

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

A. RAMA KRISHNA and KRISHNA FAMILY	:	
TRUST U/A/D OCTOBER 11, 2005,	:	
	:	
Plaintiffs,	:	
	:	
v	:	C. A. No.
	:	2022-0914-MTZ
PZENA INVESTMENT MANAGEMENT, INC.,	:	
	:	
Defendant.	:	

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Chancery Court Chambers
Leonard L. Williams Justice Center
500 North King Street
Wilmington, Delaware
Monday, May 8, 2023
3:15 p.m.

- - -

BEFORE: HON. MORGAN T. ZURN, Vice Chancellor

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TELEPHONIC RULINGS OF THE COURT ON DEFENDANT'S MOTION
TO DISMISS

CHANCERY COURT REPORTERS
Leonard L. Williams Justice Center
500 North King Street - Suite 11400
Wilmington, Delaware 19801
(302) 255-0533

1 APPEARANCES:

2 JOHN A. SENSING, ESQ.
Potter, Anderson & Corroon LLP

3 -and-

4 ANNE E. BEAUMONT, ESQ.
LINDSAY FUNK, ESQ.
of the New York Bar
5 Friedman Kaplan Seiler Adelman & Robbins LLP
for Plaintiffs

6

7 GARRETT B. MORITZ, ESQ.
THOMAS C. MANDRACCHIA, ESQ.
Ross Aronstam & Moritz LLP

8 -and-

9 JACOB W. BUCHDAHL, ESQ.
ARI RUBEN, ESQ.
SHAWN J. RABIN, ESQ.
10 of the New York Bar
Susman Godfrey LLP
11 for Defendant

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1 THE COURT: Good afternoon. This is
2 Morgan Zurn. May I have appearances, please,
3 beginning with counsel for the plaintiffs?

4 ATTORNEY SENSING: Certainly, Your
5 Honor. Good afternoon. This is John Sensing from
6 Potter Anderson & Corroon on behalf of plaintiffs.
7 Also on the line with me is my co-counsel Anne
8 Beaumont and Lindsay Funk from Friedman Kaplan Seiler
9 Adelman & Robbins in New York City.

10 THE COURT: Thank you.
11 Counsel for defendants?

12 ATTORNEY MORITZ: Good afternoon, Your
13 Honor. This is Garrett Moritz from Ross Aronstam &
14 Moritz on behalf of defendants Pzena Investment
15 Management, Inc. I'm joined by my colleague Tom
16 Mandracchia, and also by co-counsel from Susman
17 Godfrey, Jacob Buchdahl, Shawn Rabin, and Ari Ruben.
18 And we also have a client representative, Geoff Bauer,
19 the general counsel of Pzena on the line.

20 THE COURT: Thank you.

21 I have a bench ruling to share, so if
22 you could all mute your lines. I appreciate everyone
23 getting on the phone today.

24 For the reasons that follow,

1 defendant's motion to dismiss is granted.

2 My following recitation of the
3 relevant background is drawn from the pleadings,
4 taking them as true. I also consider the content of
5 documents that are integral to or incorporated by
6 reference into the amended and supplemental complaint.

7 Plaintiffs A. Rama Krishna and Krishna
8 Family Trust together owned 3,121,539 units of Class B
9 equity in nonparty Pzena Investment Management, LLC,
10 the "LLC." Each owner of Class B units was the
11 beneficial holder of an equal quantity of Class B
12 shares of defendant Pzena Investment Management, Inc.,
13 which I'll call "Inc." Krishna also owned 37,936
14 Class A shares of Inc. And Inc. was a publicly traded
15 investment management firm.

16 Inc. issued Class A units, which were
17 publicly traded and carried one vote per share and
18 economic benefits in the form of a dividend, and Class
19 B units, which carried voting benefits in the form of
20 five votes per share. Inc. held all of the LLC's
21 Class A units. Each holder of Inc. Class B units held
22 an equal number of LLC Class B units.

