IN THE SUPREME COURT OF
THE STATE OF DELAWARE

BEVERYLY PFEFFER, individually and on behalf of all others similarly situated,	§	No. 115, 2008
Plaintiff Below, Appellant	§	Court Below: Court of Chancery of the State of Delaware, Honorable Stephen P. Lamb (C.A. No. 2317-VCL)
v.	§	
SUMNER M. REDSTONE, GEORGE S. ABRAMS, DAVID R. ANDLEMAN, JOSEPH A. CALIFANO, JR., WILLIAM S. COHEN, PHILIPPE P. DAUMAN, ALAN C. GREENBERG, JAN LESCHLY, SHARI REDSTONE, FREDERIC V. SALERNO, WILLIAM SCHWARTZ, PATTY STONESIFER, ROBERT D. WALTER, NATIONAL AMUSEMENT, INC., JOHN F. ANTIOCO, RICHARD J. BRESSLER, JACKIE M. CLEGG, MICHAEL D. FRICKLAS, LINDA GRIEGO, JOHN L. MUETHING, AND CBS CORP. (f.k.a. VIACOM, INC.),	§	
Defendants Below, Appellees.	§	

APPELLANT'S [CORRECTED] OPENING BRIEF

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Dated: April 21, 2008

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I. NATURE OF PROCEEDINGS

This appeal follows the decision dated February 1, 2008 of the Court of Chancery to dismiss Plaintiff's Amended Complaint. *Pfeffer v. Redstone*, 2008 WL 308450 (Del. Ch.) (A1920-58). Plaintiff Beverly Pfeffer ("Plaintiff" or "Pfeffer"), a minority shareholder of Viacom, Incorporated ("Viacom" or the "Company") who received shares of Blockbuster, Incorporated ("Blockbuster") in an Exchange Offer completed by Viacom 2004, appeals the Chancery Court's ruling that Plaintiff did not adequately plead that the directors of Viacom[1] ("Viacom Defendants") and Viacom's majority shareholder breached their fiduciary duties to Viacom's minority shareholders in connection with Viacom's divestiture of Blockbuster.

In the fall of 2004, at the behest of Viacom's majority shareholder, National Amusements, Inc. ("NAI") (which itself was controlled by Viacom's founder, CEO and Chairman of the Board, Sumner Redstone), Viacom transferred its 82.3% interest in Blockbuster to Viacom's minority shareholders. The Viacom board, at Redstone's direction, extracted hundreds of millions of dollars from Blockbuster, and then sold Viacom's stock in Blockbuster to Viacom's minority shareholders in an Exchange Offer in which NAI did not participate.

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[1] The directors of Viacom at the time of the Exchange Offer were Sumner M. Redstone ("Redstone"); George S. Abrams ("Abrams"); David R. Andelman ("Andelman"); Joseph A. Califano, Jr. ("Califano"); William S. Cohen ("Cohen"); Philippe P. Dauman ("Dauman"); Alan C. Greenberg ("Greenberg"); Jan Leschly ("Leschly"); Shari Redstone; Frederic V. Salerno ("Salerno"); William Schwartz ("Schwartz"); Patty Stonesifer ("Stonesifer"); and Robert D. Walter ("Walter"). *See* Amended Class Action Complaint ("Amended Complaint") at ¶¶8-20.

NAI and the Viacom Defendants convinced Viacom's minority shareholders to tender their shares by representing that Viacom would pay Blockbuster stock based on an exchange ratio designed to provide a significant premium to the value of the Viacom shares tendered. However, the truth was that Blockbuster's stock was artificially inflated because, unknown to the investing public or Viacom's minority shareholders, Blockbuster lacked sufficient cash flow to meet its projected business plans. A year later, after details of Blockbuster's inability to fund its operations became public, Blockbuster's stock had plummeted by over 45%. Rather than the "premium" Viacom's minority shareholders were supposed to receive in Blockbuster stock, they actually received Blockbuster stock at a *discount* of over 39% to the value of the Viacom shares they tendered. Since Redstone, the Chairman and CEO of Viacom and its controlling shareholder, and a Blockbuster director, knew these undisclosed facts, he wanted to divest himself of any interest in Blockbuster.

Pfeffer brought this action on behalf of herself and a class of similarly situated shareholders who tendered Viacom shares in exchange for Blockbuster shares in the Exchange Offer (the "Viacom Class"). She appeals the Chancery Court's decision dismissing Plaintiff's claims that Viacom Defendants breached their duty of loyalty by failing to disclose material facts to minority shareholders in connection with the Exchange Offer (Count I), and in breaching their fiduciary duties by structuring Viacom's divestiture of Blockbuster in a manner that unfairly benefited Viacom's controlling shareholder, NAI, and Redstone (Counts II, III and IV).

II. SUMMARY OF ARGUMENT

The decision of the court below is the product of clear error. While quoting the standards of review applicable in the context of a motion to dismiss, the Chancery Court disregarded those standards entirely, rejecting reasonable inferences that should have been drawn in Plaintiff's favor and instead adopting inferences in favor of the Defendants, raising issues of "credibility" that have no place in decisions relating to motions to dismiss, and making legal determinations on issues of materiality that were contrary to the alleged facts. In doing so, the court below applied a heightened pleading standard akin to the standards applicable to federal securities claims subject to the Private Securities Litigation Reform Act of 1994 (the "PSLRA") that is contrary to the notice-pleading standard applicable to pleadings in Chancery Court.

1. The Amended Complaint fairly alleges that the NAI and the Viacom Defendants breached their fiduciary duties by structuring the divestiture of Blockbuster in such a manner as to deliberately promote the interests of the Company's majority shareholder, NAI, over the interests of the minority stockholders. In a two-step divestiture plan, Redstone and the other the Viacom Defendants saddled Blockbuster, an already struggling company, with hundreds of millions of dollars in debt, and then sold Viacom's Blockbuster shares to the Company's minority stockholders who, unlike the majority shareholder NAI, were not privy to and did not have access to significant information revealing that Blockbuster lacked the necessary cash flow to fund its operations.

2. The Chancery Court erred in holding that disclosures in the Prospectus that overstated Blockbuster's operational cash flows by 58% were not material *as a matter of law* despite the facts, alleged in the Amended Complaint, that (1) Blockbuster's cash flow statements did not comply with GAAP, and Blockbuster was forced to restate its financial reports, and (2) the Prospectus specifically highlighted Blockbuster's supposed ability to meet crucial business initiatives *because of* supposedly healthy operating cash flows. The Chancery Court observed: "While there is no dispute that some of the cash flow numbers in the Prospectus were later restated, the plaintiff must sufficiently *demonstrate* materiality." A1941. (emphasis supplied). In this regard, the Chancery Court was simply incorrect. In the context of a motion to dismiss, Plaintiff was not required to "demonstrate materiality" – but merely to plead materiality. And the Amended Complaint more than sufficiently satisfies this requirement.

