Special Situations Fund III QP, L.P. v Overland Stor., Inc.
2017 NY Slip Op 32125(U)
September 27, 2017
Supreme Court, New York County
Docket Number: 651557/2014
Judge: Marcy Friedman

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: Hon. Marcy Friedman, J.S.C.

SPECIAL SITUATIONS FUND III QP, L.P., SPECIAL SITUATIONS PRIVATE EQUITY FUND, L.P., SPECIAL SITUATIONS TECHNOLOGY FUND, L.P. and SPECIAL SITUATIONS TECHNOLOGY FUND II, L.P.

Plaintiffs,

– against –

OVERLAND STORAGE, INC.,

Defendant.

Index No.: 651557/2014

DECISION/ORDER

Plaintiffs Special Situations Fund III QP, L.P., Special Situations Private Equity Fund, L.P., Special Situations Technology Fund, L.P., and Special Situations Technology Fund II, L.P. (collectively, the Funds) bring this action to recover a contractual payment of $6 million allegedly owed to them by defendant Overland Storage, Inc. (Overland). Pursuant to a Purchase Agreement, dated as of December 21, 2010 (the Purchase Agreement or Agreement), Overland sold the Funds an interest in certain patent infringement claims that Overland was pursuing in federal district court and before the International Trade Commission. The Funds were to receive a specified percentage of any monetary award or settlement recovered by Overland on these patent claims. If, however, a "Specified Transaction" occurred prior to the final resolution of the claims, Overland was required to make a lump sum payment of $6 million to the Funds. In this action, the Funds allege that Overland breached its contractual obligation to pay the Funds $6 million upon Overland's entry into a Specified Transaction, referred to by the parties as the "Tandberg Transaction." In the alternative, the Funds allege that Overland breached the implied

covenant of good faith and fair dealing by settling the patent claims for no cash consideration shortly before the closing of a second Specified Transaction, referred to as the "Sphere Transaction," in order to avoid making any payment to the Funds. Both parties now move for summary judgment.

BACKGROUND

Following discovery in this action, the following material facts are not in dispute: Defendant Overland is a California corporation and "a global provider of unified data management, data storage, and data protection technologies and services. Among other products, Overland supplies the tapes that provide automated backup and archiving capacities for computer servers." (Joint Statement of Undisputed Material Facts [JS], ¶ 2.) In February 2010, the Funds acquired rights to more than 7.7 million of Overland's common shares. (Id., ¶ 6; Defs.' Memo. In Supp., at 4-5.)

On August 13, 2010, Overland commenced a patent infringement lawsuit in the U.S. District Court for the Southern District of California against, among others, non-party BDT AG (BDT), a German data storage company and Overland competitor. Overland alleged that certain BDT products infringed two patents owned by Overland. (JS, ¶ 4.) On October 19, 2010, Overland also filed a complaint against BDT in the International Trade Commission (the ITC) (together with the district court litigation, the Patent Litigation). Overland asked the ITC to find that BDT unlawfully imported into the United States various products that infringed Overland's patents. (Id., ¶ 5.)

On December 21, 2010, Overland and the Funds executed the Purchase Agreement. (Id., ¶ 8 & Exh. A.) Under the Agreement, the Funds paid Overland $3 million in return for a 20% interest in any Litigation Award—defined, in pertinent part, as "the amount of any damages

award (compensatory, statutory, punitive or otherwise) or settlement amount payable to Seller [Overland] or its Affiliates in cash and arising out of the Patent Litigation," minus attorneys' fees and expenses. (Agreement, §§ 1.5-1.7, 2.1-2.3 & Signature Page; JS, ¶ 8.) Pursuant to section 5.1 of the Agreement, Overland was required to

> ". . . use its commercially reasonable efforts to prosecute the Patent Litigation to a final and non-appealable judgment or to a final, definitive settlement as promptly as practicable. The parties hereto acknowledge and agree that [Overland] shall have the right, in its sole discretion, to determine whether to settle the Patent Litigation and to determine the terms and conditions of any such settlement."

The Agreement further provides that, in the event of a "Specified Transaction," "in lieu of" a 20% percentage payment on any Litigation Award, the Funds would receive a $6 million payment. (See Agreement, § 2.4 & Exh. B; JS, ¶ 13.) The Agreement thus provides, in relevant part:

> "If [Overland] consummates a Specified Transaction, then promptly following payment to [Overland] or its shareholders of any proceeds from such Specified Transaction, [Overland] shall pay to [the Funds], in lieu of any Percentage Payment to which [the Funds are] or may become entitled hereunder with respect to the Patent Litigation, an amount equal to two (2) times the aggregate purchase price actually paid by [the Funds] to [Overland] pursuant to section 2.2 [i.e., $6 million] . . . ."

(Agreement, Exh. B.)

Section 1.15 sets forth four definitions of the term Specified Transaction. The parties agree that only the first two definitions are pertinent to their dispute. A Specified Transaction means, among other things:

> "(i) an acquisition by any Person and its Affiliates of more than 50% of the then outstanding voting power of Seller [Overland];" or
>
> "(ii) the merger, consolidation or other business combination transaction of Seller with any Person or any of its Affiliates pursuant to which the shareholders of Seller immediately prior to such transaction own less than a majority of the aggregate voting power of Seller or the successor entity

of such transaction . . . ."

In August 2012, Overland began discussing the possibility of a business combination with non-party Tandberg Data Holdings S.á.r.l. (Tandberg), another data storage company and Overland competitor. (JS, ¶ 22.) At the time, Tandberg was wholly owned by FBC Holdings S.á.r.l. (FBC), a special-purpose investment vehicle. FBC, in turn, was owned by certain investment funds managed by Cyrus Capital Partners, L.P. (the Cyrus Funds). (Id., ¶ 23.) At the time of Overland's discussions with Tandberg, the Cyrus Funds were also shareholders of Overland, holding 7,945,500 common shares, or 19.99% of Overland's outstanding common stock. (Id., ¶ 27.)

On or around November 1, 2013, Overland entered into an Acquisition Agreement with the shareholders of Tandberg and FBC. (JS, ¶ 23 & Exh. B.) The Funds and Overland agree that "[t]he contract required Tandberg's shareholders to sell all of Tandberg's capital stock to Overland in exchange for 54% of Overland's common stock." (Id., ¶ 23.) Thus, on January 21, 2014, "Overland and Tandberg consummated a business transaction whereby Overland acquired 100% of Tandberg's outstanding securities from FBC, . . . and in return FBC acquired 47,152,630 shares of Overland's common stock." (Id., ¶ 25.) The parties stipulate that "[t]he shares acquired by FBC constituted approximately 54% of Overland's then-outstanding fully diluted securities." (Id., ¶ 26.) Moreover, because the Cyrus Funds already owned 7,945,500 Overland common shares prior to the Tandberg Transaction, following the transaction the Cyrus Funds directly or with their affiliate FBC held approximately 63% of Overland's outstanding stock. (Id., ¶ 27.)

In connection with the closing of the Tandberg Transaction, Overland and FBC also entered into a Voting Agreement, dated as of January 21, 2014. (JS, ¶ 28 & Exh. D.) The

Voting Agreement restricted, until the earlier of either September 30, 2015 or the filing of Overland's Form 10-K for the fiscal year ending on June 30, 2015, FBC's rights to nominate and vote for directors of the board of Overland. (Voting Agreement, §§ 3-5.) In particular, the Voting Agreement precluded FBC from nominating more than two nominees for election to Overland's seven-member board (id., § 3 [a]-[b]) and required FBC to exercise its voting rights for the remaining five positions "in the same proportion" that other Unaffiliated Shareholders of Overland (i.e., holders of shares other than FBC) voted. (Id., § 5.)

On January 22, 2014, the Funds notified Overland that they considered the Tandberg Transaction to constitute a Specified Transaction under the Purchase Agreement, and demanded a $6 million payment. Overland disagreed and refused to make any payment to the Funds. (JS, ¶ 29.)

During this period, Overland continued to litigate its patent claims. In August and September 2011, the ITC had held a trial concerning Overland's infringement allegations. (JS, ¶ 31.) On May 28, 2013, a full panel of the ITC modified in part a decision of the administrative law judge and terminated the ITC proceeding. (See JS, ¶ 32; see generally Notice of Commission Decision, dated May 28, 2013 [JS, Exh. E].) In February 2014, the district court case, which had been stayed for several years pending a final determination in the ITC proceeding (JS, ¶ 30), was again stayed when Overland sought inter partes review from the U.S. Patent and Trademark Office (USPTO). (Id., ¶ 33.) In January or February 2014, Overland and BDT, the defendant in the Patent Litigation, "began renewed settlement discussions." (Id., ¶ 34.)