23 Pursuant to the LLC agreement, vested
24 Class B units in Inc. could be exchanged for Class B

1 shares, subject to certain volume and timing
2 restrictions. The LLC agreement and its exhibits are
3 attached as Exhibit 1 to the amended complaint.
4 Exhibit B to the LLC agreement laid out the exchange
5 rights of Class B members. I will call this the
6 "Exchange Rights Agreement." Section 2.01 of the
7 Exchange Rights Agreement regulated the timing of the
8 Class B unit exchanges.

9 Section 2.01(a) provides: "The
10 Managing Member shall establish one or more dates in
11 each Annual Period as a date on which the Class B
12 Members shall be permitted to Exchange their Class B
13 Units (such date, an 'Exchange Date') provided that
14 the Managing Member may, by notice to each Class B
15 member, postpone any Exchange Date one or more times.
16 For the avoidance of doubt, the Managing Member may
17 establish as many Exchange Dates as it shall determine
18 in its sole discretion."

19 Section 2.01(b) provides, in part:
20 "The Managing Member shall provide, in respect of at
21 least one [] Exchange Date in each Annual Period, a
22 written notice (an 'Exchange Notice') to all Class B
23 Members at least fifteen [] calendar days prior to
24 such Exchange Date. 'Annual Period' is defined as

1 "(a) the First Period and (b) each annual period
2 beginning on a date after the First Period and ending
3 on an annual anniversary of the IPO Date." Through
4 October 25, 2021, defendant as managing member
5 established at least one exchange date for all Class B
6 members of the LLC for each annual period.

7 On July 26, 2022, Inc. announced a
8 going-private transaction in which its Class A
9 stockholders stood to receive \$9.60 per share as
10 consideration for the merger of Inc. into a merger
11 subsidiary controlled by the LLC. Inc. set
12 September 16, 2022, as the record date for the special
13 meeting to vote on the going-private transaction. The
14 transaction was scheduled to close on October 27,
15 2020.

16 Once the proposed transaction closed,
17 Inc. would cease to exist; its Class A shares would be
18 canceled; the merger subsidiary would survive; and the
19 outstanding Class B shares of Inc. would automatically
20 be canceled and the holders thereof would not receive
21 any merger consideration. "Payment of the Merger
22 Consideration (and certain other expenses) was to be
23 funded by up to \$200 million in debt financing to
24 [the] LLC." The transaction agreement is attached as

1 Exhibit 4 to the amended complaint.

2 On July 27, the day after Inc.
3 announced the proposed transaction, plaintiff Krishna
4 asked Inc. when would it set an exchange date. Inc.
5 responded it did not intend to establish one. Inc.
6 gave the same response when asked by a different Class
7 B member on July 28. By letter dated September 28,
8 plaintiff Krishna demanded that Inc. establish an
9 exchange date for all Class B members during the
10 "Current Annual Period" ending October 25, 2022. By
11 this time, the record date had passed.

12 On October 6, Inc. issued an exchange
13 notice to plaintiffs, a copy of which is Exhibit 8 to
14 the amended complaint, which stated in part: "[Y]ou
15 are hereby notified that the Company has selected
16 October 25, 2022 as an Exchange Date ... on which you
17 may be able to exchange your vested Class B units.
18 However, in light of the announced take-private
19 transaction, the company has decided to postpone the
20 Exchange Date, in accordance with the terms of the
21 Exchange Rights of Class B Members until the
22 completion of the transaction or the termination of
23 the merger agreement."

24 On October 10, 2022, plaintiffs filed

1 a complaint, motion to expedite, and a motion for
2 preliminary injunction to prevent Inc. from closing
3 the transaction. On October 14, the parties
4 stipulated to expedition and a hearing on the PI was
5 scheduled for October 28.