3. The Chancery Court erred in holding that the Viacom Defendants did not breach their duty of disclosure by omitting from the Prospectus an analysis showing that Viacom did not have the cash flow to execute its business plan. In doing so, the Court not only adopted improper inferences in favor of the defendants, but also applied the wrong inquiry. The relevant question was *not* whether the Viacom Directors *saw* a particular report referenced in the Amended Complaint, but whether the cash flow analysis or the information contained therein was "reasonably available" to Viacom's directors.[2]

[2] When questioned during oral argument before the Court below regarding the details of the report referenced in the Amended Complaint, Plaintiff's counsel admitted that he had not personally read a copy of

And the Amended Complaint alleges sufficient facts to give rise to an inference that information demonstrating that Blockbuster lacked the cash flows necessary to meet its disclosed business plans was "reasonably available" to the Viacom Defendants.

4. The Chancery Court erred in holding that the nature of how Viacom calculated the exchange ratio was not material as a matter of law because the Prospectus did not specifically claim that the consideration was "fair." This rationale was specifically rejected by this Court in *Frank v. Arnelle*, 725 A.2d 441, 1999 WL 89284 (Del. 1999)(table).

5. The Chancery Court erred in concluding that the identity of the Viacom directors who served on the "committee" appointed to finalize the Company's divestment of Blockbuster was immaterial as a matter of law because the Company never represented that the Committee was, in fact, independent. But whether a conflict existed on the committee charged with finalizing Viacom's divestiture of Blockbuster affected the "total mix" of information available to Viacom's minority

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the report, and stated his belief that a copy of the report was, in fact, available and that the allegations in the Amended Complaint were based on a physical review of that report. *See* A1944-45. In this regard, Plaintiff's counsel's belief was incorrect. Plaintiff does *not* have a copy of the subject report, which is why a copy of the report was not delivered to the Chancery Court. Rather, the source of Plaintiff's knowledge regarding the substance of the report was a personal interview conducted by co-counsel with the former Blockbuster employee who *wrote* that report. That employee, Julie Mingus, is identified by name in Paragraph 62 of the Amended Complaint. Nevertheless, by questioning the underlying factual support for the well-plead allegations of the Amended Complaint, the Chancery Court disregarded the axiom that, in ruling on a motion to dismiss, such facts *must* be accepted as true. *See Krasner v. Moffett*, 826 A.2d 277, 283 (Del. 2003) (holding that the Chancery Court must accept as true all well pled allegations).

shareholders, and is thus material, does not depend merely on whether the Company specifically disclosed that the "committee" was independent, but whether such information would have been useful to Viacom's minority shareholders in determining whether to tender their shares into the Exchange Offer.

6. The Chancery Court erred in dismissing Count II. Allegations of a defendant's state of mind may be averred generally. Del. Ch. Ct. R. 9(b). Plaintiff properly alleged that Viacom Defendants knowingly made the above material misrepresentations and omissions in bad faith to enrich Viacom and NAI at the expense of majority shareholders. For purposes of stating a claim, that is all that is required.

III. STATEMENT OF FACTS

A. Factual Background

Sumner Redstone is the founder, CEO and Chairman of the Board of Viacom. ¶8. He is also the majority shareholder of NAI, which, in turn, is the majority shareholder of Viacom. ¶¶8, 34. As of the time of the Exchange Offer, Redstone, through NAI, controlled 71% of the voting power of Viacom. Redstone also was a director of Blockbuster, and appointed other agents of NAI to serve on Viacom's board.[3] NAI, therefore, controlled Viacom. ¶34.[4] Viacom, in turn, owned 95.9% of the total voting power of Blockbuster, and used its power over the company to elect directors with substantial financial ties to Viacom and/or NAI. ¶36.[5]

On February 10, 2004, Viacom announced plans to spin off Blockbuster, issuing a press release justifying the decision to divest itself of Blockbuster "based on the conclusion that Blockbuster would be better positioned as a company completely independent of Viacom."

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[3] Specifically, (1) Defendant Abrams was a director of both NAI and Viacom; (2) Defendant Dauman was a director at both NAI and Viacom; and (3) Defendant Shari Redstone, daughter of Defendant Redstone, was Executive Vice Chairman of Viacom's board of directors and also President of NAI. ¶¶8-20.

[4] Viacom's 10K for 2005 disclosed that "NAI is in a position to control the outcome of corporate actions that require shareholder approval, including the election of directors, issuance of securities and transactions involving a change of control." ¶34.

[5] Specifically Viacom elected (1) Dauman, who was a director of NAI and Viacom; (2) Redstone, who was the chairman and CEO of Viacom and NAI; (3) Bressler, who was Senior Executive Vice President and Chief Financial Officer of Viacom; (4) and Fricklas, who was Executive Vice President, General Counsel, and Secretary of Viacom. ¶¶8-29, 71. Thus, four of eight Blockbuster directors had an interest in or were employed by Viacom and/or NAI, and all of them depended on Viacom for their appointment to the board.

¶37. The truth was different. Redstone wanted to sell because Blockbuster's business was failing and he no longer wanted to have a personal stake in it. NAI and Redstone devised and executed a scheme to unload Blockbuster on Viacom's minority shareholders. The scheme had three parts: (1) cause Blockbuster to issue a crippling $5 Special Dividend (¶38); (2) mislead the public about the continued ability of Blockbuster to execute its business plan after issuing the Special Dividend (¶¶48-71); and (3) orchestrate the Exchange Offer, where Viacom shareholders could tender their shares of Viacom for Blockbuster shares owned by Viacom at a price inflated by false and misleading statements. ¶39. Because NAI did not tender its Viacom shares in the Exchange Offer, the scheme had the effect of ridding Viacom and NAI (and thus Redstone) of Blockbuster at a tremendous profit, while unloading a financially strapped Blockbuster on Viacom's minority shareholders. ¶46. The Viacom board did as it always had - it followed Redstone's instruction.

Despite the weakened state of Blockbuster, NAI and the Viacom Defendants had to convince minority Viacom shareholders to participate in the Exchange Offer. While touting Blockbuster's business prospects through investments in new initiatives (¶¶47-53), NAI and the Viacom Defendants actively concealed or failed to disclose significant facts indicating that Blockbuster's cash flows were not sufficient to fund its ambitious business plans.

