IN THE SUPREME COURT OF
THE STATE OF DELAWARE

BEVERYLY PFEFFER, individually and on behalf of all others similarly situated, Plaintiff Below, Appellant 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.	§ §	**No. 115, 2008** **Court Below: Court of Chancery of the State of Delaware, Honorable Stephen P. Lamb (C.A. No. 2317-VCL)**

APPELLANT'S REPLY BRIEF

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I. INTRODUCTION

Sumner Redstone, the controlling shareholder, Chairman of the Board and Chief Executive Officer of Viacom, decided to divest his interest in a failing subsidiary by selling it to Viacom's minority shareholders without disclosing the true facts about the subsidiary's business condition. Before doing so, he caused the subsidiary to pay a $905 million dividend, of which $738 million went to Viacom, the corporation he controls. This is a classic breach of fiduciary duty claim whereby the Viacom board has favored the interests of the majority shareholder over those of the minority shareholders. In an attempt to obfuscate the clear contours of Plaintiff's claims of fiduciary misconduct, the Defendants, in the Court of Chancery and again here, attempt to atomize Plaintiff's claims, arguing that each particular event must be viewed separately and none of them individually amount to a breach of duty.

For example, Defendants argue that the "Exchange Offer" was "not coercive," that NAI "did not participate" in the "Exchange Offer," and that the "Special Dividend" was unobjectionable because Viacom merely received its "pro rata" share. *See* Def. Br. at 11-15. NAI's lack of participation in the Exchange Offer is precisely the point here. Sumner Redstone – through NAI – caused Viacom's Board to structure a transaction that enabled NAI to divest itself of its interest in Blockbuster by shifting that interest to Viacom's minority shareholders. This misconduct alone establishes the elements of a breach of fiduciary duty claim against Viacom's board, whether or not the entire fairness standard applies. But the standard does apply because the transaction was structured to benefit Viacom's majority shareholder, NAI, at the expense of the minority shareholders of the company. *See Gradient OC Master, Ltd. v. NBC Universal, Inc.* 930 A.2d 104, 130 (Del. Ch. 2007) (holding that where a controlling shareholder "extracts financial benefit from the shareholders and procures a financial benefit exclusive to himself . . . the entire fairness standard applies and defendants must then prove that the transaction alleged involved fair dealing and a fair price"); *see also Feldman v. Cutaia*, 2006 WL 920420, at *6 (Del. Ch.). Defendants' argument to the contrary ignores the factual and economic realities of the divestiture, and requires the Court to evaluate the Exchange Offer and the Special Dividend completely separately, when it is apparent that Viacom's divestiture of Blockbuster was structured as a single unified scheme (the "Divestiture"). But even if the entire fairness standard does not apply, the Complaint still adequately alleges that the Viacom Defendants unlawfully favored the interests of NAI over the interests of Viacom's minority stockholders, and this is sufficient to state a claim regardless of the applicable standard of review. *See Weinstein Enters., 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.").

Defendants also argue Plaintiff's disclosure claims were properly dismissed because the problems Plaintiff identified in the Prospectus were not material as a matter of law. Defendants argue, and the

Chancery Court accepted, that (i) clear misstatements about Blockbuster's *operational* cash flows were not material because the company's other financial metrics were correct; (ii) Defendants never had any obligation to disclose how the exchange ratio was calculated in the Exchange Offer because, despite the fact that they promoted the Exchange Offer as providing a 19% premium over the price of Viacom shares tendered, they never specifically claimed that the deal was "fair"; and (iii) Defendants were not required to disclose the identities of the individuals who spearheaded Viacom's divestiture of Blockbuster because they never claimed that the committee charged with finalizing the exchange ratio was at all independent. However, defendants' arguments about materiality either misapply the appropriate standard of review or raise factual issues that are inappropriate for resolution in the context of a motion to dismiss. *See O'Malley v. Boris*, 742 A.2d 845, 850 (Del. 1999)("The determination of materiality is a mixed question of fact and law that generally can not be resolved on the pleadings."). For this reason, also, the Chancery Court's dismissal of Plaintiff's disclosure claims should be reversed.