6 On October 26, the parties filed a
7 stipulated proposed order agreeing to resolve
8 plaintiffs' motion for PI, whereby plaintiffs would
9 withdraw their motion seeking to enjoin the
10 transaction. That same day the Court held a
11 teleconference, after which I granted the proposed
12 order and canceled the October 28 hearing.

13 The next day, Inc.'s stockholders
14 approved the going-private transaction. The
15 transaction closed on October 31. Inc. ceased to
16 exist, and its outstanding shares were canceled.

17 On November 9, plaintiffs filed their
18 verified amended and supplemented complaint. Count I
19 alleges Inc. breached the LLC agreement by not
20 establishing an exchange date for all Class B members
21 during the current annual period. In the alternative
22 to Count I, Count II alleges Inc. breached the implied
23 covenant of good faith and fair dealing by not
24 establishing an exchange date during the current

1 annual period, which would have given Class B members
2 an exchange opportunity before the transaction closed.

3 On December 9, Inc. moved to dismiss
4 the amended complaint. The parties briefed that
5 motion and I heard argument on May 2.

6 Inc. has moved to dismiss plaintiffs'
7 amended complaint for failure to state a claim upon
8 which relief can be granted. The standard for a
9 motion to dismiss under 12(b)(6) is familiar and I
10 will not repeat it here.

11 "In order to survive a motion to
12 dismiss for failure to state a breach of contract
13 claim, the plaintiff[s] must demonstrate: First, the
14 existence of the contract, whether express or implied;
15 second, the breach of an obligation imposed by that
16 contract; and third, the resultant damage to the
17 plaintiff[s]." That is a quote from the Delaware
18 Supreme Court's 2003 opinion in *VLIW Technology v.*
19 *Hewlett-Packard*.

20 In interpreting the relevant contract
21 here, I apply Delaware's typical rules of contract
22 construction. When interpreting contract language,
23 Delaware courts aim to "give priority to the parties'
24 intentions as reflected in the four corners of the

1 agreement, construing the agreement as a whole and
2 giving effect to all its provisions." That's a quote
3 from *Salamone v. Gorman*.

4 "Delaware adheres to the 'objective'
5 theory of contracts, [meaning that] a contract's
6 construction should be that which would be understood
7 by an objective, reasonable third party. [Delaware
8 courts] will read a contract as a whole and [] will
9 give each provision and term effect, so as not to
10 render any part of the contract mere surplusage ...
11 When the contract is clear and unambiguous, Delaware
12 courts will give effect to the plain meaning of the
13 contract's terms and provisions." That's an altered
14 quote from *Osborn ex rel. Osborn v. Kemp*.

15 Delaware courts enforce the terms of a
16 contract as written and "cannot rewrite contracts or
17 supply omitted provisions." That is from *Murfey v.*
18 *WHC Ventures*. This Court will not interpret terms and
19 provisions in a manner that would "lead to absurd
20 results to which no reasonable person would have
21 agreed." That's a quote from *Charney v. American*
22 *Apparel*. "If a contract is unambiguous, extrinsic
23 evidence may not be used to interpret the intent of
24 the parties, to vary the terms of the contract, or to

1 create an ambiguity." That's from the 1997 opinion
2 out of our Supreme Court, *Eagle Industries v.*
3 *DeVilbiss Healthcare.*

4 Plaintiffs claim Inc. breached the LLC
5 agreement by "fail[ing] and refus[ing] to establish an
6 Exchange Date for all Class B Members of [the] LLC
7 during the Current Annual Period that would have given
8 all Class B members of [the] LLC the opportunity to
9 exchange their Class B Units for Class A Shares of
10 Inc." That's a quote from the amended complaint,
11 paragraphs 50 to 51.

12 Plaintiffs allege Inc. breached
13 Section 2.01 by postponing the exchange date such that
14 none was established within the annual period, which
15 deprived plaintiffs of an opportunity to exchange
16 their Class B units in the annual period ending on
17 October 25, 2022.