1. False and Misleading Cash Flow Disclosures

NAI and the Viacom Defendants misrepresented Blockbuster's chances of executing its ambitious business plans. *First*, the Viacom

Defendants misrepresented the true status of Blockbuster's operating cash flows, thus concealing the inability of that company to meet its projected business plans. ¶42. Because the bulk of Blockbuster's retail library assets are new releases, those acquisitions should have been classified as current assets on Blockbuster's financial statements. Blockbuster, however, classified its acquisition of new releases as non-current, investment-related assets. ¶42. As a result, Blockbuster accounted for the *expense* of acquiring its inventory of new releases as a *capital* (*i.e.*, investment-related) expense rather than an *operational* expense. By so doing, Blockbuster materially inflated its reported net cash flow from operations. ¶42. This inflation of operating cash flow was part of a scheme to deliberately conceal that Blockbuster was unable to execute its business plan. ¶41. That Blockbuster in fact overstated its operational cash flow is *not disputed*. Indeed, after Blockbuster's stock collapsed amid disclosures of the Company's inability to successfully implement its crucial business initiatives, Blockbuster *admitted* that it had been improperly accounting for its operational expenses and was forced to restate its financial reports. ¶78. Plaintiff pled the materiality of these misstatements. *See, e.g.*, ¶¶60, 61, 96.

Second, NAI and the Viacom Defendants failed to disclose that Blockbuster had conducted its own cash flow analysis, and found that Blockbuster could ***not***, in fact, pay off the debt it had incurred in connection with the Special Dividend while simultaneously executing its announced business plan. ¶62. Specifically, Julie Mingus, a treasury department manager at Blockbuster, performed a cash flow

analysis in February or March of 2004 - *prior* to the announcement and payment of the Special Dividend - concluding that *Blockbuster could not meet its new business objectives*. *Id.* The purpose of the analysis was to evaluate Blockbuster's cash flow over 12 to 18 months to determine whether money from newly incurred debt and operating income would be sufficient to both fund the Special Dividend and help Blockbuster adapt its business plan. *Id.* The cash flow analysis concluded that the Special Dividend would leave Blockbuster without the financial resources required to implement its ambitious strategic plan. Specifically, this analysis revealed that core in-store rental operations would not generate sufficient cash flow to fund Blockbuster's investment in "new initiatives." ¶62. Although the cash flow analysis was distributed to senior management of Blockbuster, it was never disclosed in the Prospectus. Indeed, Mary Bell, Senior Vice President of Investor Relations and Treasurer of Blockbuster ("Bell") specifically told subordinates not to disclose the analysis to analysts or investors. ¶63. Further, Blockbuster financial analysts presented Antioco and other members of Blockbuster's senior management with forecasting models showing that Blockbuster's proposed subscription service would not be profitable for the company. ¶67. Instead of disclosing these models to investors, Blockbuster executives altered the models to fraudulently show that the new initiative would be profitable. ¶67.

Plaintiff pled that Redstone (and thus NAI) knew that operating cash flow was inflated and that a cash flow analysis showed that Blockbuster could not finance its changing business plan. ¶68.

Further, Plaintiff pled that the Viacom Defendants knew or should have known such facts. ¶68.

2. False and Misleading Disclosures about the Exchange Offer

In addition to mischaracterizing the financial health of Blockbuster, the Prospectus failed to disclose important information about the structure of the Exchange Offer. The Prospectus stated that in calculating the Exchange Ratio "among other things," Viacom considered: (1) recent and historical prices of Viacom and Blockbuster common stock, and (2) information from co-dealer managers as to what price would induce Viacom shareholders to tender their shares. ¶70. It never stated precisely what factors Viacom took into account when determining the exchange ratio, and as such, omitted information that would have been relevant to the "total mix" of information available to Viacom shareholders in evaluating whether to participate in the Exchange Offer. ¶70.

Additionally, the Prospectus stated that a committee of Viacom's Board approved "the final form of the divestiture of Blockbuster from Viacom." ¶71. However, the Prospectus never stated who sat on the Board. ¶71. Such information was important and material because two of Viacom directors (Greenberg and Salerno) were affiliated with Bear Stearns, which served as co-deal manager for Viacom's split off of Blockbuster. ¶71. Further, a number of Viacom Directors - Shari Redstone, Abrams, and Dauman - had ties to and/or served on the Board of NAI. ¶71. Specifically, at all relevant times, Defendant Shari Redstone was the president and a director of NAI (¶34); Abrams was a director of NAI (¶9); and Dauman was a director of NAI (¶13). Thus,

by concealing the names of the Viacom Defendants who approved the Exchange Offer, Viacom Defendants withheld information critical for shareholders to determine if the Exchange Offer was conducted by persons with ties to NAI.

3. Plaintiff and the Class Tender Their Shares and Suffer Loss When the Truth is Revealed

The scheme worked as planned. The Exchange Offer was oversubscribed and Viacom accepted 9.55% of the tendered shares, or 27,961,165 shares of Viacom common stock, in exchange for 144 million shares of Blockbuster common stock. ¶¶30, 36, 44-5, 80. Therefore, through the Exchange Offer, Redstone completely divested himself of his interest in Blockbuster. Before the Exchange Offer, Viacom owned 82.3% of the equity of Blockbuster. After the Exchange Offer, Viacom's interest was zero. ¶36. As Viacom's controlling shareholder, Redstone had successfully eliminated his investment in, and thus exposure to, Blockbuster's failing business model at the expense of Viacom's minority shareholders.

Subsequently, the truth eventually became known: The Special Dividend crippled the company and Blockbuster was wholly unable to execute its business plans. On October 27, 2004, only three weeks after the Exchange Offer was completed, Blockbuster announced that profitability for the fourth quarter of 2004 would be lower than the previous year. ¶72. From that date to March 9, 2006, the company gradually admitted that softness in the rental market would substantially diminish profitability to a level significantly less than represented in the Prospectus. As it became clear that Blockbuster, saddled with debt, was foundering, its debt was

downgraded. By November 2005, the company warned that it may have to seek bankruptcy protection. ¶76. By November 9, 2005, Blockbuster shares were trading at $4.11 per share, down 45% since the date of the Exchange Offer. Thus, once the truth about Blockbuster became known, it was evident that the exchange ratio offered to Viacom minority shareholders did not constitute a 19.2 percent premium as the Viacom Defendants stated, but rather *a discount of over a 39 percent*. ¶31.[6]

Further, the bad news about Blockbuster did not stop. The SEC forced Blockbuster to downwardly restate its operating cash flow. Specifically, the SEC pointed out that Blockbuster had improperly inflated its operating cash flow by not counting expenditures on its rental libraries as an operating cash outflow. ¶78.