Finally, Plaintiff has adequately pled that Defendants knowingly or recklessly made false statements and omissions to benefit NAI at the expense of minority shareholders. Defendants' argument to the contrary seeks to impose a pleading standard that is not warranted under Delaware law.

II. ARGUMENT

A. The Complaint Adequately Alleges That The Defendants Breached Their Fiduciary Duties By Structuring The Divestiture Of Blockbuster To Specifically Favor The Interests Of NAI Over The Interests Of Viacom's Minority Stockholders.

Defendants' argument that the Exchange Offer was a non-coercive tender offer to which the entire fairness standard does not apply (Def. Br. at 10) completely misses the point. The issue in this case is not merely the Exchange Offer, but the manner in which the Defendants structured the Divestiture of Blockbuster itself.

This Court consistently has held that directors of a Delaware corporation may not elevate the interests of a majority shareholder over the interests of the minority. *See Weinstein Enters.,* 870 A.2d at 509. Yet that is precisely what Plaintiff alleges that Defendants did here. Viacom's Divestiture of Blockbuster was conceived as a two-step transaction that first saddled Blockbuster with $950 million in debt and rendered that company financially unable to fund crucial "new business initiatives," and then sold Viacom's interest in Blockbuster to Viacom's minority shareholders at an inflated price not reflective of Blockbuster's true financial condition. ¶¶40-41,56. The Divestiture was thus structured to benefit NAI by permitting NAI to retain its equity investment in and control over Viacom, while eliminating Viacom's investment in (and exposure to) Blockbuster at the expense of Viacom's minority shareholders. Sumner Redstone, who served both as Viacom's Chairman and CEO, and the Chairman of Viacom's majority shareholder NAI, also served as a director of Blockbuster. ¶8. Unlike Viacom's minority stockholders, therefore, NAI (through

Redstone) knew of and had access to information detailing Blockbuster's inability to fund its business operations following payment of the Special Dividend. ¶¶68-9, 111-12. Because the Divestiture elevated NAI's interest in eliminating its exposure to Blockbuster over the interests of Viacom's minority stockholders (who were duped into buying Blockbuster stock at an inflated price), the Defendants breached their fiduciary duties to the minority and they should be compelled to prove the entire fairness of the Divestiture. *See Gradient OC Master*, 930 A.2d at 130.

Defendants' arguments to the contrary carry no weight. First, Defendants' assertion that "'Plaintiff ma[de] no allegation that NAI directed the actions of Viacom" Def. Br. at 11 (quoting Feb 1, 2008 Opinion ("Op.") at 34), is simply wrong. Plaintiff specifically pled that "NAI breached its fiduciary duties owed to the Viacom minority (and the Viacom Class) by causing the Viacom Director Defendants to approve and recommend [] the Exchange Offer to Viacom's minority shareholders." ¶110. This allegation was not, as Defendants argue, merely "conclusory" in nature. Def. Br. at 12 n.4. Rather, Plaintiff pled that NAI had a financial stake in the transaction; the Exchange Offer increased NAI's control over Viacom while divesting Viacom of an underperforming subsidiary at an inflated price. ¶3. Further, NAI used its majority status to appoint its employees to the Viacom Board, including Redstone, Viacom's Chairman and CEO. ¶¶8,9,13,16 (identifying Viacom Board members who had connections to NAI or Redstone). Additionally, there is absolutely no indication *any* board members independent of NAI considered the Exchange Offer. Indeed, Viacom deceptively disclosed that a "committee" of board members approved the transaction, without stating who those board members were. ¶71.

In this regard, this case is similar to *In re Primedia Inc. Derivative Litig.*, 910 A.2d 248, 257 (Del. Ch. 2006) where the court held that plaintiff adequately pled that a controlling shareholder exercised control over a transaction where (1) the proxy stated that the controlling shareholder was an influential force behind the transaction; (2) the controlling shareholder appointed associates to the company's board; (3) there was no evidence to suggest an independent committee of directors considered the transaction; and (4) the shareholder had a financial stake in the transaction. For the same reasons, here, Plaintiff's allegations are sufficient to allege that NAI caused Viacom to enter into the Exchange Offer.[1]

