the provision is otherwise valid and enforceable." *Id.* at 560.

Plaintiff does not argue that a stockholder cannot under any circumstances be bound to a bylaw that was unilaterally enacted after Plaintiff became a stockholder. Rather, at the crux of Plaintiff's argument is the questionable timing of bylaw's adoption. Plaintiff submits that he cannot be bound by a bylaw that was adopted after his interest —along with the interest of every single minority stockholder of First Aviation — was involuntarily extinguished through the Reverse Stock Split.

Plaintiff's position is not inconsistent with the Court's opinion in *ATP*, as the Court did not consider the situation where a corporation purported to bind a former stockholder whose interest had already been extinguished at the time the bylaw was adopted. Although on its face the bylaw in question in *ATP* applies to "prior" members, the Court only opined on the narrow issue of whether a member can be bound to a bylaw that was adopted after an individual became a member of the corporation, not whether a member can be bound to a bylaw that was adopted after a prior member ceased being a member of the corporation. The Court's condonation of the former does not imply the permissibility of the latter.

IV. Plaintiff's Position is Not Inconsistent with Plaintiff's Ability to Bring a Direct Suit

Defendants attempt to confuse the Court by arguing that Plaintiff should not be able to have it both ways – to be free of imposition of new bylaws enacted after Plaintiff's ownership interest was extinguished and to be simultaneously allowed to assert his rights in a direct suit arising out of his claims as a stockholder of First Aviation. However, Plaintiff is not attempting to enforce a contractual right. A claim for breach of fiduciary duties arises under the common law. *Beard Research, Inc. v. Kates*, 8 A.3d 573,602 (Del. Ch. 2010) ("the success of the common law claim (breach of fiduciary duty) does not depend on the success of the trade secrets claim"). Thus, the cases relied upon by Defendants are inapposite because a stockholder's right to sue is not grounded in contractual rights alone. *Compare Aveta Inc. v. Cavallieri*, 23 A.3d 157 (Del. Ch. 2010), (finding that non-signatory defendants bound themselves to a forum selection provision by their conduct "because their claims arise out of and relate to the Purchase Agreement."). In the instant case, Plaintiff's claims do not arise merely out of a contractual agreement, but form an integral part of Delaware common law. *Beard* 8 A.3d at 602. ("A breach of fiduciary duty occurs when a fiduciary commits an unfair, fraudulent, or wrongful act.")

In the instant case, Plaintiff is not a non-signatory to the contract. He was a party to the contract and that contract has been terminated by Defendants. Plaintiff

never claimed third party beneficiary status after the expiration of the contract. *Compare Town of Smyrna v. Kent County Levy Court*, C.A. No. 244-K, 2004 WL 2671745, at *3 (Del. Ch. November 9, 2004) (finding that parties who once claimed third party beneficiary status under an agreement for services cannot later argue that they are only incidental beneficiaries to the contract and are not bound by the agreement's arbitration clause). Defendants cannot purport to bind Plaintiff to unilateral board- adopted bylaws for the remainder of his days merely because Plaintiff was once a First Aviation stockholder.

As the *Seaport Village* case relied upon by Defendants admits, "[a]s a general matter, "only parties to a contract are bound by that contract." *Seaport Village Ltd v. Seaport Village Operating Co*., C.A. No. 8841-VCL, 2014 WL 4782817 at *2 (Del. Ch. September 24, 2014). In *Seaport Village*, the defendant adopted an amendment stating "[a] member ... is bound by the limited liability company agreement whether or not the member ... executes the limited liability company agreement" making it clear that plaintiffs were bound by the agreement even though they did not sign it. *Id.* Thus, the court found that plaintiff could conversely sue defendant to enforce a term of the agreement. *Id.* By contrast, in this case, Plaintiff was doubtlessly a party to the agreement. However, that agreement was terminated by Defendants and Plaintiff's rights under that agreement were extinguished. Now Plaintiff brings a cause of action that is

grounded in his common law right to sue for breach of fiduciary duty. That act, does not, as Defendants insist, reignite the stockholder agreement or otherwise constitute an act of cherry-picking on Plaintiff's part.

