Published on *The National Law Review* https://natlawreview.com

Chancery Court Dismisses Plaintiff's Claims Against Three Former Members of the Board

Article By:

Scott E. Waxman

In *Jacob Hasher Hindlin v. Lukasz Gottwald et al.,* C.A. No. 2019-0586-JRS (Del. Ch. July 22, 2020), the Delaware Court of Chancery (the "Court") dismissed Plaintiff's claims against three former members of the board of managers of Core Nutrition, LLC ("Core" or the "Company") for breach of fiduciary duty and the implied contractual covenant of good faith and fair dealing.

Plaintiff, Jacob Hindlin ("Hindlin"), is a well-known writer and producer of pop music. Encouraged by his business manager, Defendant, Lawrence Spielman ("Spielman"), Hindlin first invested in Core in February 2015, acquiring 2,000 units of the Company for $12,000. In connection with this investment, Hindlin signed a Joinder Agreement and Signature Page to the Limited Liability Company Agreement of Core Nutrition, LLC (the "LLC Agreement"). In early 2017, Hindlin acquired additional 2000 units of the Company for the same price, again at Spielman's urging.

The dispute arose from the acquisition of the Company by Keuring Dr. Pepper Inc. ("KDP") for an aggregate transaction value of $449 million. Based on his 0.6 percent ownership stake in Core as of the end of 2017, Hindlin believed he was entitled to $2.75 million for his units. According to Core, however, he was owed only $393,582.89.

Hindlin brought this action to recover what he believed he was owed by Core against three former members of Core's board of managers seeking compensatory and punitive damages and attorneys' fees. He alleged Defendants, Spielman, Lukasz Gottwald and Renee Karalian, improperly diluted the interest of Core's minority shareholders in breach of the implied contractual covenant of good faith and fair dealing and the Defendants' fiduciary duties.

In his complaint, Hindlin offered three bases to infer importer dilution by the Defendants. First, he alleged that the Company issued a large number of so-called "Incentive Units" prior to the KDP transaction. These Incentive Units allegedly constituted approximately 18 percent of the Company units exchanged for KDP shares in the transaction, and Hindlin alleged Core's refusal to identify to whom these united were allocated suggested that their sole purpose was to dilute the interest of the minority shareholders. Next, Hindlin identified changes in the Company's 2017 capital account as evidence of dilution. Core issued 271,829 units that year, and according to Hindlin, the Company's year-end capital should have totaled $24.6 million. Instead, the Company recorded a year-end capital balance of $1.4 million. Core's capital losses that year were $18.37 million, $4.85 million less than the year-end capital total suggests. Hindlin asserted this discrepancy could only be explained by the issuance of dilutive units. Lastly, Hindlin noted that a shift in the proportion of his membership interest to capital interest permitted an inference of dilution. In 2015 and 2016, Hindlin's membership interest was three to four times greater than his capital interest. By the end of 2017, however, his membership interest was only about 15 percent of his capital interest, and he asserted that this must be the result of dilution.

Defendants disagreed and moved to dismiss the complaint under for failure to state a claim, for failure adequately to plead demand futility, and for lack of standing under Sections 1001 through 1003 of the Delaware Limited Liability Company Act.

To survive dismissal, all complaints, at a minimum, must give general notice of the claim asserted to Defendants. This so-called "notice pleading" standard sets a low bar, and yet, the Court found that Hindlin's complaint did not satisfy it. Because dilution is not per se wrongful, to survive dismissal on a wrongful dilution claim, a plaintiff must plead not only that his interest was diluted, but also that the Defendants did something wrongful that caused his interest to be improperly diluted. According to the Court, Hindlin accused the Defendants of issuing dilutive Incentive Units to divert consideration from minority shareholders to insiders, but then pleaded no facts to back that conclusory allegation. Accordingly, the Court held that in the absence of such pleaded facts, it could not presume wrongdoing.

Furthermore, the Court found that even assuming that the complaint did adequately put the Defendants on notice, Hindlin still failed to state a claim for breach of the implied covenant of good faith and fair dealing, as a matter of law. According to the Court, this type of claim may only be invoked when the contract is truly silent concerning the matter at hand, which was not the case here, as the LLC Agreement addressed the issuance of both Incentive Units specifically and the issuance of units generally. Furthermore, according to the Court's precedent, even if the LLC Agreement did not specifically address dilution, the implied covenant of good faith and fair dealing could not be employed to impose new contract terms that could have been bargained for but were not. The Court found that there is nothing unforeseeable about dilution, and Hindlin could have attempted to bargain for anti-dilution protection or could have chosen not to invest in Core in the absence of this protection. Consequently, the Court held that under these circumstances, Hindlin's attempt to invoke the implied covenant could not be accepted as a matter of law.

Finally, the Court turned to Hindlin's breach of fiduciary duty claim. Defendants argued that Hindlin's dilution claim was "classically derivative," and that his standing to prosecute the claim was extinguished upon completion of the KDP transaction. Hindlin, however, responded that he was asserting a "dual-natured claim" as described by *Gentile v. Rossette*, and therefore, his direct claim had survived the acquisition. In *Gentile*, the Delaware Supreme Court held that a shareholder dilution claim is both derivative and direct when: "(1) a stockholder having majority or effective control causes the corporation to issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders." The Delaware Supreme Court clarified this in *El Paso Pipeline GP Co*. by holding that dilution claims are only dual-natured "when there is some expropriation of control, in addition to economic value, from minority stockholders." Applying this standard, the Court held that no such expropriation of control was alleged here, and more importantly, even if such an allegation could be found from the complaint, Hindlin did not sufficiently plead the existence of a controller or control group. Accordingly, the Court found that even if the notice pleading standard was met, Hindlin still had lost his standing to prosecute his dilution-based breach of fiduciary claims upon consummation of the acquisition, and for that reason, the breach of fiduciary claim must be dismissed.

National Law Review, Volume X, Number 239