Thus, Redstone profited from the Exchange Offer Scheme through receipt of the Special Dividend. By liquidating his interest in Blockbuster through the Exchange Offer before the truth of Blockbuster's cash flow problems became known, Redstone was able to dump 144 million Blockbuster shares on Viacom's minority shareholders at a price of almost $1.14 billion, and therefore avoided a loss of well over half a billion dollars that Viacom (and thus Redstone) would have suffered had the truth of Blockbuster's finances been disclosed. (A1276).

[6] The Amended Complaint contains a mathematical error that incorrectly calculated the post-disclosure discount at just 34.5%. (A0048). The economic realities of the situation were actually worse. (A1275).

B. Procedural History

Plaintiff filed her initial Class Action Complaint ("Complaint") on August 3, 2006. On October 26, 2006, Defendants moved to dismiss the Complaint or, in the alternative, stay the case in favor of *Congregation Ezra Sholom v. Blockbuster, Inc., et al.*, 3:05 CV 2213-N (N.D. Tex.) (*Congregation Ezra Sholom*), a case involving claims under the federal securities laws. On January 12, 2007, Plaintiff filed the Amended Complaint, adding allegations and counts against NAI, Viacom, and Blockbuster Defendants on behalf of Viacom shareholders who participated in the Exchange Offer and on behalf of Blockbuster shareholders who held their shares at the time the Special Dividend was calculated. On April 27, 2007, all Defendants moved to dismiss or, in the alternative, stay the action until the resolution of *Congregation Ezra Sholom*. On August 22, 2007, the District Court for the Northern District of Texas dismissed the plaintiffs' claims in *Congregation Ezra Sholom*, mooting the issue of whether a stay was appropriate. On February 1, 2008, the Chancery Court dismissed all of Plaintiff's claims against the Viacom Defendants, the Blockbuster Defendants, Viacom, and NAI. Plaintiff now appeals only the dismissal of Counts I, II and III of the Amended Complaint brought on behalf of the Viacom Class against the Viacom Defendants, and Count IV brought on behalf of the Viacom Class against NAI.[7]

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[7] The Amended Complaint asserted six separate claims for relief. In this appeal, Plaintiff seeks review only of the dismissal of Counts I, II, III, and IV, and hereby withdraws her notice of appeal as it applies to the Blockbuster Defendants, except Messrs. Redstone and Dauman, who also served as directors of Viacom.

IV. ARGUMENT

"A pleading which sets forth a claim for relief … shall contain (1) a short and plain statement of the claim showing that the pleader is entitled to relief and (2) a demand for judgment for the relief to which the party deems itself entitled." Del. Ch. Ct. R. 8(a). Indeed, "[t]o withstand a 12(b)(6) motion to dismiss, the plaintiff is only required to state a claim, not to plead the evidence upon which the claim is based." *Branson v. Exide Electronics Corp.*, 1994 WL 164084, at *3 (Del.) While allegations of fraud or mistake must be alleged with particularity, "[m]alice, intent, knowledge and other condition of mind of a person may be averred generally." Del. Ch. Ct. R. 9(b).

This Court has observed that "[a] trial court must not dismiss any claim pursuant to Rule 12(b)(6) unless it appears with reasonable certainty that the plaintiff cannot prevail on any set of facts which might be proven to support the allegations in the complaint." *VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 615 (Del. 2003). Further, "the Court must assume the truthfulness of all well-pled allegations in the complaint and view those facts, and all reasonable inferences drawn from them, in the light most favorable to the plaintiff." *Tooley v. AXA Fin., Inc.*, 2005 WL 1252378, at *3 (Del.Ch.). The Chancery Court's decision must be reversed because it misapplied the standards applicable on a motion to dismiss and failed to view the well-pled allegations of the Amended Complaint in the light most favorable to the Plaintiff.

A. NAI And The Viacom Directors Breached Their Fiduciary Duties By Structuring The Divestiture Of Blockbuster In A Manner That Elevated The Interests Of NAI Over The Interests Of The Minority.

1. Question Presented

Whether directors of a corporation and the corporation's majority shareholder breach their fiduciary duties by structuring the divestiture of an underperforming subsidiary in a manner that elevates the interests of the company's majority and controlling stockholder over the interests of the minority, and specifically by selling the subsidiary to the minority at a price the directors knew was artificially inflated so that the majority shareholder could divest himself of his interest in the subsidiary. This question was preserved before the Chancery Court in Plaintiff's Answering Brief in Opposition to Defendants' Motions to Stay or Dismiss. (A1296-1301).

2. Scope of Review

This Court reviews dismissals under Chancery Court Rule 12(b)(6) *de novo*. *See Desert Equities, Inc. v. Morgan Stanley, Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1204 (Del. 1993); *see also Krasner*, 826 A.2d at 283.

3. Merits of the Argument

Directors of Delaware corporations owe a fiduciary duties to *all* shareholders, and cannot favor the interests of the majority shareholder over the interests of the minority in a transaction where the majority shareholder has a material interest. *See Emerald Partners v. Berlin*, 726 A.2d 1215, 1222 (Del. 1999)(Chancery Court erred in granting summary judgment against plaintiffs on claim that directors breached fiduciary duty to minority by unfairly structuring

merger involving corporations owned by majority shareholder; entire fairness applied). Similarly, majority shareholders also owe fiduciary duties to the minority shareholders. *See Kahn v. Lynch Communication Sys.*, 638 A.2d 1110, 1113 (Del. 1994).

The Chancery Court held that the entire fairness standard did not apply because NAI was not on both sides of the Exchange Offer. (A1938). But entire fairness *does* apply when the corporate board, dominated by a controlling shareholder,[8] approves a business transaction in which that controlling shareholder has financial interests different from the minority. Moreover, whether the entire fairness standard applies or not, the Viacom directors still breached their fiduciary duty to Viacom's minority shareholders because it is improper for a board to structure a transaction to benefit an insider-majority shareholder at the expense of the minority. So even if entire fairness does *not* apply, it was still error for the Chancery Court to dismiss Plaintiff's claims. *See In re Pure Resources, Inc., Shareholders Litig.*, 808 A.2d 421, 450 (Del.Ch. 2002) (holding directors breached their fiduciary duty of disclosure despite holding that the entire fairness standard did not apply).