On July 30, 2014, Overland entered into a Patent Cross-License and Settlement Agreement with BDT in which the parties resolved all claims Overland had asserted against BDT in the Patent Litigation. "The terms of the settlement included, among other things,

Overland and BDT each granting to the other an irrevocable, nonexclusive, royalty free, worldwide license to the other parties' patents and patent rights related to tape-based solutions." (Id., ¶ 35.) "On September 19, 2014, Overland notified the Funds of the BDT settlement and took the position that because, in Overland's view, litigation fees and expenses exceeded any settlement amounts payable to Overland in cash arising out of the Patent Litigation, the Agreement was being terminated without any payment to the Funds." (Id., ¶ 36.)

In April 2014, Overland entered into merger discussions with another company, non-party Sphere 3D Corporation (Sphere 3D). (Id., ¶ 39.) On May 15, 2014, it "announced that it was entering into a business combination with Sphere 3D, under which Sphere 3D would acquire 100% of Overland's outstanding shares of common stock in exchange for 29% of Sphere 3D's common stock." (Id., ¶ 40.) The merger closed on December 2, 2014 (the Sphere Transaction). (Id., ¶ 42.) It is undisputed that, "[i]f the [Purchase] Agreement were in effect on that date, the merger would have constituted a 'Specified Transaction' under the Agreement entitling the Funds to a $6 million payment from Overland." (Id.)

The Funds commenced this action on May 21, 2014 by filing a summons and complaint. (NYSCEF No. 1.) The Funds filed an amended complaint on November 10, 2014, following the settlement of the Patent Litigation and the announcement of the Sphere Transaction. The amended complaint pleads three causes of action. The first and second causes of action, for breach of contract, are based upon Overland's refusal to pay $6 million to the Funds following the Tandberg Transaction, and seek specific performance and damages, respectively. (Am. Compl., ¶¶ 51-59, 60-68.) The third cause of action, for breach of the implied covenant of good faith and fair dealing, pleads that, "[i]n the event that the Court determines that the Tandberg Transaction did not constitute a Specified Transaction under the Purchase Agreement, Overland

breached the implied covenant . . . by intentionally entering into a no-cash settlement prior to the closing of the Sphere Transaction, for the purpose of terminating the contract prior to the Sphere Transaction." (Id., ¶¶ 78, 69-81.)

DISCUSSION

The standards for summary judgment are well settled. The movant must tender evidence, by proof in admissible form, to establish the cause of action "sufficiently to warrant the court as a matter of law in directing judgment." (CPLR 3212 [b]; Zuckerman v City of New York, 49 NY2d 557, 562 [1980].) "Failure to make such showing requires denial of the motion, regardless of the sufficiency of the opposing papers." (Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 [1985].) Once such proof has been offered, to defeat summary judgment "the opposing party must 'show facts sufficient to require a trial of any issue of fact' (CPLR 3212, subd. [b])." (Zuckerman, 49 NY2d at 562.) "[I]ssue-finding, rather than issue-determination, is key. Issues of credibility in particular are to be resolved at trial, not by summary judgment." (Shapiro v Boulevard Hous. Corp., 70 AD3d 474, 475 [1st Dept 2010], citing S.J. Capelin Assoc., Inc. v Globe Mfg. Corp., 34 NY2d 338, 341 [1974] [other internal citations omitted].)

BREACH OF CONTRACT CAUSES OF ACTION—THE TANDBERG TRANSACTION

Both parties move for summary judgment on the Funds' first and second causes of action for breach of contract. The threshold question on these branches of the motions is whether the Tandberg Transaction constituted a Specified Transaction as that term is defined in clause (i) of section 1.15 of the Purchase Agreement. It is undisputed that California law governs the interpretation of the Purchase Agreement.[1]

[1] Section 8.3 of the Purchase Agreement provides, in pertinent part, that "[t]his Agreement shall be construed, and the legal relations between the parties hereto shall be determined, in accordance with the laws of the United States of America and the State of California, USA, as such laws apply to contracts signed and fully performed in such state without regard to the principles of conflicts of laws thereof."

Under California law, "[a] contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." (Cal Civ Code § 1636.) "A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates." (Id. § 1647; Falkowski v Imation Corp., 33 Cal Rptr 3d 724, 729 [Ct App 2005] ["In evaluating the contractual language . . . we [] take into account all the facts, circumstances and conditions surrounding the execution of the contract" (internal quotation marks, brackets, and citations omitted)].) Indeed, "[w]here the meaning of the words used in a contract is disputed, the trial court must provisionally receive any proffered extrinsic evidence which is relevant to show whether the contract is reasonably susceptible of a particular meaning." (Wolf v Superior Court, 8 Cal Rptr 3d 649, 655 [Ct App 2004] [Wolf] [internal quotation marks and citation omitted].)

As held in Pacific Gas & Electric Co. v G.W. Thomas Drayage & Rigging Co., Inc. (69 Cal2d 33 [1968]), the landmark California decision on the consideration of extrinsic evidence in interpreting contracts, "[t]he test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible." (Id., at 37.) The Court explained that, "[a]lthough extrinsic evidence is not admissible to add to, detract from, or vary the terms of a written contract, these terms must first be determined before it can be decided whether or not extrinsic evidence is being offered for a prohibited purpose."[2] (Id., at 39.) Thus,

"[w]hen the meaning of the words used in a contract is disputed, the trial

[2] The Court articulated the rationale for the test as follows: "A rule that would limit the determination of the meaning of a written instrument to its four-corners merely because it seems to the court to be clear and unambiguous, would either deny the relevance of the intention of the parties or presuppose a degree of verbal precision and stability our language has not attained." (Id., at 37.)

> court engages in a three-step process. First, it provisionally receives any proffered extrinsic evidence that is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. If, in light of the extrinsic evidence, the language is reasonably susceptible to the interpretation urged, the extrinsic evidence is then admitted to aid the court in its role in interpreting the contract. When there is no material conflict in the extrinsic evidence, the trial court interprets the contract as a matter of law. . . . If, however, there is a conflict in the extrinsic evidence, the factual conflict is to be resolved by the jury."

Wolf v Walt Disney Pictures & Television, 76 Cal Rptr 3d 585, 602 [Ct App 2008] [Walt Disney] [internal citations and parentheticals omitted].) As further elaborated by the California Courts, "while extrinsic evidence may not be introduced to contradict the written terms of a contract, such evidence may be introduced to explain the meaning of a written contract so long as the meaning urged is one to which the written contract terms are reasonably susceptible." (Ri-Joyce, Inc. v New Motor Veh. Bd., 3 Cal Rptr 2d 546, 549 n 1 [Ct App 1992], citing Pacific Gas & Electric Co., 69 Cal2d at 40.)

"Person And Its Affiliates"

Overland contends that the Tandberg Transaction was not a Specified Transaction under clause (i) of the Specified Transaction provision because the Transaction resulted, at most, in an acquisition of voting power by a single Person—FBC—not by a "Person and its Affiliates." (Def.'s Memo. In Supp. Of Def.'s Motion, at 11.) Overland emphasizes that the use of the word "and" in the phrase "Person and its Affiliates" is "unambiguously conjunctive," and requires acquisition by an Affiliate. (Id.)

The Funds contend that the voting power acquired by a Person and its Affiliates may be aggregated to reach the required threshold of more than 50%, and argue in effect that because FBC itself acquired such amount in the Tandberg Transaction, a Specified Transaction occurred under clause (i). (Pls.' Memo. In Opp. To Def.'s Motion, at 17 [arguing that "[i]f FBC acquired

more than 50% and its affiliates acquired zero, then simple addition mandates that 'FBC and its affiliates' acquired more than 50%"].) The Funds also contend that, because Cyrus controlled FBC, both FBC and Cyrus acquired "voting power." (Id., at 16.)

Applying the California rules of construction, the court finds that clause (i) of the Specified Transaction provision is reasonably susceptible of the interpretation advanced by the Funds—that acquisition of the required threshold of voting power by a single Person is sufficient to satisfy the clause. Overland's interpretation, although arguably supported by a very literal reading of the contractual language, is unreasonable when read in the context of the Agreement as a whole and in light of its undisputed purpose.

As Overland itself recognizes, "the contemporaneous documentation of the negotiations and both sides' testimony in this case confirms that the parties agreed to the Specified Transaction provision to protect the Funds[']] investment in the Patent Litigation by mandating a payment if a third party obtained control of Overland . . . ," an occurrence that the Funds were concerned could be used to terminate or otherwise interfere with the Patent Litigation. (See Def.'s Memo. In Opp. To Pl.'s Motion, at 11 [emphasis in original]; see also Def.'s Memo. In Supp. Of Def.'s Motion, at 7 [citing deposition testimony of Overland's CEO, Eric Kelly, and the Funds' principal negotiator, Larry Cook].) This undisputed purpose would be frustrated by Overland's interpretation, which would render clause (i) inapplicable to any acquisition by a single entity (or "Person") of more than 50% of the voting power of Overland—i.e., the most straightforward form of a change of control transaction.