Defendants' argument that NAI did not "benefit" from the Exchange Offer because it did not "participate" in the Exchange Offer (Def. Br. at 12, 14) completely misses the point. Of course NAI did not "participate" in the Exchange Offer; the very purpose of the Exchange Offer was to perfect NAI's *divestment* of its exposure to Blockbuster – not to acquire a more significant interest. And Plaintiff pled that NAI benefited from the Divestment in two ways. The value of NAI's

[1] Thus, this case is distinguishable from *Cinerama, Inc. v. Technicolor*, *Inc.*, 1991 WL 111134, at *19 (Del Ch.), *aff'd in part, rev'd on other grounds sub nom.*, *Cede v. Technicolor*, *Inc.*, 634 A.2d 345 (Del. 1994) (*see* Def. Br. at 12), where the court held "when . . . a majority shareholder takes no . . . action, generally no special duty will be imposed." In this case, Plaintiff has pled that NAI caused the Exchange Offer and thus had fiduciary duties of care and loyalty in structuring the transaction.

majority stake in Viacom increased after Defendants rid Viacom of an underperforming subsidiary at an inflated price, and the Exchange Offer reduced the public float of Viacom stock. ¶¶57,69,71.[2] NAI, therefore, plainly did benefit from Viacom's Divestment of Blockbuster.

Finally, Defendants wholly misconstrue Plaintiff's allegations concerning the Special Dividend. Plaintiff is not alleging that the Special Dividend *itself* constituted self dealing. Rather, when considered together with the Exchange Offer, it is apparent that the underlying purpose of the Special Dividend was to transfer wealth to Viacom (and thus NAI) at the ultimate expense of Viacom's minority shareholders. Viacom received $738 million in tax free profits from the Special Dividend, thus benefiting Viacom's minority shareholder NAI, and then unloaded its stockholdings in Blockbuster on Viacom's minority shareholders before the consequences of the Special Dividend on Blockbuster became known, thus further benefitting NAI at the expense of Viacom's minority stockholders. ¶38, 72-78. This elevation of the interests of NAI at the expense of Viacom's minority shareholders is sufficient to trigger the entire fairness standard of review. *See Gradient OC Master*, 930 A.2d at 130.[3]

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[2] The Chancery Court's holding that the increase in NAI's ownership of Viacom following the Exchange Offer was *de minimums* is both irrelevant and inappropriate. *See* Def. Br. at 13 (quoting Op. at 12 n.17). The Amended Complaint specifically alleges that Redstone and NAI viewed even a small reduction in Viacom's public float as beneficial. ¶ 69. Moreover, it is irrelevant factually as the clear motivation for Redstone was to divest his interest in Blockbuster, not necessarily to increase his control over Viacom.

[3] But even if the entire fairness standard was not implicated here, the Complaint *still* adequately stated a claim that the Viacom

B. The Chancery Court's Dismissal Of Plaintiff's Duty Of Disclosure Claims Should Be Reversed Because Plaintiff Has Pled That Defendants Made Material False Statements And Omissions In The Prospectus

The Chancery Court's dismissal of Plaintiff's disclosure claims was erroneous and the Defendants' brief on appeal does not change this fact. First, Defendants' arguments regarding materiality are both inconsistent with Delaware law and raise factual disputes that should not have been resolved by the Chancery Court in the context of a motion to dismiss. They cannot defend the standard of review applied by the Chancery Court, so they resort instead to accusing Plaintiff of engaging in a game of "semantics." Def. Br. at 18. Yet, as detailed in Appellant's Opening Brief ("Opening Brief"), the Complaint alleges specific information either falsely disclosed to or improperly hid from Viacom's minority shareholders that would have been material to their decision to tender shares in the Exchange Offer.

Second, Defendants' argument that Plaintiff's disclosure claims are deficient because she did not allege that the Defendants physically possessed a particular cash flow report detailing Blockbuster's inability to fund its operations completely misses the point. The relevant question is *not* whether the Defendants had the particular report, *but whether they had access to the information contained in the report.* And based on the factual allegations in the

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Defendants breached their fiduciary duties by improperly elevating the interests of Sumner Redstone and NAI over the interests of Viacom's minority shareholders by selling Viacom's interest in Blockbuster to Viacom's minority shareholders without adequate disclosures of Blockbuster's true financial condition. *See In re Pure Resources, Inc. S'holders 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).