18 Inc. argues Count I should be
19 dismissed because plaintiffs fail to plead a breach.
20 And Inc. argues Section 2.01 does not impose an
21 obligation to hold an exchange date within an annual
22 period.

23 While both parties tried to introduce
24 extrinsic evidence in support of their interpretation

1 of the LLC agreement, neither asserts it is ambiguous.
2 I begin and end with the plain meaning of the
3 Section 2.01.

4 The first clause of Section 2.01(a)
5 requires Inc. to "establish" one or more exchange
6 dates in each annual period on which the Class B
7 members shall be permitted to exchange their Class B
8 units.

9 Black's law dictionary defines
10 "establish" as: "To make or form; to bring about or
11 into existence." Delaware courts have recognized that
12 under this definition, once something is established,
13 it can still be modified. For example, in its 2005
14 *Disney* opinion, this Court concluded "[t]he very
15 definition of 'establish' contemplates some form of
16 negotiation or molding where 'approve' does not."

17 The rest of Section 2.01(a) supports
18 this interpretation that the exchange date may be
19 modified. The managing member shall establish one or
20 more exchange dates in each annual period "provided
21 that the Managing Member may ... postpone any Exchange
22 Date one or more times." This second clause is a
23 proviso, i.e., "a clause that introduces a condition
24 by the word provided." A proviso "conditions the

1 principal matter that it qualifies," which is "almost
2 always the matter immediately preceding." That was a
3 quote from *ITG Brands v. Reynolds American*, which, in
4 turn, quotes Justice Scalia's "Reading Law."

5 This proviso makes clear that if the
6 managing member establishes an exchange date – which
7 by its plain meaning is subject to further
8 modification and need not be performed and established
9 – that the managing member may postpone that exchange
10 date established in the immediately preceding
11 dependent clause "one or more times," as long as the
12 managing member noticed the exchange date and noticed
13 the postponement under 2.01(b). Something that is
14 established, but subject to modification, can be
15 postponed; something that has been immutably set or
16 performed cannot.

17 The LLC agreement does not limit the
18 length or frequency of postponements of the exchange
19 date. The parties did negotiate limits to
20 postponements elsewhere in the LLC agreement, as in,
21 for example, Section 8.02. The parties also
22 negotiated timing limits in Article II of the Exchange
23 Rights Agreement, as in, for example, Section 2.01(b)
24 and 2.03.

1 It is a well-settled principle of
2 contract interpretation "that use of different
3 language in different sections of a contract suggests
4 that the difference is intentional – [in other words]
5 the parties intended for the sections to have
6 different meanings." That modified quote is from this
7 Court's 2020 opinion in *Williams Companies v. Energy*
8 *Transfer LP*. The absence of any limits on postponing
9 the exchange date supports the conclusion that none
10 were intended.

11 Accordingly, a reasonable
12 interpretation is that Section 2.01(a) provides for an
13 obligation to establish an exchange date in the annual
14 period, which the managing member may then postpone
15 "one or more times." The plain language of
16 Section 2.01(a) puts no limits on postponing an
17 exchange date established within an annual period,
18 even if the exchange date is postponed beyond the
19 annual period. And nothing in the LLC agreement or
20 its exhibits precludes a notice that establishes and
21 postpones at the same time.

22 Plaintiffs argue this interpretation
23 renders their right to exchange their Class B units
24 illusory or meaningless, because defendant could, in

1 theory, postpone the exchange date forever. As it
2 happened, at the time of the October 6 exchange
3 notice, the October 27 shareholder vote had not yet
4 taken place. As written, the exchange notice
5 contemplated the postponed exchange date would occur
6 only if the vote failed.

7 But plaintiffs do not have a right to
8 exchange their Class B units. Section 2.01 does not
9 provide for a right that an exchange date be held
10 during an annual period. At argument, plaintiffs
11 could not point to any other source for such a right,
12 nor could the Court find one. And even under
13 Section 2.01(c), plaintiffs as Class B members did not
14 have absolute rights to exchange their Class B units.