Overland in effect argues that no matter how much voting power an entity acquires, clause (i) is not satisfied unless an affiliate of that entity also acquires at least some voting

power.[3] There is no support in either the plain language of the Purchase Agreement or the extrinsic evidence for this interpretation, and Overland does not offer any business reason why such a requirement should be read into the clause. With respect to the plain language, Overland contends that its interpretation is supported by comparison of the use of the words "and" and "or" in clauses (i) and (ii), respectively, of the Specified Transaction provision. (Def.'s Memo. In Supp. Of Def.'s Motion, at 12.) In particular, Overland emphasizes that clause (i) refers to "an acquisition by any Person and its Affiliates," whereas clause (ii) refers to a merger of Overland "with any Person or any of its Affiliates." (Emphases supplied.) Overland also attempts to support its argument with extrinsic evidence of the drafting history of the Purchase Agreement, which indicates that the Funds purposely changed the pertinent phrase in clause (i) from "Person or its Affiliates" to "Person and its Affiliates" during negotiation of the Agreement. (Id., at 13-14.) Overland distinguishes between "and," a conjunctive, and "or," a disjunctive, and contends that the court cannot read the terms synonymously.

The court does not read "and" and "or" synonymously in holding that clause (i) imposes no requirement of acquisition of voting power by an Affiliate. Nor does the court give the word "and" a disjunctive meaning. Read in the context of the Agreement as a whole, and in light of its undisputed purpose, the use of the word "and" merely signifies that any acquisition of voting power by an Affiliate is to be added to the acquisition of voting power by its affiliated Person in calculating whether more than 50% of voting power has been acquired under clause (i). In other words, any acquisition of voting power by an Affiliate is to be included in the calculation of

[3] In fact, the word "Affiliates" in clause (i) is plural. If the court were to accept Overland's overly technical reading of the clause, in the case of an acquisition by a Person with multiple Affiliates, every Affiliate might have to acquire stock in order for a transaction to result in an acquisition of voting power by a "Person and its Affiliates." Overland has not offered any business reason why sophisticated parties would have negotiated for such a limitation on the scope of clause (i).

voting power; but there is no requirement that an Affiliate acquire voting power.

This reading is also consistent with the Funds' replacement of the word "or" with the word "and" in drafting clause (i). Had clause (i) read that only an acquisition of more than 50% of voting power by a "Person or its Affiliates" could constitute a Specified Transaction, a hypothetical acquisition by a Person of 50% and an Affiliate of 1% may not have qualified, notwithstanding that those entities together might have been able to control Overland and terminate the Patent Litigation. (See Houge v Ford, 44 Cal2d 706, 712 [1955] ["In its ordinary sense, the function of the word 'or' is to mark an alternative such as 'either this or that'"]; E.M.M.I. Inc. v Zurich Am. Ins. Co., 32 Cal 4th 465, 473 [2004] [same].) By changing the word "or" to the word "and," the Funds unambiguously signaled their intent that any acquisitions by Affiliates of a Person acquiring voting power should be considered together with the acquisition of that Person. In this way, the Funds protected their interest in the Patent Litigation from potential interference by a combination of related entities acquiring voting power in Overland.

In addition, even accepting that "the ordinary usage of 'and' is to condition one of two conjoined requirements . . ." (Kobzoff v Los Angeles County Harbor/UCLA Med. Ctr., 19 Cal 4th 851, 861 [1998] [internal quotation marks and citations omitted]), departure from the ordinary usage is appropriate under the California rules of construction where the intent of the parties, as gleaned from the context in which the word is used, shows they intended a different meaning. (See Houge, 44 Cal2d at 712.) Here, as discussed above, the purpose of the Specified Transaction provision would be defeated by interpreting clause (i) to require acquisition of Overland voting power by an Affiliate as well as by a Person, where the Person by itself acquired more than 50% of the voting power. In light of the parties' undisputed purpose, clause (i) must be read merely as requiring an acquisition of more than 50% of voting power by any Person

including its Affiliates.

"Voting Power"

Overland further contends that the Tandberg Transaction was not a Specified Transaction within the meaning of the Purchase Agreement because FBC did not acquire more than 50% of the "voting power" of Overland. Overland argues that the term "voting power" must be read to mean the power to elect corporate directors. In support of this contention, Overland reasons as follows: Only Overland's board of directors could terminate the Patent Litigation. Interpreting "voting power" to mean the power to elect directors is thus the "only reasonable reading of that term" given the purpose of the Specified Transaction provision "to protect the Funds' investment in the Patent Litigation by mandating a payment if a third party obtained control of Overland and used that control to terminate the Patent Litigation." (Def.'s Reply Memo. On Def.'s Motion, at 4; Def.'s Memo. In Opp. To Pls.' Motion, at 11.) Overland further contends that, "[a]lthough FBC received 54% of Overland's common stock in the Tandberg Transaction, those shares did not come with 'voting power' because they were restricted by the voting agreement," and that "[t]he term 'voting power' cannot be reasonably construed to encompass the acquisition of common stock stripped of its power to elect directors."[4] (Def.'s Memo. In Supp. Of Def.'s Motion, at 14.)

The Funds contend that the term "voting power" means "the ability to vote" and is not limited to the election of directors, but extends to other fundamental matters of corporate governance, including "approving executive compensation; amending the Articles of Incorporation; approving mergers and acquisitions; and approving 'golden parachute' compensation." (Pls.' Memo. In Supp. Of Pls.' Motion, at 19 [internal citations omitted].) The

[4] As discussed above, in the Voting Agreement between Overland and FBC, FBC temporarily agreed, among other things, to vote for five of the board's seven members in the same proportion as other shareholders.

Funds also dispute Overland's assertion that only the board of directors could terminate the Patent Litigation, and assert that "[m]anagement of a company can discontinue litigation without board approval." (Pls.' Reply Memo. On Pls.' Motion, at 11.) Finally, the Funds dispute Overland's assertion that the Voting Agreement prevented FBC from acquiring the power to vote for directors of Overland. The Funds characterize the interplay of the Tandberg Transaction and the Voting Agreement as follows: FBC "acquired the power to vote for the election of directors, and then agreed to exercise that voting power by temporarily voting for five of Defendant's seven directors in the same proportion as all other Overland shareholders voted." (Pls.' Memo. In Supp. Of Pls.' Motion, at 23.) According to the Funds, FBC first had to acquire the power to vote in order to agree, under the Voting Agreement, to the manner in which the power would be exercised. (Id.)

The Purchase Agreement does not define the term "voting power" or otherwise specify the manner in which "voting power" should be calculated. The Agreement by its terms neither restricts the meaning of "voting power" to the power to elect directors, nor provides that "voting power" includes a shareholder's power to vote on matters other than the election of directors.[5] The Agreement also does not expressly state whether a shareholder acquires "voting power" when it takes ownership of securities but simultaneously enters into a contractual arrangement that restricts it from exercising the voting rights associated with those securities. The Agreement

[5] For an example of a change in control provision that more specifically defines voting power as it relates to management of the corporation, see Matter of Charter Communications v Charter Communications Operating, LLC (419 BR 221, 238 [Bankr SD NY, Nov. 17, 2009, No. 09-11435] [provision in credit agreement mandated against the consummation of any transaction by which another "person" or "group" would gain "the power, directly or indirectly, to vote or direct the voting of Equity Interests having more than 35% . . . of the ordinary voting power for the management of the Borrower, unless [a specified group related to the Borrower] has the power, directly or indirectly, to vote or direct the voting of Equity Interests having a greater percentage . . . of the ordinary voting power for the management of the Borrower than such 'person' or 'group' . . ." (emphasis supplied, ellipses in original)]).

thus does not on its face establish the meaning of the term "voting power." Under California law, discussed above, the court accordingly looks to extrinsic evidence to construe the term.

California law provides that "[t]he words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or unless a special meaning is given to them by usage, in which case the latter must be followed." (Cal Civ Code § 1644.) "Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense." (Id. § 1645.) Moreover, "[a] contract is to be interpreted according to the law and usage of the place where it is to be performed . . . ." (Id. § 1646; see also Frontier Oil Corp. v RLI Ins. Co., 63 Cal Rptr 3d 816, 826 n 5 [Ct App 2007] [noting that "Civil Code section 1646 prescribes both a choice-of-law rule concerning the interpretation of contracts and a rule of interpretation regarding word usage. The California Supreme Court has cited section 1646 in several opinions to support the admissibility of evidence of usage for the purpose of interpreting a contract"].)