Furthermore, Delaware courts have long held that a former stockholder may proceed in a direct suit even after the former stockholder has been cashed out. *See Cede & Co. v. Technicolor, Inc.* 542 A.2d 1182, n. 10 (Del. 1988)("a breach of an individual stockholder's 'membership' contract or some other interference with the rights that are traditionally viewed as incident to the individual's ownership of stock gives rise to a non-derivative, or direct, action by the injured stockholder or stockholders.")*;* *Kramer v. Western Pacific Industries, Inc.*, 546 A.2d 348, 354 (Del. 1988) ("direct attacks against a given corporate transaction (attacks involving fair dealing or fair price) give complaining stockholders standing to pursue individual actions even after they are cashed-out through the effectuation of a merger."); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1143 (Del. 1989) ("where allegations of fraud and breaches of fiduciary duty exist in connection with a merger, an action … may and indeed must be maintained."). This is grounded in the idea that similar to a former owner suing for loss of property through deception or fraud, a former stockholder has standing to right the wrong that arguably caused the former stockholder to suffer a loss. *Cede*, 542 A.2d at 1188.

Contrary to Defendants' characterization, Plaintiff is not attempting to assert that portions of a contract do not apply to him all the while maintaining that other provisions of the contract should be enforced to benefit him. *See* Defendants' Answering Brief ("Ans. Br.") at 14. Plaintiff contends that the contract has been terminated and that he is no longer bound to its terms. Plaintiff retains the ability to enforce his common law rights and bring suit for breach of fiduciary duty even after a cash-out merger has been effectuated.

V. There is No Danger of Varying and Inconsistent Bylaws Applying to Various Groups of Stockholders

Defendants make much of the argument that varying and inconsistent bylaws will apply to different groups of stockholders based on when each of the stockholders sold their stock, suggesting that adoption of Plaintiff's position will "wreak havoc" in mixed derivative and direct suits. Ans. Br. at 1. However, there is no such concern in the instant case. All of First Aviation's minority stockholders were cashed out as a result of the Reverse Stock Split, which occurred prior to the adoption of the fee-shifting bylaw. As a result, First Aviation's minority stockholders were divested of their shares simultaneously, prior to the adoption of the fee-shifting bylaw. Consequently, there is no concern here over varying bylaws applying depending on when each individual stockholder sold their shares.

Further, First Aviation's minority stockholders did not voluntarily sell their shares as Defendants suggest, but rather, were involuntarily cashed out through the Reverse Stock Split. Indeed, the substance of Plaintiff's underlying suit alleges that First Aviation's stockholders were squeezed out by the company's controlling stockholder involuntarily through an insufficient process rife with conflicts of interest and at an inadequate price.

The parade of horribles that Defendants hypothesize concerning disparate bylaws applying to disparate classes of stockholders simply is not at issue in this case. Furthermore, cases involving multiple classes, each with their own unique circumstances, are routinely litigated in the courts and have not led to a demise of the judicial system or the corporate structure.

VI. Plaintiff Did Not Voluntarily Sell His Shares and Divest Himself of the Right to Amend and Repeal Bylaws.

In response to Plaintiff's arguments, Defendants argue that it was Plaintiff's act of selling his shares that divested Plaintiff of his right to amend or repeal bylaws. Ans. Br. at 15. However, Plaintiff did not make a voluntary decision to sell his shares. Rather, Plaintiff was involuntarily cashed out by virtue of the Reverse Stock Split. Defendants cannot now argue that it was due to Plaintiff's voluntary relinquishment of his ownership interests of the company that Plaintiff did not retain the right to repeal or amend the bylaw when it was Defendants' own actions that forcibly squeezed Plaintiff out of the company.

Further, Defendants claim that "taken to its extreme, [Plaintiff's] argument would mean that every time a cash-out merger occurred, it would run afoul of §109(a) to the extent that… the company could no longer amend or repeal bylaws." Ans. Br.at 15. Plaintiff does not argue that a corporation cannot adopt unilateral bylaws subsequent to a cash-out merger, but merely that it can only purport to bind the corporation's remaining shareholders. Put another way, Plaintiff submits that a corporation's board of directors may only regulate the

rights or powers of current stockholders, not former stockholders, in accordance with DGCL§109(b).[4]