15 Inc. established an exchange date for
16 October 25 by an October 6 notice, thereby satisfying
17 the requirement that it do so once within the
18 then-current annual period. Inc. also met
19 Section 2.01(b)'s 15 days' notice requirement. In
20 Inc.'s same October 6th notice, it also noticed a
21 postponement of the October 25 exchange date "until
22 the completion of the transaction or the termination
23 of the merger agreement."

24 Defendant did not have an obligation

1 under the LLC agreement to notice, establish, and hold
2 an exchange date for Class B members before the end of
3 the annual period on October 25. Thus, plaintiffs
4 have not stated a breach of contract claim.
5 Plaintiffs have not stated a claim for breach of
6 Section 2.01(a)'s requirement that Inc. establish an
7 exchange date within an annual period.

8 So the motion is granted as to Count
9 I, and I need not address the parties' other
10 arguments.

11 In the alternative to Count I, Count
12 II alleges defendant breached the implied covenant of
13 good faith and fair dealing by failing to "establish
14 an Exchange Date for all Class B Members ... during
15 the Current Annual Period which would have given all
16 Class B Members ... a final opportunity to exchange
17 their Class B Units for Class A shares of [Defendant]
18 before the Proposed Transaction closed."

19 As explained in my Count I analysis,
20 the plain text of the LLC agreement does not impose on
21 Inc. any obligation to hold an exchange date or grant
22 an exchange request in the annual period. Any
23 obligation to do so, or to hold an exchange date
24 before the transaction closed, must come from the

1 implied covenant.

2 "The implied covenant of good faith
3 and fair dealing inheres in every contract and
4 'requires a party in a contractual relationship to
5 refrain from arbitrary or unreasonable conduct which
6 has the effect of preventing the other party to the
7 contract from receiving the fruits' of the bargain."
8 And "rather than constituting a free floating duty
9 imposed on a contracting party, the implied covenant
10 can only be used conservatively to ensure the parties'
11 reasonable expectations are fulfilled." Accordingly,
12 to state a claim for breach of the implied covenant, a
13 plaintiff "must allege a specific implied contractual
14 obligation, a breach of that obligation ... and
15 resulting damage" Those principles are from this
16 Court's 2009 opinion in *Kuroda v. SPJS Holdings*.

17 An essential predicate for the
18 application of the implied covenant is the existence
19 of a "gap" in the relevant agreement. "[I]f the
20 contract at issue expressly addresses a particular
21 matter, an implied covenant claim respecting that
22 matter is duplicative and not viable." That's a quote
23 from *Edinburgh Holdings v. Education Affiliates*.

24 "The implied covenant enables a court

1 to supply fundamental terms addressing unforeseen
2 issues that they parties would have addressed if they
3 thought to negotiate on the subject." That quote is
4 from *Symbiont.io v. Ipreo Holdings*.

5 When analyzing a claim for a breach of
6 the implied covenant, courts "must assess the parties'
7 reasonable expectations at the time of contracting and
8 not rewrite the contract to appease a party who latter
9 wishes to rewrite a contract he now believes to have
10 been a bad deal. Parties have a right to enter into
11 good and bad contracts, the law enforces both."
12 That's a quote from the Supreme Court's decision in
13 *Nemec v. Shrader*.

14 Plaintiffs argue their breach of the
15 implied covenant claim under two theories. First,
16 they assert the implied covenant can be used to supply
17 an obligation in unexpected circumstances. Plaintiffs
18 assert the "gap" in the LLC agreement is "the Managing
19 Member's obligation to set an Exchange Date during the
20 Annual Period prior to the unforeseen permanent
21 extinguishment of the Exchange Right."

22 Defendants argue Count II fails to
23 state a claim because there are no gaps in the LLC
24 agreement for the implied covenant to fill.