Case law, statutes, and other legal authority are among the extrinsic sources California Courts look to in analyzing whether a disputed phrase is a "legal term of art" or otherwise has a technical or specialized meaning in a particular field. (See e.g. Mundy v Lenc, 138 Cal Rptr 3d 464, 471-472 [Ct App. 2012] [citing case law to interpret the phrase "causes of action" in contractual release]; Hambrecht & Quist Venture Partners v American Med. Intl., Inc., 46 Cal Rptr 2d 33, 37-40 [Ct App 1995] [citing case law, statutory law, and secondary authority to interpret the word "laws" in contractual choice of law provision]; Falkowski, 33 Cal Rptr 3d at 736 [giving the term "subsidiary" its "commonly understood meaning," as evidenced by case law and the definition provided in the California Corporations Code].)

California Courts have also long considered evidence of trade usage in interpreting contracts, even where no ambiguity exists on the face of the contract. (See e.g. Pacific Gas & Elec. Co., 69 Cal2d at 39 & n 6 [collecting authorities]; Beneficial Fire & Cas. Ins. Co. v Kurt Hitke & Co., Inc., 46 Cal2d 517, 523, 525-527 [1956]; Ermolieff v R.K.O. Radio Pictures, Inc., 19 Cal2d 543, 550 [1942].) "Parties are presumed to contract pursuant to a fixed and established usage and custom of the trade or industry" in which they operate. (Southern Pac. Transp. Co. v Santa Fe Pac. Pipelines, Inc., 88 Cal Rptr 2d 777, 786 [Ct App 1999].) Even where not shown to be entirely uniform, evidence of industry usage may reveal that a term has "more than one possible meaning," making such evidence "relevant and admissible to expose the latent ambiguity in the contract language . . . ." (See Wolf, 8 Cal Rptr 3d at 661.)

Neither party cites comprehensive authority on the meaning of the term "voting power." The court's own research confirms that the term is one of art frequently used in corporate regulation and in general corporate legal parlance. The term appears in numerous provisions of the California Corporations Code, which governs the affairs of all California corporations, including Overland (see e.g. Cal Corp Code §§ 160 [b], 189, 194.5, 308, 707 [b], 1001 [d], 1101, 1201-1201.5, 1800 [b] [3], 1900-1902, 2318); in several provisions of the federal Internal Revenue Code related to corporate taxation (see e.g. IRC §§ 269 [a], 368 [c], 1504 [a] [2] [A], 1563 [a]; see also 26 CFR 1.957-1); and in provisions of the California tax code (see e.g. Cal Rev & Tax Code §§ 23736.1 [a] [6], 24431 [a], 24438 [d] [5], 24465 [g], 24943, 25105, 25113 [b] [3]).

In the corporate context, extensive authorities define and calculate "voting power" either solely or primarily with reference to the power to elect directors. Section 194.5 of the California Corporations Code, relied upon by Overland, provides in pertinent part that "'[v]oting power'

means the power to vote for the election of directors at the time any determination of voting power is made and does not include the right to vote upon the happening of some condition or event which has not yet occurred." The statute does not reference or include within this definition the power to vote on fundamental corporate changes. The statute's definition, moreover, is not unique. The corporations statutes of numerous jurisdictions define "voting power" in a manner consistent with the California Corporations Code. (See e.g. CGSA § 33-602 [36] [Connecticut]; 18 Okla St Ann §§ 1145, 1148A [3] [Oklahoma]; WS 1977 § 17-16-140 [a] [xlv] [Wyoming]; Miss Code Ann § 79-4-1.40 [47] [Mississippi]; LSA-RS 12:1-140 [27] [Louisiana]; IC § 30-29-140 [29] [Idaho].) The American Bar Association's Model Business Corporation Act also contains a similar definition. (Model Business Corp Act § 1.40 [27] ["'Voting power' means the current power to vote in the election of directors"].)[6]

The Funds contend that the California Corporations Code definition of "voting power" is "irrelevant" to this case because there is no evidence that the statutory definition was considered by the parties in drafting the Purchase Agreement. (Pls.' Memo. In Supp. Of Pls.' Motion, at 23-24.) The court rejects this contention in view of the express mandate, under California law, that statutory and case law be considered as extrinsic aids in construing a contract.[7]

In their initial briefing, the Funds submitted an affirmation from John D. Hogoboom, an attorney who represented the Funds in connection with their negotiation of the Purchase Agreement. In this affirmation, he stated that he changed the definition of Specified Transaction

[6] This court has identified only one jurisdiction that defines "voting power" as including the power to vote on fundamental corporate changes. (DC ST § 29-301.02 [25] [District of Columbia] ["'Voting power' means the current power to vote in the election of directors or to vote on approval of any type of fundamental transaction"].) This statute has not been cited by the parties and has no relevance to the parties' dispute, which concerns a California corporation and is governed by a California choice of law clause.

[7] Texas Instruments Inc. v Tessera, Inc. (231 F3d 1325, 1329-1331 [Fed Cir 2000]), on which the Funds rely, is not to the contrary. There, the Court declined to apply a California statutory definition (the definition of "litigation" in the California "Vexatious Litigants" statute) that was irrelevant to the patent litigation at issue.

in the draft Purchase Agreement to provide that a Specified Transaction would occur upon an acquisition of 50% of "voting power" as opposed to 50% of "voting securities." According to Mr. Hogoboom, he did not insert the term "voting power" "based on any California statute or regulation defining the term 'voting power.'" (Hogoboom Aff., ¶ 11.) Rather, the purpose of this change was to "expand the definition of Specified Transaction" to address the "concern . . . that someone could acquire control over Overland by acquiring a majority of the votes attached to Overland's securities, without acquiring a majority of its 'voting securities.'" (Id., ¶¶ 9.) After the court expressed concern that Mr. Hogoboom's affirmation may implicate the advocate-witness rule (22 NYCRR 1200, Rule 3.7), the Funds determined to refile their motion without the affirmation. (See Tr. of Oral Argument on Apr. 21, 2016.) Even if Mr. Hogoboom's affirmation were to be considered, however, his conclusory assertion that he did not consider the California statute does not require this court to disregard that statute, which evidences the common and technical usage of that term in the corporate context in California, and accordingly bears on the parties' understanding of the term under the California authorities discussed above.

Although the Funds assert that the California Corporations Code is not relevant to the interpretation of the term "voting power," they, like Overland, appear to acknowledge the relevance of federal tax authorities in interpreting the term. (Pls.' Reply Memo To Pls.' Motion, at 12.) Neither party comprehensively briefs the extensive tax authorities. This court's review of these authorities, however, supports the conclusion that they define "voting power" primarily, if not solely, with reference to the power to elect directors, as opposed to the power to vote on other fundamental corporate decisions. (See Alumax Inc. v Commissioner of Internal Revenue, 165 F3d 822, 824-825 [11th Cir 1999] [holding, in the context of interpreting the phrase "voting power" in IRC § 1504 [a], that the "historical judicial and IRS interpretation is that 'voting

power' means the power to control the corporation's business through the election of the board of directors"]; see also Stuart Lazar, The Definition of Voting Stock and the Computation of Voting Power Under Sections 368 [c] and 1504 [a], 17 Va Tax Rev 103, 109, 135 [1997] [explaining that, as "voting stock is defined as stock that participates in the management of the corporation through the election of directors, the most common method of measuring the voting power inherent in stock held by a taxpayer is to calculate the percentage of the directors of a corporation the taxpayer can elect"].)

Although some tax authorities take into account a shareholder's ability to vote on fundamental corporate changes in assessing "voting power," the parties have not cited any case in which a shareholder was found to possess a required threshold of "voting power" based solely upon its power to vote on fundamental corporate changes, without an equivalent power to vote for directors. (Hermes Consol., Inc. v United States, 14 Cl Ct 398, 405-407 [1988] [Hermes] [reasoning, in the context of assessing "voting power" pursuant to IRC § 269, that "the power to elect a corporation's board of directors is more indicative of voting power than the power to participate in fundamental corporate changes because the power to participate [in] fundamental corporate changes is generally attendant with all stock ownership under local state law"];[8] accord Fish v Commissioner of Internal Revenue, 106 TCM [CCH] 608 [2013] [holding, under IRC § 1239 (c) (1), that the required "more than 50%" threshold of "voting power" was satisfied by the shareholder's power to elect directors, notwithstanding the finding that the shareholder might not

[8] In Hermes, a corporate taxpayer (Hermes) claimed that the IRS had erroneously disallowed carry-over deductions claimed on its tax return. Resolution of this claim required the Court to decide, for purposes of IRC § 269, whether another corporation (Hamilton) had acquired, among other things, "'at least 50 percent of the total combined voting power of all classes of stock [of Hermes] entitled to vote.'" (Id., at 405, quoting IRC § 269 [a].) The Court held that the shareholder lacked the requisite percentage of "voting power" under IRC § 269 because, although the shareholder held 50% of the voting power necessary to approve or disapprove of corporate changes, it did not hold 50% of the voting power necessary to elect the board.

meet the required threshold of "voting power" with respect to fundamental corporate changes].)