Complaint, drawing all reasonable inferences in Plaintiff's favor, clearly they did.

1. The Prospectus Contained A Material False Statement Because It Inflated Operational Cash Flow By 58%

Defendants cannot dispute that Blockbuster's operational cash flows identified in the Prospectus for the Exchange Offer were overstated by a whopping 58%. *See* ¶¶42, 61. Rather, Defendants argue that "no allegations supported Plaintiff's argument that an alleged misclassification of Blockbuster's cash flows was material to Viacom stockholders' decision to tender their shares. . . ." Def. Br. at 17.[4] Defendants are wrong.

First, the fact that the overstatement of operational cash flow did not impact other financial metrics is completely irrelevant and does not render the false statements immaterial as a matter of law. Blockbuster's inflated operational cash flow figures created the misleading impression that Blockbuster was able to finance its debt and engage in an ambitious new business plans. As the Prospectus stated: "[T]he steady *operating cash flow* from our core rental business has provided us with the ability to invest in new initiatives." ¶47 (emphasis supplied). In reality, money classified as operating cash flow was used to pay for rental libraries, and thus

[4] To support the argument that Defendants' inflation of cash flow was not material, Defendants recite the following facts: (1) inflating operating income did not affect "earnings, total cash flow, net income, or any other accounting measure;" (2) the complaint did not allege that anyone relied on inflated operating cash flow in deciding to tender their shares; (3) the audited financial statements correctly set forth the accounting principles that Blockbuster relied upon to report operating cash flow; and (4) Blockbuster's stock was not affected by disclosure of the misstated operating income. *See* Def. Br. at 16-19.

was *not* available to "invest in new initiatives." *See* ¶¶47,62,78.

As explained in the Opening Brief, investors look to operational – not investment – cash flow as a metric to determine whether the company has a sustainable cash flow not derived from a sideline investment. *See* Opening Brief at 25. Before the Chancery Court below, Plaintiff identified commentary from both The Wall Street Journal and a professional treatise that not only explained why *Blockbuster's* misrepresentations of its operational cash flows were material to investors, but also explained why operational cash flows are more important than other financial cash flow metrics generally. A1289. Specifically, The Wall Street Journal criticized Blockbuster's attempt to downplay the impact of its admitted overstatement of operational cash flows as follows:

> But when it comes to cash flow – all the money coming in and going out the door every day – geography can be important.
>
> Specifically, the restatement changes how Blockbuster accounts for its rental library, that is, the cost of buying the DVDs it rents to customers.
>
> * * *
>
> Mr. Zine, the chief financial officer, said Blockbuster's total cash flow doesn't change: As operating cash flow declines, investing cash flow rises by the same amount, as the rental-library costs move out of that part of the cash-flow statement.
>
> ***But 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*, Wall St.

J., March 14, 2006 at C3 ("Moving the Market") (A1737) (emphasis supplied). Plaintiff also identified and provided to the Chancery Court excerpts from a professional treatise that explained the importance of *operational* cash flows versus cash flows from investments. 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.***")(emphasis supplied)(A1742).

In its opinion below, the Chancery Court completely ignored these sources, and in their brief to this Court, Defendants ignore them as well. But if both The Wall Street Journal and professional treatises acknowledge the importance of operational cash flows to investors, how can the Chancery Court's holding that the metric is not material *as a matter of law* be justified? Indeed, the Staff of the Securities and Exchange Commission (the "SEC") has cautioned that:

> The importance of appropriate classification and presentation of items in the consolidated statement of cash flows cannot be overstated. [A]ccurate presentation of ... cash receipts and cash payments based on activity (operating, investing and financing) ... assists the reader in determining the registrant's ability to meet its obligations, pay dividends, generate cash flows sufficient to grow its business, etc.

SEC Staff Statement, Current Accounting and Disclosure Issues in the Division of Corporation Finance at 35 (Nov. 30, 2006) (available at http://www.sec.gov/divisions/corpfin/cfacctdisclosureissues.pdf). The Chancery Court's summary holding that overstatements of Blockbuster's operational cash flows were not "material" as a matter of law thus ignores a crucial distinction identified by The Wall Street Journal, professional investors, and the Staff of the SEC.