VII. The Fee-Shifting Bylaw Affects Plaintiff's Substantive Rights

The fee-shifting bylaw does not merely affect remedies as Defendants suggest, but severely impinges Plaintiff's substantive right to bring a lawsuit. Ans. Br. at 19. The three fundamental rights of a stockholder in a Delaware corporation are the right to vote, the right to sell his stock, and the right to sue.[5] The fee-shifting bylaw, rather than merely regulating *where* a plaintiff can bring a lawsuit as a forum selection bylaw does, effectively *precludes* plaintiffs from bringing a lawsuit altogether. No reasonable investor would be willing to risk facing the kind of uncontrollable financial exposure that would be inherent in filing a lawsuit against a corporation with a fee-shifting provision. If there are no willing plaintiffs, there will be no meritorious lawsuits. This impinges on the rights of

[4] DGCL§109(b) reads "The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." Notably missing from §109(b) is any mention of former stockholders. Importantly, when the Delaware State Legislature intends to confer upon the corporation the ability to regulate former affiliates of the company, it does so explicitly. *Compare* DGCL § 145, which explicitly allows for indemnification of former directors, officers, employees, or agents.

[5] "Generally speaking, stockholders in public corporations do three things: they sell, they vote, and they sue." D. Gordon Smith, Matthew Wright, Marcus Kai Hintze, "Private Ordering With Stockholder Bylaws" 80 Fordham L. Rev. 125, 126 (2011).

stockholders of Delaware corporations, and has a detrimental effect on corporations themselves who could be exposed to ever-increasing mismanagement from this unilateral grant of immunity. Fee-shifting bylaws contravene "strongly and widely held expectations about the rights of stockholders of Delaware Corporations." Lawrence A. Hamermesh, "Consent in Corporate Law" The Business Lawyer, v. 70, p. 161, 171 (Winter 2014/2015).[6]

There can be no question that fee-shifting bylaws nearly obliterate Plaintiff's substantive right to sue in sharp contrast to forum selection bylaws which merely regulate "where stockholders may file suit, not whether the stockholder may file suit or the kind of remedy that the stockholder may obtain on behalf of herself or the corporation." *Compare Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 952 (Del. Ch. 2013). Accordingly, Defendants argument that the bylaw in question does not affect Plaintiff's substantive rights rings hollow, as does Defendants reliance on *Bear Sterns Mortgage Funding Trust v. EMC*

[6] Professor Hamermesh aptly questions the fundamental and inalienable nature of a stockholder's right to bring suit when he asks "are there not some corporate actions that, while technically permissible and even properly motivated, so impair the rights of investors that we don't remit the stockholder to the corporate voting process for relief from such actions." *Consent in Corporate Law* at 171. Professor Hamermesh concludes that "the fee-shifting bylaw… is perhaps a rare example of a provision that contravenes what might be called the constitutional limits of corporate law, in that it is not an appropriate subject for private ordering, at least in publically traded companies." *Id.*

Mortgage, LLC, C.A. No. 7701–VCL 2015 WL 139731 (Del. Ch. Jan. 12, 2015) for the proposition that an exception to Delaware's general presumption against retroactivity should exist in this case.

VIII. The Court Should Find That the Fee-Shifting Bylaw Cannot Apply to Former Stockholders

i. The Timing of the Adoption of the Fee-Shifting Bylaw Violates the Implied Covenant of Good Faith & Fair Dealing

Under Delaware law, an important restriction on one party's right to unilaterally amend an agreement governing the parties' relationship is the implied covenant of good faith and fair dealing. The implied covenant of good faith and fair dealing inheres in every contract and "requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct." (internal quotations omitted) *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872, 888 (Del. Ch. 2009) (quoting Dunlap v. State Farm Fire & Cas. Co., 878 A.2d 434, 442 (Del. 2005)).

The implied covenant is used "to ensure the parties' reasonable expectations are fulfilled." *Id.* Application of the implied covenant of good faith and fair dealing is appropriate when "it is clear from the underlying contract that the contracting parties would have agreed to proscribe the act later complained of ... had they thought to negotiate with respect to that matter." *Winshall v. Viacom Intern.*, Inc. 55 A.3d 629, 637 (Del. Ch. 2011).