As explained by the Eleventh Circuit in Alumax, this treatment of "voting power," as primarily concerned with the power to elect directors, is based upon an assumption, "which [is] completely sound as a matter of default state corporate law," that "the directors manage a corporation's business." (165 F3d at 825.) Where that assumption is "belied," as where the usual power of the directors to manage the business of a corporation has been contractually altered or restricted, a different approach to calculating "voting power" may be warranted.[9] (See id., at 825-826.)

Like the corporation statutes of New York and Delaware, the California Corporations Code provides that, with certain exceptions not here relevant, "the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board. The board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board." (Cal Corp Code § 300 [a]; see also NY BCL § 701; 8 Del C § 141.) "Except as otherwise provided by the articles or bylaws, officers shall be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment." (Cal Corp Code § 312 [b].) Thus, as a matter of

[9] In Alumax, the plaintiff (Alumax) appealed a tax court decision that Alumax was not entitled to join the consolidated return of one of its shareholders (Amax). The relevant tax provision, Internal Revenue Code § 1501, permitted corporations belonging to an "affiliated group" to file a consolidated return. Under Internal Revenue Code § 1504 (a), "affiliated group" was defined to mean "a member of a chain of corporations in which a parent 'owns directly stock possessing at least 80 percent of the voting power of all classes of stock.'" (165 F3d at 824, quoting IRC § 1504 [a].)

The Eleventh Circuit held that Amax did not possess the 80% threshold of "voting power" required to file a consolidated tax return, even though it had the power to elect a supermajority of the corporation's board. (Id., at 823.) Notwithstanding this power, under the corporation's particular structure, Amax and its elected directors lacked the power to control several "basic management functions," including the selection of a chief executive officer (id., at 826), and other shareholders had the power to render board actions ineffective. (Id., at 823.) The Court concluded that Amax did not hold stock possessing the required threshold of "voting power."

default California corporation law, the board of directors—not the shareholders—controls and/or oversees the everyday management of the corporation, including the conduct and decisions of officers. The shareholders exercise control over management indirectly, through their power to replace directors with whom they are dissatisfied.

In this case, the Funds do not contend that there are any special provisions in Overland's articles or bylaws that gave FBC or other shareholders control over "basic management functions." (Compare Alumax, 165 F3d at 826.) They do not contend, for example, that FBC acquired with its securities the power to terminate the Patent Litigation or to direct management's actions with respect to that Litigation. Absent any claim to the contrary, the court finds that the California default rules control. The Funds have not explained how, under those rules, FBC, as an acquiring shareholder, could have obtained control over the management of Overland or forced management to change its litigation strategy, other than by replacing the directors responsible for overseeing management.[10] Nor have the Funds produced any extrinsic evidence that raises a triable issue of fact as to whether the term "voting power" means anything other than the power to elect directors. (See Walt Disney, 76 Cal Rptr 3d at 601-603.) Overland's construction best accords with both the purpose of the Agreement and the technical usage of "voting power," in California and elsewhere. (See Cal Civ Code § 1645.) The court accordingly holds as a matter of law that FBC's acquisition of the power to vote for fundamental corporate changes, without an equivalent power to vote for the election of directors, was not an acquisition of "voting power" for purposes of the Specified Transaction provision.

[10] In contending that FBC's power to vote for fundamental corporate changes constituted voting power, the Funds point to the fact that FBC voted for the Sphere 3D merger. (Pls.' Reply Memo., at 8.) This contention is inconsistent with the authorities discussed above. It is noted, moreover, that the Purchase Agreement protected the Funds from this merger, as it qualified as a Specified Transaction.

Effect Of The Voting Agreement

Although the Funds dispute that the term "voting power" means the power to elect directors, they also assert that FBC did acquire such power. The court accordingly turns to that issue. As discussed above, it is undisputed that, as a result of the Tandberg Transaction, FBC acquired 54% of the stock of Overland entitled to vote in director elections. Overland does not deny that, if not for the Voting Agreement, FBC would have immediately acquired the power to elect a majority of the company's board of directors. The Voting Agreement, however, temporarily prohibited FBC from electing a majority of directors of its own choosing to the board. The question therefore remains whether a calculation of "voting power" under the Purchase Agreement must take into account the effect of the Voting Agreement on FBC's actual power to control corporate management during the effective period of the Voting Agreement, or whether FBC's mere acquisition of stock, carrying with it the inherent right to vote in director elections, satisfies the "voting power" requirement of the Purchase Agreement.

The authorities that analyze "voting power" are not uniform in their consideration of, or refusal to consider, shareholder voting agreements. On these motions, the parties do not address the extensive authorities on this issue, and identify only limited authorities supportive of their respective positions, without attempting to reconcile them or explain their apparently contradictory approaches. (See Pls.' Reply Memo. On Pls.' Motion, at 12; Defs.' Memo. In Opp. To Pls.' Motion, at 10.) It appears that some of the tax statutes and regulations analyzed by these authorities describe "voting power" as an attribute of stock, while others describe "voting power" as a possession of shareholders.

In the first category are statutes which describe "voting power" as an attribute or characteristic of the stock owned by a shareholder, rather than as a possession of the shareholder

itself. IRC § 368 (c), for example, defines "control" as "the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote" and at least 80 percent of the shares of all other non-voting stock. (Emphasis supplied.) Federal authorities applying this provision have looked to the "voting rights [] inherent in the stock," rather than "whether the particular shareholder owning the stock actually has the legal right to vote its shares." (Lazar, 17 Va Tax Rev at 112.) These authorities appear not to take into account the effect of voting agreements, which are personal to the shareholder, and do not alter the inherent characteristics of the stock. (See Hermes, 14 Cl Ct at 405 [quoting B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders § 3.08, at 3-34 (3d ed. 1979) for the proposition that, under Internal Revenue Code § 368 (c), "it is usually assumed that the computation of 'total combined voting power' is not to take account of shareholders' voting agreements or similar arrangements even though they may alter the balance of power; but the question is not foreclosed by case law or rulings" (emphasis supplied)]; Lazar, 17 Va Tax Rev at 116-117 [noting that the IRS has found IRC § 368 (c) satisfied even where, as part of a corporate reorganization, shareholders "agreed for three years following the transaction to vote any shares of acquiring corporation stock owned by them for a slate of directors designated by the management of the acquiring corporation," as "the stock received in the reorganization constituted voting stock notwithstanding the contemporaneous voting agreement"].)

Other statutes and regulations are more similar to the Purchase Agreement, to the extent that they require that a shareholder, specifically, possess or own a particular percentage of "voting power." One example is 26 CRF § 1.957-1, which defines the term "controlled foreign corporation" for purposes of federal income tax law. This regulation provides, in part, that a foreign corporation is a "controlled foreign corporation" if "more than 50 percent" of the "total

combined voting power of all classes of stock entitled to vote" is "considered as owned . . . by United States shareholders . . . ." (Emphasis supplied.) The regulation further provides that "[t]he mere ownership of stock entitled to vote does not by itself mean that the shareholder owning such stock has the voting power of such stock for purposes of [26 USC 957]. For example, if there is any agreement, whether express or implied, that any shareholder will not vote his stock or will vote it only in a specified manner, or that shareholders owning stock having not more than 50 percent of the total combined voting power will exercise voting power normally possessed by a majority of stockholders, then the nominal ownership of the voting power will be disregarded in determining which shareholders actually hold such voting power, and this determination will be made on the basis of such agreement." (Id., § 1.957-1 [b] [2].)

On this cursorily briefed record, the court cannot decide the extent to which the difference in wording of the statutes and regulations—i.e., the characterization of voting power as an attribute of stock, as opposed to a possession of the shareholder—explains the divergence of the authorities on whether shareholder voting agreements should be considered in determining whether voting power has been acquired. Tax policies underlying the differing statutes and regulations may also explain the seemingly different outcomes, but have not been discussed on these motions. The court need not, however, resolve these issues. Even assuming that the divergence of authority renders the term "voting power" in the Purchase Agreement reasonably susceptible of a construction that would ignore the effect of the Voting Agreement, the court holds that the resulting ambiguity must be resolved against the Funds based on the extrinsic evidence in the record as to the parties' actual intent.