Second, Defendants' argument that Plaintiff did not plead that any person relied on Blockbuster's operational cash flow is immaterial. ***Reliance is not an element of a breach of a duty of disclosure claim under Delaware law where stockholders are being asked to tender their shares***. *Malone v. Brincat*, 722 A.2d 5, 12 (Del. 1998) ("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 elements of reliance, causation and actual quantifiable monetary damages."). Thus, regardless of whether Plaintiff has identified specific persons who relied on the misstatement, Plaintiff has adequately pled that it was material.

Third, Defendants are incorrect in asserting that "anyone examining Blockbuster's cash flow statements could discern its treatment of new releases and that treatment's effect on operating and investment cash flows." Def. Br. at 18. Their point is also irrelevant. As an initial matter, class members are entitled to rely on Defendants' statements that its financial statements are made in accordance with GAAP. *See 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."). More fundamentally, however, even if a reasonable investor knew that Blockbuster was classifying its rental libraries as current assets, Defendants do not argue that investors had sufficient knowledge to know that rental libraries *should have been* classified as non-current assets, *i.e*. they were assets that generated short term revenue and not investments for long term growth. Thus, Plaintiff and the Class were misled about the nature of revenue generated by Blockbuster's rental libraries in a manner that greatly inflated operating cash flow. *See*, *e.g.*, Rappaport, *Moving the Market* (A1737). Regardless of whether a GAAP violation is a per se material misstatement as a matter of Delaware law, a GAAP violation is, at the very least, *evidence* of materiality that should not have been summarily disregarded as a matter of law by the Chancery Court. Indeed, GAAP only requires restatement of *material* inaccuracies. *See In The Matter of Huntington Bancshares, Inc.*, 85 S.E.C. Docket 1433, 2005 WL 1307747, at * 10 ("Huntington's restatements are admissions of material error in violation of GAAP, which requires restatement only for material misstatements.").

Fourth, the fact that Blockbuster's stock did not drop following the restatement does not mean that the overstatement of operational cash flows was not material as a matter of law. *See* Def. Br. at 18. As explained in the Opening Brief (at pp. 25-26) and to the Chancery Court, by the time Blockbuster's true operational cash flows were disclosed in March 2006, investors already knew that Blockbuster could not fund its new business plans and the stock already had collapsed. ¶78. The fact that Blockbuster's stock did not fall immediately after Blockbuster came clean and explained how it had been manipulating its cash flow statements, therefore, most certainly does *not* justify the

Chancery Court's holding that the misstatements were not material as a matter of law. Other courts recognize, for example, that a fraudulent statement in a company's financial statements may be material in producing a resulting loss even if the price of the company's stock falls before the company admits the specific misstatement:

> Precluding a plaintiff from establishing loss causation merely because of the absence of the kind of explicit corrective disclosure that Defendants would require, where the market in fact learned and absorbed the relevant truth anyway, seems unduly harsh.
>
> Moreover, Defendants' proposed rule would provide 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. The plaintiff would be unable to tie its loss, *i.e.*, the share price decline, to the fraud, rather than to the apparently unrelated announcement. As one court put it, the loss causation requirement should not allow securities fraud defendants to "immunize themselves with a protracted series of partial disclosures."

In re Motorola Sec. Litig., 505 F. Supp. 2d 501, 544 (N.D. Ill. 2007)(citation omitted).[5]

The Chancery Court's determination that the mere fact Blockbuster's stock did not fall following the company's restatement

[5] Commentators analyzing loss causation issues also have specifically noted that requiring a *mea culpa* statement to plead loss causation creates the ability for corporate malefactors to avoid liability for securities fraud by manipulating their public statements. For example, "[a] company seeking to cover up fraud may attempt to control market reactions by issuing disclaimers or making additional false statements. It may deliberately let some of the truth out, a little at a time, in anticipation of market reactions and in order to stay ahead of them." *See* Richard Kaplan et al., *Rediscovering the Economics of Loss Causation* (December 27, 2005) (Berkeley Electronic Press, Working Paper No. 892) at 14.