Although corporate bylaws are not seamlessly analogous to contracts, Delaware courts have viewed corporate bylaws as contracts and have held that the canons of interpretation applicable to contracts are also applicable to corporate bylaws. *See Airgas Inc. v. Air Products & Chems., Inc*, 8 A.3d 1182, 1188 (Del. 2010) ("Corporate charters and bylaws are contracts among a corporation's stockholders; therefore, our rules of contract interpretation apply.").

While corporate bylaws differ from ordinary contracts in that they are not negotiated, it is nevertheless undeniable that a stockholder would wish to proscribe a corporation's ability to affect changes to the corporation's bylaws that purport to bind the stockholder once that stockholder's ownership interest has been extinguished. A stockholder's reasonable expectation is that he will not be bound to changes in the corporation's bylaws that take effect after his ownership interest has been extinguished. Any attempt to institute retroactive bylaws that purport to bind former stockholders whose ownership interest was extinguished prior to the adoption of the bylaw is patently unreasonable and not in line with the reasonable stockholder's expectations.[7]

ii. The Timing of the Adoption of the Fee-Shifting Bylaw Is Plainly Inequitable

[7] In his recent article, "Consent in Corporate Law", Professor Hamermesh questions "how could a bylaw that imposes intolerable risk on the stockholder's decision to sue directors for breach of fiduciary duty be consistent with reasonable investor expectations?" *Consent in Corporate Law* at 171.

Delaware adheres to the twice testing principle most recently described by Vice Chancellor Laster in *Sinchareonkul v. Fahnemann*, C.A. No. 10543-VCL, 2015 WL 292314 (Del. Ch. January 22, 2015). ("When assessing challenges to corporate acts, Delaware law distinguishes between arguments that the act is not legally permissible and arguments that it was inequitable under the circumstances presented for those in control of the corporation to take otherwise permissible legal action."). In Delaware, corporate acts are twice tested, once by the law, and again by equity. *See Sample v. Morgan*, 914 A.d 647, 673 (Del. Ch. 2007); *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 641 (Del. Ch. 2013) ("Corporate acts are 'twice-tested,' once for statutory compliance, and again in equity.").

"When evaluating corporate action for legal compliance, a court examines whether the action contravenes the entity-specific corporate contract." *Sinchareonkul* at *12. Even if the action complies with the DGCL, the corporate charter, and the bylaws, the court must still ask whether this action is an equitable one. In this case, the corporation is attempting to bind former stockholders to a bylaw that was adopted after the stockholders were involuntarily cashed out through a reverse share split and their ownership interests extinguished. It is plainly inequitable for a corporation to purport to bind a former stockholder to a self-serving bylaw that was unilaterally adopted after the former stockholder's ownership in the corporation was abruptly terminated by the corporation itself.

In the instant case, to allow a corporation to bind former stockholders to bylaws unilaterally adopted after the elimination of those stockholders' ownership interests would allow for an ever shifting playing field. Stockholders rights cannot be adequately protected if they are vulnerable to unilateral bylaw amendments after the termination of the stockholder relationship. There are myriad ways in which a corporation could impinge upon the rights of stockholder through unilateral bylaws adopted after a stockholder's interests have been extinguished, leaving the stockholder with no warning and no recourse, in contravention of law, equity, and stockholders' reasonable expectations. Accordingly, Plaintiff respectfully submits that stockholders cannot be bound by bylaws adopted after a stockholder's interest has been extinguished.

CONCLUSION

For the foregoing reasons, Plaintiff respectfully requests that this Court grant his motion for partial judgment on the pleadings, finding that the Bylaw is invalid as applied against Plaintiff and the putative Class, and any other relief that this court deems appropriate.

Dated: February 13, 2015

MONTGOMERY McCRACKEN WALKER & RHOADS, LLP

By:

/s/ Sidney S. Liebesman

Sidney S. Liebesman (DE #3702)
Lisa Zwally Brown (DE #4328)
1105 N. Market St., 15th Floor
Wilmington, DE 19801
Tel. (302) 504-7800
Fax: (302) 504-7820

Attorneys for Plaintiff

OF COUNSEL:

POMERANTZ LLP
Gustavo F. Bruckner
Alla Zayenchik
600 Third Avenue
New York, NY 10016
(212) 661-1100

General Information

Court	Delaware Court of Chancery
Docket Number	9770