The drafting history of the Specified Transaction provision constitutes undisputed evidence of such intent. Although the Funds rely on this evidence in support of their motion (see

Pls.' Memo. In Supp. Of Pls.' Motion, at 22), the court finds that it provides no support for their interpretation of "voting power." More specifically, the Funds submit evidence that they substituted the phrase "voting power" for the phrase "voting securities" in the final drafts of the Purchase Agreement. (See Hampson Aff. In Supp. Of Pls.' Motion, Exh. O.) According to the Funds, they replaced the term "voting securities" with the term "voting power" based on their concern that Overland might eventually issue new "classes or series of stock [with] . . . more than one vote per share." (See Pls.' Memo. In Supp. Of Pls.' Motion, at 10.) The Funds recognized that such an issuance could enable a shareholder acquiring such stock to gain "real control" of the management of Overland, despite owning less than a majority of all classes or series of "voting securities," and use that control to interfere with the Patent Litigation. (Id., at 22; Dep. of Larry Cook [Funds' negotiator for the Purchase Agreement], at 181, 307-308 [Rudzin Aff. In Supp., Exh. F].) They assert that "the drafting history confirms that it was the parties' intent for the Specified Transaction provision to be triggered when a third party acquired more than half of Defendant's aggregate votes." (Pls.' Memo. In Supp. Of Pls.' Motion, at 22; see also Hogoboom Aff., ¶ 9.[11])

In fact, no new class of stock with enhanced voting rights was ever issued, and FBC acquired 54% of the "voting securities" of Overland (i.e., the stock carrying with it the right to vote in director elections) in the Tandberg Transaction. Although FBC thus acquired a majority of the "aggregate votes" to be cast in director elections, as a result of the Voting Agreement FBC did not, at the time of the Tandberg Transaction, acquire discretion as to how to cast those

[11] As discussed above, the Funds withdrew the affirmation of Mr. Hogoboom after this court expressed concern that his testimony may implicate the advocate-witness rule. For the reasons stated above, the breach of contract causes of action must be dismissed whether or not this affidavit is considered.

majority votes or the power to control management.[12]

The Funds' attempt to characterize the term "voting power" as concerned solely with the aggregate votes acquired by a Person (FBC), and not with the Person's actual ability to control corporate management, is unpersuasive. Significantly, the Funds did not bargain for a provision stating that a Specified Transaction would occur upon a Person's acquisition of ownership of more than 50% of the "aggregate votes" to be cast in director elections. Moreover, their characterization of "voting power" as "aggregate votes" is plainly inconsistent with their admission on these motions that the term "voting power" was inserted to protect the Funds from an actual change in the control of Overland management, which could have posed a threat to their interest in the Patent Litigation. The Funds have not claimed, let alone articulated any theory to support a claim, that FBC's acquisition of a majority of "aggregate votes"—without any accompanying power to exercise "real control" over management—posed any threat to that interest.[13]

The court accordingly holds that Overland's interpretation "embodies the intention of the parties." (See Falkowski, 33 Cal Rptr 3d at 509-510 [holding that the defendant's interpretation of disputed language of stock option plans "embodie[d] the intention of the parties" based, in

[12] The Funds do not contend that the termination of the Voting Agreement resulted in FBC "acqui[ring]" "voting power," and there is no evidence as to when the Voting Agreement was terminated in relation to the settlement of the Patent Litigation and the termination of the Purchase Agreement. Assuming, therefore, that FBC acquired "voting power" upon the termination of the Voting Agreement, the Funds have not shown that this acquisition triggered Overland's obligation to pay the Funds $6 million.

[13] The weakness of the Funds' argument is further demonstrated by application of their construction to hypothetical alternative acquisitions. Assume, for example, that instead of acquiring 54% of the voting securities of Overland, FBC acquired only 49% of those securities, but simultaneously secured by shareholder voting agreement the right to control an additional 2% of the votes at director elections. Under the Funds' interpretation of "voting power," which is concerned solely with the aggregate number of votes associated with securities owned by FBC, and not FBC's actual power to elect directors, FBC would not have acquired more than 50% of the "voting power" of Overland in such a scenario, notwithstanding its ability to replace a majority of the board and use that control to terminate the Patent Litigation. The Funds' interpretation must be considered no less strained when applied to the actual facts of this case.

part, on conclusion that "[p]laintiffs' interpretation [] fails to further the purposes for which the incentive stock option plans were created"].)

In so holding, the court rejects the Funds' argument that FBC "first had to acquire the power to vote in director elections before agreeing on how to exercise that power." (Pls.' Memo. In Opp. To Def.'s Motion, at 13 [emphasis in original].) This argument ignores the reality of the transaction, in which FBC agreed contemporaneously upon acquiring its shares not to exercise control over the election of Overland's directors.

The remaining extrinsic evidence submitted by the Funds does not suffice to raise a triable issue of fact as to the meaning of "voting power." The Funds argue that a Proxy Statement, filed by Overland with the Securities Exchange Commission (SEC) on December 19, 2013, contains admissions by Overland that FBC would acquire a majority of the "voting power" of Overland. (Proxy Statement [Hampson Aff. In Supp. Of Pls.' Motion, Exh. J]; Pls.' Memo. In Opp. To Def.'s Motion, at 11-12.) In the Statement, Overland disclosed the impending Tandberg Transaction to shareholders and solicited shareholders to vote at a January 16, 2014 special meeting in favor of the Transaction. (JS, ¶ 24.) Although the court rejects Overland's contention that the Proxy Statement, which post-dates the drafting and execution of the Purchase Agreement, is "irrelevant" to the meaning of "voting power" (Def.'s Memo. In Opp. To Pls.' Motion, at 12), the court also rejects the Funds' contention that the Statement contains an admission. The Statement does not reference the Purchase Agreement and is at best equivocal in the way it describes the effect of the Tandberg Transaction on "voting power." It thus does not constitute an admission or otherwise create a triable issue of fact with respect to the meaning of the term in the Purchase Agreement, drafted three years earlier. (Compare e.g. Proxy Statement, at 2 [representing that, "[a]s a result of the Acquisition [i.e., the Tandberg Transaction], our

shareholders' existing ownership and voting power will be diluted by the issuance of 47,152,630 new shares, which represent 119% of our outstanding common stock as of December 2, 2013 and 54% of our outstanding common stock that would be outstanding at the closing of the Acquisition"] with Proxy Statement, at 4 [representing that, as a result of the Tandberg Transaction, "the Cyrus Funds and affiliates . . . would own approximately 55,098,130 shares of our common stock (including the Acquisition Shares), which subject to the Voting Agreement described on page 3, is expected to represent approximately 63% of the total voting power of the Company's voting securities following the closing of the Acquisition" (emphasis supplied)].)

The court accordingly finds, in light of the undisputed purpose and the drafting history of the Purchase Agreement, and consistent with the extrinsic evidence of the technical meaning of the words, that "voting power" must be read to refer to a shareholder's actual power and discretion to control the election of directors. To the extent, however, that there remains any ambiguity in the record, such ambiguity must be resolved against the Funds, as the parties responsible for the term "voting power" appearing in the Purchase Agreement. (Cal Civ Code § 1654 ["In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist"].) The Funds, all sophisticated parties, could certainly have drafted a provision that covered the situation at bar. In fact, the Funds changed language that would arguably have covered the instant facts. They cannot now profit from the infirmity of their own replacement language.

Neither party has argued that the term "voting power" is used differently in clause (ii) than in clause (i). For the same reasons that FBC did not immediately acquire "voting power" as a result of the Tandberg Transaction, the shareholders of Overland did not immediately lose "voting power." The Voting Agreement maintained, for a time, the status quo with respect to the

control of Overland management.

For all of the above reasons, the branch of the Funds' motion for summary judgment on the first and second causes of action for breach of contract will be denied. The branch of Overland's motion for summary judgment on these causes of action will be granted.

IMPLIED COVENANT CAUSE OF ACTION—THE SPHERE TRANSACTION

The third cause of action, for breach of the implied covenant of good faith and fair dealing, is based on the allegation that Overland settled the Patent Litigation for no cash consideration, shortly before the closing of the Sphere Transaction, in order to avoid its obligation to pay the Funds $6 million under the Purchase Agreement. (See Am. Compl., ¶ 78 [quoted supra at 6-7].) As noted above, the parties agree that, if not for the settlement of the Patent Litigation, the Sphere Transaction would have satisfied the requirements of the Specified Transaction provision. (JS, ¶ 42.)

Overland seeks summary judgment on this cause of action on two grounds. First, Overland argues that it did not have a duty to act in good faith in settling the Patent Litigation because "the Agreement granted [it] unfettered authority over the Patent Litigation." (Defs.' Memo. In Supp. Of Defs.' Motion, at 19.) Second, Overland argues that the Funds do not present any evidence that raises an inference of bad faith. (Id., at 18.) According to Overland, the evidence establishes that its "decision to settle was driven by its increasingly bleak recovery prospects" in the Litigation due, among other things, to the ITC panel's decision, and by "real business considerations," such as Overland's discovery that BDT would likely be incapable financially of paying a large settlement or damages award. (Id., at 23.)