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[8] Neither the Chancery Court nor the Viacom Defendants have contested Plaintiff's allegation that Redstone, through his position with the Company and ownership of NAI, controlled the Viacom Board. ¶34. Indeed, there is no question he did. *See* Robert Lenzner and Devon Pendleton, *Family Feud*, Forbes, November 12, 2007, 2007 WLNR 21320825 (commenting on his opposition to his daughter's efforts to assume control of Viacom, Redstone quipped: "'If she insists on trying to succeed me, there's no question the boards will do what I ask them,' he warns. *'They've never gone against my wishes.'*" (emphasis supplied)).

In *Feldman v. Cutaia*, 2006 WL 920420, at *6 (Del. Ch.), for example, the Chancery Court applied an entire fairness standard of review where "allegations with respect to the repurchase suggest that the self-tender offer was an interested transaction." *Id.* at *6. Similarly, in this case, Plaintiff pled facts giving rise to the inference that directors on the committee to approve the Exchange Offer had a stake in NAI and priced the Exchange Offer to benefit NAI over minority Viacom shareholder. ¶71. Because the overall transaction - the declaration of the Special Dividend followed immediately by an Exchange Offer that hid the true impact that the Special Dividend had on Blockbuster's finances - was interested, it should be subject to review under an "entire fairness" standard. The Chancery Court's observation that NAI did not appear on both sides of the Exchange Offer, therefore, missed the point. Of course NAI did not participate in the Exchange Offer - the entire purpose of the transaction was to divest Viacom's interest (and thus NAI's exposure to) Blockbuster, not acquire more shares. The relevant "transaction" that the Chancery Court should have considered was the entire two-step divestment, not just the Exchange Offer.

Directors cannot favor the interests of a majority shareholder to the detriment of minority shareholders or the corporation. *See Weinstein Enterprises, Inc. v. Orloff*, 870 A.2d 499, 509 (Del. 2005) ("This Court has consistently held that the fact the directors of a corporation are elected by the majority stockholder does not relieve those directors of their fiduciary duties to the corporation and its minority stockholders."). Here, the Viacom Defendants structured the

Exchange Offer transaction to benefit Viacom's majority shareholder, NAI, by selling Blockbuster to Viacom's minority shareholders at an inflated price after extracting most of the value from Blockbuster through the Special Dividend. The Chancery Court erred when it held: "The plaintiff makes no allegation that NAI directed the actions of Viacom." (A1955). This is incorrect. Plaintiff alleged that NAI and Redstone were the driving forces behind the divestiture. ¶¶34, 68, 69, 81, 94, 99-101, 108-113 (highlighting Redstone and NAI's control, Redstone's "preoccupation" with reducing the public float of Viacom, and that the divestiture of Blockbuster was structured to further solidify NAI's control).

Further, the Special Dividend - as part of the two-step divestiture - must be judged under the entire fairness standard. This Court in *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) held: "If such a dividend is in essence self-dealing by the parent, then the intrinsic fairness standard is the proper standard." *Id.* at 721. This Court in *Sinclair* defined self dealing as follows: "[The majority shareholder] would be receiving something from the subsidiary to the exclusion of and detrimental to its minority stockholders." *Id.* Here, entire fairness applies to the Special Dividend because Viacom received the Special Dividend knowing that Blockbuster would be crippled and knowing that Redstone/NAI would be cashed out before minority shareholders became aware of the truth of Blockbuster's diminished status. In short, Redstone received the benefit of the Special Dividend, plus the premium when Viacom sold its Blockbuster stock at an inflated price.

While the Chancery Court correctly points out that non-coercive tender offers are generally not scrutinized under entire fairness, Plaintiff alleged that this transaction - the Special Dividend and Exchange Offer – *was* structured to benefit the majority shareholder to the detriment of minority shareholders. ¶¶3-4, 37-71. Specifically, the Viacom Defendants, under the direction of Redstone, structured the Blockbuster divestiture so as to dump grossly overvalued Blockbuster stock on Viacom's minority shareholders, thus ridding NAI (and Redstone) of a significantly underperforming asset while enjoying an enormous profit through the issuance of the Special Dividend and the repurchase of Viacom shares at a bargain-basement price. ¶¶37-46. The same logic that justifies an entire fairness standard of review in cases analyzing transactions where a corporation *acquired* property from a majority shareholder applies with equal force to the situation where the Company *sold* a significant asset to the minority shareholders in order to rid the Company and the majority shareholder of exposure to an underperforming asset. *See California Public Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, *13 (Del. Ch.) (entire fairness applied to company's purchase of corporation owned by acquiring company's Chairman, CEO and largest shareholder).

The Chancery Court erred, therefore, in holding that Plaintiff failed to allege that the Viacom Defendants breached their fiduciary duties in selling Blockbuster to Viacom's minority shareholders at a price they knew or reasonably should have known was artificially inflated, specifically to rid Viacom and its majority shareholder, NAI, from exposure to a significantly underperforming asset.

B. The Chancery Court's Dismissal of Plaintiff's Claims Alleging that NAI and the Viacom Defendants Breached Their Fiduciary Duties by Making False Disclosures and Omitting Material Information From The Prospects Was In Error

1. Question Presented

Whether the Chancery Court required a level of factual pleading not required to state a claim under notice pleading standards when dismissing Plaintiff's allegation that the Viacom Defendants breached their fiduciary duties by making material false statements and omissions in the Prospectus. This question was preserved before the Chancery Court in Plaintiff's Answering Brief in Opposition to Defendants' Motions to Stay or Dismiss. (A1284-1296).

2. Scope of Review

This Court reviews dismissals under Chancery Court Rule 12(b)(6) *de novo*. *See Desert Equities*, 624 A.2d at 1204.

3. Merits of Argument

"Whenever directors communicate publicly or directly with shareholders about the corporation's affairs, with or without a request for shareholder action, directors have a fiduciary duty to shareholders to exercise due care, good faith and loyalty." *Malone v. Brincat*, 722 A.2d 5, 10 (Del 1998). The Amended Complaint contains sufficient allegations that the Viacom Defendants breached their fiduciary duties by issuing a false and misleading Prospectus.

(a) The Chancery Court Erred In Holding That Statements In The Prospectus That Overstated Blockbuster's Operational Cash Flows By 58% Were Not Material As A Matter Of Law

"To state a claim for breach of the fiduciary duty of disclosure on the basis of a false statement or representation," the Chancery

Court correctly observed, "a plaintiff must identify (1) a material statement or representation in a communication contemplating stockholder action (2) that is false." (A1940) (quoting *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 916 (Del. Ch. 1999)). Although the Chancery Court's recitation of the applicable standard was undoubtedly correct, the Chancery Court erred in holding that statements regarding Blockbuster's operational cash flows were not material as a matter of law. (A1942).