constitutes some sort of dispositive evidence that the operational cash flow statements were not material as a matter of law, therefore, ignores reality. Indeed, the fact that investors were able to connect the dots and to determine, well before Blockbuster finally came clean and explained its accounting shenanigans, does *not* mean that Blockbuster's previous statements at the time of the Exchange Offer regarding its ability to fund operations from operational cash flows were somehow immaterial as a matter of law. To the contrary, the fact that Blockbuster lacked the cash flow to fund its operations was precisely the reason that the company's stock price collapsed, even if the Blockbuster board did not reveal its accounting games until much later. *See also In re Winstar Commc'ns*, 2006 WL 473885, at *14 (S.D.N.Y.) (holding that the fact that a corporation did not issue any restatements about accounting misstatements did not preclude a finding that the company's accounting misstatements, in fact, were material to investors and that the company's stock collapsed as the investing public learned the truth of the company's financial condition from other sources). Thus, Plaintiff has pled sufficient facts explaining why inflated operational cash flow was material.

2. Defendants Omitted A Material Cash Flow Analysis From The Prospectus

As alleged in the Complaint, Defendants also breached their duty of disclosure by failing to disclose facts indicating that Blockbuster lacked adequate cash to fund its highly publicized "new business initiatives." ¶¶62-64. Plaintiff based its allegations in this regard on a the existence of a cash flow report written by an employee of Blockbuster that revealed that Blockbuster could not, in fact, fund its operations following payment of the Special Dividend. Defendants argue that Blockbuster's cash flow problems were adequately disclosed, and that Plaintiff's allegations that Defendants knew of the particular cash flow analysis cited in the Complaint amounted to "untethered supposition." Def. Br. at 20. Defendants are wrong on both counts.

First, with respect to Ms. Mingus's cash flow report, the allegations in Plaintiff's Complaint are more than sufficient to give rise to an inference that Defendants had access to the information contained in Ms. Mingus's report if not to the report itself. Plaintiff's allegations regarding Ms. Mingus's report are quite specific and particularlized. Based on internal Blockbuster projections, Ms. Mingus prepared her report, shared internally within Blockbuster's Treasury Department, detailing the crushing effect that the Special Dividend had on Blockbuster's finances. ¶¶62-3. At the time, Blockbuster's board included not only Sumner Redstone and Philippe Dauman, who were both directors of both NAI and Viacom, but also Richard Bressler and Michael Fricklas, who were the Senior Executive Vice President and Chief Financial Officer of Viacom, and the Executive Vice President, General Counsel and Secretary of Viacom, respectively. ¶¶ 8,13,24,26. Fully half of Blockbuster's board, therefore, worked for Viacom and at the direction and under the control of Sumner Redstone. It is thus reasonable to infer that the Viacom Defendants, to whom their agents on the Blockbuster board reported, were aware, if not of Ms. Mingus's specific cash flow analysis, of the information contained in that report. For example, in holding that a plaintiff adequately pled facts giving rise to an inference that directors knew of certain facts relating to their company's stock buying program, the court in *Alessi v. Beracha*, held:

> [The] inference [of knowledge] comports with the principle that "[t]he business and affairs" of [the corporation] was to "be managed by or under the direction" of the director defendants. Assuming that the director defendants were not sensibly informed of [the corporation's] affairs is an unreasonable inference to draw from the allegations in the complaint.

849 A.2d 939, 943 (Del. Ch. 2004)(quoting 8 Del. C. § 141(a)). Similarly, Plaintiff's allegation that Viacom Defendants, including Redstone, the CEO and controlling stockholder of NAI, knew of Ms. Mingus's negative cash flow report, or of the information contained therein, is reasonable given Redstone's inside position at Blockbuster.

Second, Defendants' argument that they fully disclosed Blockbuster's cash flow problems is without merit. Disclosure of more positive projections from financial advisers in no way excused the Defendants for failing to disclose the existence of a negative cash flow analysis. *See Lynch v. Vickers Energy Corp.*, 383 A.2d 278, 281 (Del. 1977) ("[W]hen ... management was in possession of two estimates from responsible sources one using a 'floor' approach defining value in terms of its lowest worth, and the other a more 'optimistic' or ceiling approach defining value in terms of its highest worth it is our opinion that complete candor required disclosure of both estimates.")