The Funds argue that Overland's "'sole discretion' over settlement" came with "a broad responsibility – implied by law – to exercise that discretion in good faith, and not in a way that

was designed to defeat the legitimate expectations of the Funds." (Pls.' Memo. In Opp. To Defs.' Motion, at 20.) The Funds deny that Overland "was [] given the power to abandon the litigation solely to prevent the Funds from [receiving] payment under the Specified Transaction provision." (Id.) The Funds further argue that, although section 5.1 of the Purchase Agreement afforded Overland "the sole discretion [] to determine whether to settle the Patent Litigation," this language must be read together with the preceding sentence, which required Overland to use "commercially reasonable efforts" to prosecute the Patent Litigation to a final judgment or settlement. (Id., at 21.) Finally, the Funds argue that the settlement agreed to by Overland was of no use or value to the company, and that this circumstance, combined with the "suspicious timing" of the settlement and Overland's "economic incentive to prevent the occurrence of . . . [a] Specified Transaction," raise a genuine issue of material fact as to Overland's bad faith. (Id., at 24.)

"It has long been recognized in California [that] every contract contains an implied covenant of good faith and fair dealing that 'neither party will do anything which will injure the right of the other to receive the benefits of the agreement.'" (Walt Disney, 76 Cal Rptr 3d at 597, quoting Kransco v American Empire Surplus Lines Ins. Co., 23 Cal 4th 390, 400 [2000].) The California Supreme Court has held that "[t]he covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith." (Carma Developers [Cal.], Inc. v Marathon Dev. Cal., Inc., 2 Cal 4th 342, 372 [1992] [Carma].) In the case of a discretionary power, "the covenant requires the party holding such power to exercise it for any purpose within the reasonable contemplation of the parties at the time of formation—to capture opportunities that were preserved upon entering the contract, interpreted objectively." (Id., at 372 [internal

quotation marks and citation omitted].)

As further explained by the Court in Carma, however:

> "The general rule regarding the covenant of good faith is plainly subject to the exception that the parties may, by express provisions of the contract, grant the right to engage in the very acts and conduct which would otherwise have been forbidden by an implied covenant of good faith and fair dealing. This is in accord with the general principle that, in interpreting a contract an implication should not be made when the contrary is indicated in clear and express words. As to acts and conduct authorized by the express provisions of the contract, no covenant of good faith and fair dealing can be implied which forbids such acts and conduct. And if defendants were given the right to do what they did by the express provisions of the contract there can be no breach."

(Id., at 374 [internal quotation marks, alterations to quotation, and citation omitted]; see also Guz v Bechtel Natl., Inc., 24 Cal 4th 317, 349 [2000] [the implied covenant "exists merely to prevent one contracting party from unfairly frustrating the other party's right to receive the benefits of the agreement actually made" (emphasis in original)]; Foley v Interactive Data Corp., 47 Cal3d 654, 690 [1988] ["The covenant of good faith is read into contracts in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purposes"].)

These two principles—first, that the implied covenant applies where one party is afforded discretionary power; and second, that the implied covenant cannot vary express contractual terms—come into conflict when the terms of a contract expressly afford one party complete discretion over matters affecting the rights or interests of another party. The California Court of Appeal addressed this conflict in Third Story Music, Inc. v Waits (48 Cal Rptr 2d 747 [1995] [Third Story]). The Court observed that the implied covenant has been "applied to contradict an express contractual grant of discretion when necessary to protect an agreement which otherwise would be rendered illusory and unenforceable." (Id., at 752; see e.g. Perdue v Crocker Natl.

Bank, 38 Cal3d 913 [1985] appeal dismissed 475 US 1001 [1986] [applying covenant to limit bank's express contractual discretion to set "non-sufficient" fund charges to be paid by the customer]; California Lettuce Growers, Inc. v Union Sugar Co., 45 Cal2d 474 [1955] [reading implied covenant into contract that permitted buyer of sugar beets to set the price to be paid, where contract would otherwise have been illusory].) In such cases, "[i]nterjection of the implied covenant was 'indispensable to effectuate the intention of the parties' and was 'justified by legal necessity.'" (Third Story, 48 Cal Rptr 2d at 751 [brackets omitted], quoting Lippman v Sears, Roebuck & Co., 44 Cal2d 136, 142 [1955].) The implied covenant has also been used to reconcile an ambiguity created by two seemingly conflicting contractual provisions bearing on one party's discretionary power. (See Third Story, 48 Cal Rptr 2d at 751, citing April Enters., Inc. v KTTV, 195 Cal Rptr 421, 425 [Ct App 1983] [where contract permitted a party to erase tapes of a TV show produced by the other, but also gave the producer a right to sell the old shows in syndication, reversing dismissal of breach of contract claim based on erasure of tapes, and holding that, "[i]n the case of a contradictory and ambiguous contract . . . the implied covenant may be applied to aid in construction"].)

As the Third Story Court further reasoned, a "different result ensue[s] where the contract is unambiguous, otherwise supported by adequate consideration, and the implied covenant is not needed to effectuate the parties' expressed desire for a binding agreement." (Third Story, 48 Cal Rptr 2d at 752 [covenant did not limit defendant's unambiguous discretion to elect whether or not to market music, where defendant paid plaintiff adequate consideration in the form of an advance on royalties].) Reviewing several prior cases in which the California Court of Appeal did not apply the implied covenant, the Court noted that, in each case, "one of the parties was expressly given a discretionary power but regardless of how such power was exercised, the

agreement would have been supported by adequate consideration. There was no tension between the parties' express agreement and their intention to be bound, and no necessity to impose an implied covenant to create mutuality." (Id., at 753, citing Balfour, Guthrie & Co., Ltd. v Gourmet Farms, 166 Cal Rptr 422 [Ct App 1980] [covenant did not limit broker's unambiguous discretion to set price for purchase of grain after producer missed margin call, where broker paid a specified amount up front in consideration for contract]; Brandt v Lockheed Missiles & Space Co., Inc., 201 Cal Rptr 746 [Ct App 1984] [covenant did not limit employer's sole and final discretion under employment agreement to award employee a "Special Invention Award" for valuable invention, where contract, among other things, entitled employee to an additional non-discretionary award of $600]; Gerdlund v Electronic Dispensers Intl., 235 Cal Rptr 279 [Ct App 1987] [covenant did not limit party's right to terminate a sales representative agreement upon 30-days' notice, as notice requirement supplied sufficient consideration].)[14]

In sum, "courts are not at liberty to imply a covenant directly at odds with a contract's express grant of discretionary power except in those relatively rare instances when reading the provision literally would, contrary to the parties' clear intention, result in an unenforceable, illusory agreement. In all other situations where the contract is unambiguous, the express language is to govern, and no obligation can be implied which would result in the obliteration of a right expressly given under a written contract." (Third Story, 48 Cal Rptr 2d at 753 [internal quotation marks, brackets, ellipses, and citation omitted].) In recently reaffirming this analysis, the California Court of Appeal has reasoned: "Although it has been said the implied covenant finds particular application in situations where one party is invested with a discretionary power affecting the rights of another, if the express purpose of the contract is to grant unfettered

[14] This court's review of Balfour, Brandt, and Gerlund shows that such additional consideration existed in each case, although the Courts did not expressly refer to consideration as a basis for their decisions.

discretion, and the contract is otherwise supported by adequate consideration, then the conduct is, by definition, within the reasonable expectation of the parties and can never violate an implied covenant of good faith and fair dealing." (First Am. Title Ins. Co. v Spanish Inn, Inc., 191 Cal Rptr 3d 22, 27 [Ct App 2015] [internal quotation marks, brackets, and citations omitted]; Wolf, 76 Cal Rptr 3d at 597 [same].)

The court holds that section 5.1 of the Purchase Agreement unambiguously afforded Overland the sole discretion to decide whether and on what terms to settle the Patent Litigation. The first sentence of section 5.1 provides that Overland "shall use its commercially reasonable efforts to prosecute the Patent Litigation to a final and non-appealable judgment or to a final, definitive settlement as promptly as practicable." In contrast, the second sentence provides that Overland "shall have the right, in its sole discretion, to determine whether to settle the Patent Litigation and to determine the terms and conditions of any such settlement." These two sentences must be read in relation to each another, so that both have meaning and neither sentence is interpreted to negate or render the other superfluous. When read together, it is clear that the first sentence concerns Overland's duty to prosecute the Patent Litigation, while the second sentence concerns its authority to settle. The first, by its terms, imposed upon Overland a duty to prosecute the Patent Litigation with reasonable diligence. It thus barred Overland from acting in a manner that would frustrate or unreasonably delay resolution of the Litigation. The first sentence does not conflict with or render ambiguous the second, which clearly and expressly provided Overland with the right, "in its sole discretion, to determine whether to settle the Patent Litigation and to determine the terms and conditions of any such settlement." The Funds do not submit any extrinsic evidence that renders the meaning of section 5.1 ambiguous.