As an initial matter, there is no dispute statements in the Prospectus regarding Blockbuster's operational cash flows were false. ¶78.[9] The issue is whether they were material. The Chancery Court observed: "While there is no dispute that some of the cash flow numbers in the Prospectus were later restated, the plaintiff must sufficiently *demonstrate* materiality." (A1941). In the context of a motion to dismiss, however, Plaintiff was not required to "demonstrate materiality" - as the Chancery Court suggested - but merely to *plead* materiality.

"[A]n omitted fact is material if there is a substantial likelihood that the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." *Kahn v. Tremont Corp.*, 694 A.2d 422, 431 (Del 1997).[10] However, as

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[9] *See also In re FirstEnergy*, 316 F. Supp. 2d 581, 595 (N.D. Oh. 2004) ("[T]he purpose of a restatement is to correct an error in a previously-issued financial statement. By definition then, a restatement says that the prior financial statement was false.").

[10] *See also In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 199 (Del. Ch. 2007) ("Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the

this Court recognized in *Branson v. Exide Electronics Corp.*, 1994 WL 164084 (Del.), "the issue of materiality of an alleged misstatement or omission in a prospectus is a mixed question of law and fact, but predominantly a question of fact, which is not generally suited for disposition by summary judgment." *Id.* At *2.[11] Disregarding this instruction, the Chancery Court held "there is nothing in the complaint to suggest that the misstatement of cash flow was material to a Viacom stockholder in deciding whether or not to accept the Exchange Offer." (A1942). The Chancery Court's holding in this regard is simply wrong.

First, the Complaint alleges the Prospectus represented that Blockbuster's ability to maintain sufficient operating cash flow was *critical* to funding Blockbuster's new business plan. *See* ¶47 (quoting Prospectus: "[T]he steady operating cash flow from our core rental business has provided us with the ability to invest in new initiatives") Because the entire premise of Blockbuster's spin-off from Viacom was to somehow better position Blockbuster to implement these new business initiatives (¶37), the representation that Blockbuster's ability to engage in "new initiatives" depended on "steady operating cash flow" plainly demonstrates the materiality of those figures.[12] *Second*, the fact that Blockbuster was forced to

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'total mix' of information made available.").

[11] *See Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *2 (Del. Ch.) ("The determination of materiality is a mixed question of fact and law that generally cannot be resolved on the pleadings.").

[12] *See In re Netsmart Tech.*, 924 A.2d at 177 ("A reasonable stockholder deciding how to make these important choices would find it material to know what the best estimate was of the company's expected future cash

restate its operational cash flows also supports a finding of materiality. *Third*, the fact that Blockbuster's accounting practices for operational cash flows did not comply with GAAP itself supports a finding of materiality.[13]

In holding that Blockbuster's artificially inflated operational cash flow statements were not material as a matter of law, the Chancery Court pointed out that Blockbuster's public filings disclosed the (erroneous) method the company used to calculate operational cash flows. (A1941). Yet Viacom's minority shareholders were entitled to rely on the representations in the Prospectus that Blockbuster's financial reports were prepared in accordance with GAAP. ¶42. *In re Baan Co. Sec. Litig.*, 103 F. Supp. 2d 1, 14-15 (D.D.C. 2000) ("If [Defendant] violated GAAP rules, the financial information [Defendant] published would have been misleading to anyone attempting to analyze the value of [Defendant's] stock."). And the Chancery Court's observation that Blockbuster's improper accounting for operational cash flows did not impact any other financial metric simply evidences that the Court was adopting some kind of inference that Viacom's shareholders would not have cared about the particular metric of operating cash flows. Not only would such an inference be contrary to the appropriate standard on a motion to dismiss, but it disregards the

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flows."

[13] *See* 17 C.F.R. § 210.4-01(a)(1)("Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.").

specific importance of operating cash flow to investors.[14] *See In re Netsmart Tech.*, 924 A.2d at 177.

Finally, the Chancery Court improperly conflated the concept of loss causation in a securities case with the issue of materiality for purposes of pleading a disclosure violation. Loss causation is not an element of Plaintiff's claim.[15] Nevertheless, the Chancery Court held: "The complaint also does not allege that news of the reclassification affected the Blockbuster stock price, which itself is a strong indication of immateriality." (A1941-42). Not only did the Chancery Court's observation appear to resolve a factual dispute that was inappropriate in the context of a motion to dismiss,[16] but it ignored

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[14] Reporting on Blockbuster's restatement, the WALL STREET JOURNAL specifically rejected the efforts of Blockbuster's CFO to downplay the importance of the misclassification of the Company's cash flow, observing that "when professional investors look at cash flow, it is almost always the operating figure they focus on, because that's the one that reflects the money a company is bringing in from its everyday business, as opposed to sideline investments." Michael Rapoport, *Moving the Market - Tacking the Numbers/Outside Audit: Closer Look at Blockbuster's Results Changes Picture*, THE WALL STREET JOURNAL, March 14, 2006 at C3. *See also* Charles W. Mulford and Eugene E. Comiskey, Creative Cash Flow Reporting, Uncovering Sustainable Financial Performance at 81 (Publisher: John Wiley & Sons, Inc. 2005), (commenting on the difference between operating and investing cash flows, the authors observe: "Because they are derived from less sustainable sources, investing cash inflows are not valued as highly as operating cash inflows.") (A1742).

[15] *See Malone*, 722 A.2d at 12 (Del.) ("An action for a breach of fiduciary duty arising out of disclosure violations in connection with a request for stockholder action does not include the element[] of ... causation ..."); *Turner v. Bernstein*, 776 A.2d 530, 545 (Del.Ch. 2000) ("[O]ur case law values full disclosure so highly that neither reliance nor causation are required elements of a fiduciary duty claim based on inadequate disclosures.").

[16] *See Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 321 (Del. 2004) ("A Rule 12(b)(6) motion . . . is not a proper procedural vehicle to resolve conflicting inferences of fact.")

the allegations in the Amended Complaint explaining that by the time that Blockbuster restated its cash flow in March of 2006, it was already clear that Blockbuster did not have cash to execute its new business plan. ¶78. Thus, the fact that the stock price did not drop further is not an "indication of immateriality," as the Chancery Court held, but a predictable occurrence given the previous collapse of the price of Blockbuster's stock.[17]

(b) The Chancery Court Improperly Questioned The Truthfulness Of The Well-Pled Allegations Of The Amended Complaint, Rejected Reasonable Inferences That Should Have Been Drawn In Plaintiff's Favor, And Adopted Inferences That Lacked Record Support And Were Contrary To The Allegations Of The Complaint.