3. <u>Defendants' Disclosure Concerning (1) How Viacom Calculated The Exchange Offer And (2) The Viacom Committee That Approved The Exchange Offer, Were Inadequate</u>

(a) <u>Defendants Had A Duty To Disclose How The Exchange Ratio Was Calculated</u>

Defendants argue that they were under no obligation to disclose how the Exchange Ratio was calculated because the Exchange Offer was non-coercive. Def. Br. at 21-22. Although they appear to concede that the pricing methodology would have been material had Defendants represented that the exchange ratio offered was "fair," Defendants characterize as "makeweight" Plaintiff's argument that the manner in which Defendants calculated the Exchange Ratio should have been disclosed. *Id.* According to Defendants, the "premium" offered in the deal was merely a mathematical calculation with no meaning. But, as alleged in the Complaint, the representation that the value of the Blockbuster stock offered as consideration in the deal would provide a 19.2% *premium* over the market value any Viacom shares tendered, at the very least, implied to the reasonable Viacom minority stockholder considering to tender her shares that the price offered was, in fact, adequate. ¶31. Indeed the only reason to publicize the "premium" was to encourage Viacom's minority shareholders to take the deal. For this reason, Defendants should have disclosed the pricing methodology. *See Frank v. Arnelle*, 725 A.2d 441, 1999 WL 89284, *2 (Del.)(table).

(b) <u>Defendants Had An Obligation To Disclose Who Was On The Special Committee Responsible for Approving The Exchange Offer</u>

Defendants had a duty to disclose which Viacom board members served on the committee responsible for approving the Exchange Offer.

Because there was a danger that the Exchange Offer was priced to benefit NAI at the expense of minority shareholders, it would be material to know whether directors who were independent of NAI approved the Exchange Offer. *See Zoren v. Genesis Energy, L.P.*, 836 A.2d 521, 531 n.22 (Del. Ch. 2003) ("[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. . . . [T]he materiality of the omission from the proxy statement would be a matter to resolve on a complete factual record.").

Defendants misunderstand Plaintiff's allegations, arguing that the Propsectus was not misleading because there was "no suggestion that the committee was independent of management or NAI." Def. Br. at 23. Such argument is irrelevant; the failure to disclose the names of committee members was a material omission regardless of whether the Prospectus created the impression that only independent directors approved the transaction. Given that it was disclosed that NAI was not tendering shares, it would be of actual significance in the deliberations of a reasonable shareholder to know whether NAI-affiliated board members had the power to approve the Exchange Offer.

4. <u>Defendants' Disclosure Violations Implicate The Duty Of Loyalty</u>

As discussed above, Plaintiff has pled sufficient facts to allege that Defendants knowingly breached their duty of disclosure to enrich majority shareholder NAI at the expense of Viacom. "[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). Defendants, however, argue that there are no well pled allegations that the Exchange Offer benefitted NAI. This argument is without merit; Plaintiff has pled detailed facts giving rise to the reasonable inference that the Exchange Offer was initiated to benefit NAI. *See supra* Section II, A.

Plaintiff's allegations more than satisfy the pleading standards of Rule 9(b), which states that knowledge can be averred generally. *See Desert Equities, Inc. v. Morgan Stanley leveraged Equity Fund, II, L.P.,* 624 A.2d 1199, 1209 (Del. 1993). ("Since bad faith is an issue of fact, the issue cannot be resolved on pleadings which, on their face, allege bad faith."). As this Court in *Desert Equities*, 624 A.2d at 1208 held: "[A] claim of bad faith hinges on a party's tortious state of mind. Under Rule 9(b), state of mind may be pled generally. That is because it may be virtually impossible for a party plaintiff to sufficiently and adequately describe the defendant's state of mind at the pleadings stage." As such, Plaintiff's allegations that Defendant's misstatements were made knowingly must survive a motion to dismiss.

III. CONCLUSION

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: May 29, 2008

Respectfully submitted,

GRANT & EISENHOFER P.A.

_/s/ Jay W. Eisenhofer__________

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