1 It would be unreasonable to conclude
2 that the parties did not foresee a permanent
3 extinguishment of plaintiffs' rights under the
4 Exchange Rights Agreement when they negotiated the LLC
5 agreement and its exhibits. Exchanges under the
6 Exchange Rights Agreement necessarily involve the
7 interplay between Class B units of the LLC and Class A
8 and B shares of Inc.

9 The Exchange Rights Agreement provides
10 procedures for Class B members to redeem their
11 high-vote Class B units for publicly traded Class A
12 shares, to take advantage of a liquidity event -
13 whether requested by the Class B member or whether
14 established by the managing member.

15 And Section 7.01(b) of the LLC
16 agreement contemplates, for example, "the merger,
17 consolidation, reorganization or other examination of
18 the [LLC] with or into another entity." Such
19 transactions could result in the cancellation of the
20 LLC's units, which would impede plaintiffs' rights to
21 exchange their Class B units for Class A shares by
22 divesting the Class B members of units which they
23 could exchange - the exchange provisions contain no
24 limits to accommodate such events.

1 I cannot conclude that a liquidity
2 event, such as the going-private transaction here,
3 which canceled Inc.'s shares, is something the parties
4 had not considered. The implied covenant fills no gap
5 here.

6 Plaintiffs' second theory is that the
7 implied covenant "cabins a party's exercise of
8 discretion expressly conferred by a contract."
9 Plaintiffs argue defendants acted in bad faith by
10 "unreasonably and arbitrarily using the right to
11 postpone an Exchange Date so that one would not occur
12 before the Proposed Transaction closed, and Plaintiffs
13 therefore would never have an opportunity to exchange
14 their Class B units."

15 *Allen v. El Paso Pipeline* tells us
16 that the implied covenant compels good faith adherence
17 to the "scope, purpose, and terms of the parties'
18 contract." *Vintage Rodeo Parent* explains that the
19 implied covenant does not promise "equitable
20 fairness."

21 The implied covenant will only protect
22 plaintiffs' rights to the "benefits of the bargain"
23 under the LLC agreement. As explained, plaintiffs did
24 not have absolute right to exchange their Class B

1 units under the LLC agreement and its exhibits, in an
2 annual period or in time to participate in the
3 transaction as Class A stockholders. The implied
4 covenant cannot create or supply rights that do not
5 exist.

6 Because the plaintiffs have no
7 absolute right to exchange their Class B units in an
8 annual period, the exercise of discretion by the
9 defendants is irrelevant. Plaintiffs have not pled
10 that Inc. breached the implied covenant by postponing
11 the exchange date until after the October 26 vote
12 because doing so did not violate any rights plaintiffs
13 held.

14 I decline to address the parties'
15 other arguments. And for the foregoing reasons, the
16 motion is granted as to Count II.

17 I thank everyone for getting on the
18 line.

19 Ms. Beaumont, are there any questions?
20 Is anything unclear?

21 ATTORNEY BEAUMONT: No, Your Honor.

22 THE COURT: Thank you.

23 Mr. Buchdahl, any questions? Is
24 anything unclear?

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ATTORNEY BUCHDAHL: No, Your Honor.

Thank you.

THE COURT: All right. Thank you all very much. Take care. We're adjourned.

(Proceedings adjourned at 3:36 p.m.)

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CERTIFICATE

I, KAREN L. SIEDLECKI, Official Court Reporter for the Court of Chancery for the State of Delaware, Registered Diplomate Reporter, and Certified Realtime Reporter, do hereby certify that the foregoing pages numbered 3 through 22 contain a true and correct transcription of the rulings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated, except as revised by the Vice Chancellor.

IN WITNESS WHEREOF I hereunto set my hand at Wilmington this 9th day of May, 2023.

/s/ Karen L. Siedlecki

Karen L. Siedlecki
Official Court Reporter
Registered Diplomate Reporter
Certified Realtime Reporter