The Amended Complaint alleges that Blockbuster's cash flow problems were known within Blockbuster and reasonably available to the Viacom Defendants at the time of the Exchange Offer. ¶¶60-68. Specifically, the Amended Complaint alleges that there were systemic accounting problems within Blockbuster and that an employee of Blockbuster's treasury department, Ms. Mingus, analyzed Blockbuster's operations and concluded that Blockbuster could not meet its business

[17] *See, e.g., In re Motorola Sec. Litig.*, 505 F. Supp. 2d 501, 544 (N.D. Ill. 2007) ("Defendants' proposed rule would provide for an expedient mechanism for wrongdoers to avoid securities fraud liability. A company that has, for example, booked revenue from non-existent contracts could simply issue some damaging announcement that appears on its face unrelated to any fraudulent scheme, *e.g.*, a significant earnings warning citing order weakness, wait for its share price to plummet, and then disclose the wrongdoing once the damage has been done."); *In re Parmalat Sec. Litig.*, 375 F.Supp. 2d 278, 307 (S.D.N.Y. 2005) ("That the true extent the fraud was not revealed to the public until February-after Parmalat shares were worthless and after the close of the Class Period-is immaterial where, as here, the risk allegedly concealed by defendants materialized during that time and arguably caused the decline in shareholder and bondholder value.")

goals if it issued the Special Dividend and that Blockbuster's new strategic initiatives would be unprofitable. ¶62. The Chancery Court rejected these allegations, holding that Plaintiff failed to allege facts indicating that the Viacom Defendants knew of Ms. Mingus's report. *See* A1946. However, a plaintiff need not plead that defendants had actual knowledge of the non-disclosed material fact as long as such information was reasonably available to them. *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992) ("Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action.").[18]

According to the Chancery Court, the Amended Complaint did not allege that the Viacom Defendants specifically saw the particular report referenced in the Amended Complaint and ruled that, as a matter of "general experience," directors would not be "presumed to know business operational information that is not of a kind routinely disclosed to boards of directors." (A1946). As an initial matter, the Chancery Court's unilateral assertion of fact concerning "general experience" and what kind of "business operational information" is or is not "routinely disclosed to boards of directors" lacks foundation and improperly draws an inference against Plaintiff in a manner that is wholly inappropriate in the context of a motion to dismiss. *See Tooley v. AXA Fin., Inc.*, 2005 WL 1252378, at *3 (Del. Ch.).

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[18] At a minimum, Plaintiff should have been granted leave to amend. *Fields v. Kent County*, 2006 WL 345014, at *4 (Del.Ch.) (holding that "Rule [15a] indicates that leave to amend is to be liberally conferred" and allowing plaintiff to amend complaint where it would not be futile and not cause defendant material prejudice).

Moreover, the Chancery Court's characterization of Plaintiff's inference that negative information regarding Blockbuster's cash flows and business prospects was known by Redstone and available to the Viacom Defendants as a "daisy chain of surmise and illogic" (A1945) was wholly unwarranted.[19] Is it truly "illogical" to assume that the directors of Viacom, in determining whether to divest their Company's 80% interest in Blockbuster, would conduct some modicum of due diligence into Blockbuster's future business prospects in order to make an informed decision of whether to sell or retain control while Blockbuster implemented the "initiatives" that were supposed to turn the company around? Is it also "illogical" to assume that these directors, had they properly exercised their fiduciary duties, would have demanded access to cash flow projections and analyses, both positive and negative, regarding Blockbuster's business prospects? The Chancery Court's summary dismissal of these reasonable inferences was unjustified.

Finally, contrary to the Chancery Court's observation (A1949-50), the fact that the Prospectus disclosed various "risks" that Blockbuster's cash flow would not fund its ambitious new business plan does *not* excuse the Viacom Defendants from disclosing *facts* regarding Blockbuster's cash flow problems that they knew or were reasonably available to them. *Lynch v. Vickers Energy Corp.*, 383 A.2d 278, 281

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[19] Other courts have recognized that on issues of pleading demand futility, Delaware requires more than mere notice pleading despite the language of Rule 8. *See In re Tower Air, Inc.*, 416 F.3d 229, 236 (3d Cir. 2005). However, in cases *not* involving demand, as here, this Court has *not* elevated Rule 8's notice pleading rule to the kind of particularity required for stating a claim for securities fraud under the PSLRA.

(Del. 1977). Because Plaintiff has pled that the Viacom Defendants knew or had reasonable access to specific, negative cash flow information that was not disclosed to the public, the Viacom Defendants cannot avoid liability merely because the Prospectus included boilerplate speculation that cash flow *may* in the future be inadequate.[20]

(c) The Chancery Court Erred In Holding That Information Considered By The Viacom Directors In Establishing The Exchange Ratio Was Not Material As A Matter Of Law Because The Viacom Defendants Did Not Specifically Represent That The Price Offered Was "Fair."

The Prospectus disclosed that, in calculating the Exchange Ratio, the Viacom Defendants considered "among other things," the historical market price of Blockbuster shares and the price that would cause Viacom stockholders to tender their shares. ¶70. Plaintiff alleged that Defendants' failure to disclose the "other things" considered rendered the Prospectus misleading. ¶70; *see also Malone*, 722 A.2d 5 at 12 n.31 ("[D]irectors are under a fiduciary obligation to avoid misleading partial disclosures."). Specifically, Plaintiff alleged that it was a highly misleading partial disclosure to state that Viacom was purchasing its stock at a 19.2% premium without disclosing that the market price of the Blockbuster stock being offered as

[20] *See also Credit Suisse First Boston Corp. v. ARM Fin. Group*, 2001 WL 300733, at *8 (S.D.N.Y. 2001) ("[W]arnings of specific risks like those in [defendants'] Prospectus do not shelter defendants from liability if they fail to disclose hard facts critical to appreciating the magnitude of the risks described."); *In re Prudential Sec. Inc. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) ("The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away.").

consideration was not a true reflection of the company's value. ¶31. The Chancery Court disagreed, holding that the Viacom Defendants were under no obligation to disclose *any* information regarding the calculation of the Exchange Ratio because they never specifically suggested that the consideration offered in the deal was "fair." (A1951). The Chancery Court's decision in this regard was erroneous.

Whether information relating to the price of a tender offer was material to shareholders considering tendering their shares is not determined solely with reference to whether the directors of the offering corporation characterized the price as "fair." In support of its holding, the Chancery Court cited the Chancellor's decision in *Frank v. Arnelle*, 1998 WL 668649, at *5 (Del Ch.), *aff'd* 725 A.2d 441, 1999 WL 89284 (Del.)(table). In *Frank*, a case involving a Dutch auction where the tendering shareholders establish the price (and decided in the context of a motion for summary judgment after discovery), the Chancellor held that how the defendants calculated the range for the auction was not material because they did not claim that the price was fair and shareholders had sufficient information to make an independent judgment on whether to sell their shares. *Id.*

There are two significant problems with the Chancery Court's reliance on the Chancellor's decision in *Frank*. First, in this case, the Viacom Defendants represented that the price was more than "fair" - they claimed it represented over a 19% *premium*. Second, and more importantly, this Court *rejected* the very analysis invoked by the Chancery Court here in affirming the Chancellor's decision in *Frank*: "If the Court of Chancery intended to imply that there was no

obligation by the directors to disclose information that would have been material to a stockholder's decision to hold or dispose of shares, that holding would be incorrect." *Frank*, 1999 WL 89284 at *2. The Chancery Court's holding wholly ignores this Court's observation that the relevant inquiry is *not* whether the directors said that the price offered in a tender offer was "fair," but whether in determining whether to tender their shares shareholders would deem particular information useful to a shareholder deciding whether to tender her shares.

Information that would affect the value of the consideration offered in the Exchange Offer - Blockbuster stock - undoubtedly would have been "material" to a shareholder considering whether to tender her Viacom stock. Indeed, negative information that raised questions regarding Blockbuster's ability to fund extensively promoted new business initiatives plainly would have been relevant to a Viacom shareholder's evaluation of the Exchange Offer. And the fact that Blockbuster was overstating its reported cash flow through a misapplication of GAAP provides precisely the kind of information that would impact Blockbuster's ability to fund those new business plans. Thus, the Chancery Court's decision that the Viacom Directors were under no obligation whatsoever to disclose the information that they evaluated in formulating the Exchange Ratio simply because they did not represent that the price was "fair" is the product of clear error.

(d) The Chancery Court Erred In Holding That The Identities Of The Viacom Directors Who Structured The Divestiture Were Not Material Because The Viacom Directors Did Not Specifically Represent That The Committee Responsible For Structuring The Deal Was "Independent."

The Amended Complaint alleged that the Prospectus was misleading because, while disclosing that a "committee" of Viacom directors structured Viacom's divestiture of Blockbuster, the Prospectus did not disclose the identity of the particular directors who served on that committee. ¶71. In rejecting this claim, the Chancery Court held that such information was not material because Viacom never claimed that the committee was independent. *See* A1953. The Chancery Court's holding in this regard is beside the point.

Whether board members on the committee had ties to NAI or Redstone was itself a material fact that the Viacom Defendants were required to disclose. [21] This case, therefore, is distinguishable from *Frank*, 1998 WL 668649 at *5, cited by the Chancery Court, where this Court held that a company was not required to disclose that a committee, not the whole board, approved a Dutch auction. In *Frank*, there was no allegation that certain directors had an interest different from other directors in setting the price of stock offered in the Dutch auction. Here, because Redstone and NAI had an interest in inflating the price of Blockbuster shares that Viacom exchanged, it would be highly material to a Viacom shareholder to know whether the committee consisted of a majority of directors affiliated with Redstone or NAI.

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[21] *See Zoren v. Genesis Energy, L.P.*, 836 A.2d 521, 530 n.22 (Del. Ch. 2002) ("[The complaint] alleges that the proxy statement failed to disclose the identities of the two members of the special committee who recommended the Restructuring. This is, of course, a surprising omission and one that would raise at least a litigable claim were relief possible. ... [T]he materiality of the omission from the proxy statement would be a matter to resolve on a complete factual record.")

C. The Chancery Court's Dismissal of Plaintiff's Claims Alleging that the Viacom Defendants and NAI Breached their Duty of Loyalty By Making False Disclosures and Omitting Material Information in the Prospectus Was In Error

1. Question Presented

Whether the Chancery Court required a level of factual pleading not required to allege knowledge, which may be averred generally, in dismissing Plaintiff's allegation that the Viacom Defendants breached their duty of loyalty by making material false statements and omissions in the Prospectus. This question was preserved before the Chancery Court in Plaintiff's Answering Brief in Opposition to Defendants' Motions to Stay or Dismiss. (A1296-1301).

2. Scope of Review

This Court reviews dismissals under Chancery Court Rule 12(b)(6) *de novo*. *See Desert Equities*, 624 A.2d at 1204.

3. Merits of Argument

"[W]here there is reason to believe that the board lacked good faith in approving a disclosure, the violation implicates the duty of loyalty." *In re Tyson Foods, Inc.*, 919 A.2d 563, 597-98 (Del. Ch. 2007). The Chancery Court, however, rejected Plaintiff's duty of loyalty claim, holding instead that "[t]here are simply no well pleaded allegations of fact that those directors authorized the transaction at issue in order to further the interests of NAI or Redstone or that they knowingly and in bad faith approved false and misleading disclosures in connection there-with." A1939. The Chancery Court was wrong.

The Amended Complaint alleges that the entire transaction was designed at Redstone's behest to allow Redstone to divest himself of

his interest in Blockbuster (¶¶34, 68, 69, 81, 94, 99-101, 108-113) and that the defendants acted in bad faith in failing to disclose all material facts about the Prospectus. ¶98-102. These allegations are sufficient on a motion to dismiss. *See Desert Equities, Inc.*, 624 A.2d at 1205-06.

Further, the allegations of bad faith are far from conclusory. Plaintiff has pled facts - Blockbuster's true operating cash flow, a negative cash analysis, how the exchange ratio was calculated, and the identity of the Viacom Defendants who approved the Exchange Offer - that were knowable to NAI and the Viacom Defendants and that Viacom Defendants were in a position to know. These allegations are sufficient to allege that the Viacom Defendants acted in bad faith, putting the interest of Redstone and NAI over those of minority shareholders. *See O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902, 915 (Del.Ch. 1999) ("Given the allegations in the Complaint of self-interest among two of HMI's four board members and the reasonable inference that the pleaded disclosure allegations were part of a plan to deceive HMI's stockholders . . . I cannot conclude at this stage of the proceedings that O'Reilly's allegations of bad faith, knowledge and intent are merely conclusory.").

V. CONCLUSION

WHEREFORE, for the foregoing reasons, the Chancery Court's Order dated February 1, 2008, granting Defendants'/Appellees' motion to dismiss the Amended Complaint should be REVERSED.

Dated: April 21, 2008

Respectfully submitted,

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