As the Agreement unambiguously afforded Overland sole discretion to decide whether

and on what terms to settle the Patent Litigation, Overland's actions are beyond this court's review unless the failure to imply a covenant of good faith and fair dealing at odds with the express language would render the Purchase Agreement illusory and unenforceable. Overland does not contend that the Funds' $3 million investment in Overland under the Purchase Agreement was supported by any consideration other than the 20% interest the Funds received in the Patent Litigation and their right to a $6 million payment upon the occurrence of a Specified Transaction. Overland indisputably had the power, under the Agreement, to deprive the Funds of any return on their investment. Under the circumstances, the court finds that an implied covenant of good faith and fair dealing must be read into the Agreement, notwithstanding the unambiguous language of section 5.1. This covenant prohibited Overland from exercising its settlement authority in bad faith to prevent the Funds from deriving anything of value from their investment. The court accordingly turns to the question of whether a genuine issue of material facts exists for trial.

The evidence submitted by Overland shows that it extensively prosecuted the ITC proceeding between October 19, 2010, when the complaint was filed, and May 28, 2013, when a full panel of the ITC terminated the proceeding. (JS, ¶¶ 5, 32.) This prosecution included a trial in August and September of 2011 (id., ¶ 31) and significant motion and appellate practice thereafter. (See generally Notice of Commission Decision, dated May 28, 2013 [JS, Exh. E] [detailing the procedural history of the ITC proceeding]; JS, ¶ 32 [the parties' stipulation that the Notice of Commission Decision "accurately describes the relevant rulings" of the ITC authorities].) The district court action was stayed from December 2010 through July 2013, pending a final determination of the ITC proceeding (JS, ¶ 30), and again from February through August 2014, pending inter partes review by the USPTO. (Id., ¶ 33.)

The evidence submitted by Overland further shows that Overland and BDT renewed settlement negotiations in January or February 2014 (JS, ¶ 34), and that these settlement negotiations continued over a six-to-seven-month period, until Overland and BDT entered into a Patent Cross-License and Settlement Agreement on July 30, 2014. (The Settlement Agreement [Hampson Aff. In Opp., Exh. Y].) Overland submits deposition testimony from its CFO, Kurt Kalbfleisch, and from its counsel in the Patent Litigation, Sean Cunningham, that during settlement negotiations, representatives of BDT repeatedly represented that BDT was having financial difficulties and would be unable to pay a cash settlement, and were unwilling to engage in any discussion of such a financial resolution. (See Kalbfleisch Dep., at 46-47 [Rudzin Aff. In Supp., Exh. G]; Cunningham Dep., at 53 [Rudzin Aff. In Supp., Exh. H].) Overland also became aware that "BDT was entering into certain public agreements to take out debt," which "made it appear that they were not a cash-heavy company." (Kalbfleisch Dep., at 47.)

Kalbfleisch testified that Overland therefore began to consider the possibility of a no-cash settlement. He testified that he had multiple meetings with BDT "to determine what may be most beneficial to Overland in regards to settling the litigation, and what we could receive in return for that settlement." (Kalbfleisch Dep., at 77.) He specifically testified about a meeting with BDT during which the parties "discussed their [BDT's] product set, their product offerings, both historical and potential. We discussed how that would fit into our portfolio, what products it might replace in our portfolio, the necessary pricing and costing items that would have to be in place, the specific types of interfaces and drives and other things that would need to be available if we were to move forward, as a key component of the settlement." (Id., at 76.)

The terms of the Settlement Agreement that Overland and BDT ultimately entered into on July 30, 2014 "included, among other things, Overland and BDT each granting to the other an

irrevocable, nonexclusive, royalty free, worldwide license to the other parties' patents and patent rights related to tape-based solutions." (JS, ¶ 35; Settlement Agreement, §§ 2.1-2.2.) Kalbfleisch testified that he considered this resolution beneficial to Overland because it would enable Overland, among other things, to use BDT's products and technology. For example, Kalbfleisch testified that, at the time of the settlement negotiations, Overland and Tandberg (which Overland had recently acquired) had "tape libraries [that] were very old." (Id., at 67.) Tandberg, in particular, was "having trouble keeping up with the technology." (Id.) "BDT, on the other hand, had been developing tape libraries for some time . . . ." (Id.) The BDT settlement allowed Overland to use BDT's "newer tape libraries . . . [to] replace not only the Overland products in that space, but also the Tandberg products . . . ." (Id., at 67-68.)

The court holds that this evidence makes a prima facie showing that Overland exercised its discretion in good faith in settling the Patent Litigation, and is therefore entitled to summary judgment dismissing the implied covenant cause of action. In opposition, the Funds fail to raise a triable issue of fact on this cause of action.

As a threshold matter, the court rejects the Funds' contention that Overland improperly "abandon[ed]" the Patent Litigation. (See Pls.' Memo. In Opp. To Defs.' Motion, at 20 [arguing that Overland "threw in the towel without any litigation in the district court beyond the pleadings"].) This contention simply ignores that Overland had a right, under section 5.1 of the Purchase Agreement, to settle the Litigation in lieu of continuing to prosecute it. To the extent that the Funds rely on press releases issued by Overland after the adverse ITC determination to support their claim that Overland should have continued the litigation in the district court, this contention is unpersuasive. These releases characterized the decisions of the ITC as not entirely negative to the company and stated that Overland would continue to pursue its claims in the

district court case. The releases appear to reflect the kind of posturing that one might expect to see after a defeat in a significant litigation.[15]

More important, Overland was not required, under section 5.1 of the Purchase Agreement, to litigate rather than settle its patent claims, and the Funds make no evidentiary showing in support of their contention that the value of the settlement was "illusory" or less than the value Overland could have achieved through further litigation or negotiation. (See Pls.' Memo. In Opp. To Def.'s Motion, at 24.) The Funds merely assert that the Settlement Agreement provided for "an illusory exchange of patent licenses." (Id.) Although they had the opportunity to do so, they fail to submit any expert opinion on this critical issue of the value of the settlement and, in particular, the value of the cross-license to Overland. They also fail to address Overland's testimony that at the time of the 2014 settlement, BDT's newer tape libraries were useful to replace Overland's aging technology.

Rather than submit probative evidence of the value of the settlement, the Funds rely on long-outdated projections of Overland's potential recovery in the Litigation and prior, unaccepted settlement offers by Overland. For example, the Funds rely on a presentation from Overland's counsel in September 2010—created at the inception of the ITC proceeding, prior to the adverse determination, and almost four years prior to the settlement—which valued the

[15] For example, the Funds submit a press release, dated June 25, 2012, which was issued shortly after the ITC administrative law judge issued its Initial Determination. It appears from the face of the press release that it was issued in order to correct inaccurate reports that the administrative law judge had "found no infringement." The release notes that "[t]here are additional legal requirements to find a Section 337 violation that are not requirements in finding infringement of a valid patent in a federal district court lawsuit," and quotes Overland CEO Eric Kelly as stating that "'[w]e understand that the full Initial Determination of the ITC contains positive news for our ongoing litigation.'" Kelly further stated that "'Overland plans to continue its lawsuit against BDT both in the ITC and in federal district court.'" Finally, the release notes that "the Initial Determination is not a final resolution of an ITC action." (Hampson Aff. In Opp., Exh. P.) Another press release, dated May 30, 2013, was issued just after the ITC panel's Notice of Decision. The release notes that the Notice of Decision "does not preclude Overland Storage from continuing to assert several claims . . . against BDT in [district court] . . . ," and quotes Overland's patent counsel as saying "'[w]e believe that BDT continues to infringe valid Overland Storage patents, and we will pursue those claims promptly in the pending district court case.'" (Hampson Aff. In Opp., Exh. N.)

Patent Litigation between $50 and $500 million. (Case Summary [prepared by DLA Piper], at 7 [Hampson Aff. In Opp., at I].) They also rely on a December 2011 settlement proposal by Overland—apparently rejected by BDT—which called for BDT to make an initial upfront payment of $10 million and to pay certain rebates and cash royalties for several years thereafter. (See Hampson Aff. In Opp., Exh. M.) They do not dispute Overland's testimony as to BDT's financial condition prior to the settlement, although they had the opportunity to seek discovery in that regard. They also do not make any attempt to explain how the prior settlement proposals continued to be viable in light not only of BDT's financial condition,[16] but also of the adverse ITC determination. If anything, BDT's rejection of Overland's December 2011 settlement proposal, for $10 million, supports Overland's testimony that BDT was unwilling to engage in a financial resolution of the Patent Litigation.

Finally, the Funds claim that a triable issue of fact on the implied covenant claim is raised by the "suspicious timing" of the settlement in relation to the closing of the Sphere Transaction. The Funds appear to contend that Overland required that the settlement of the Patent Litigation be completed before the closing of the Sphere Transaction, thereby preventing the occurrence of a Specified Transaction. (See Pls.' Memo. In Opp. To Defs.' Motion, at 24.) This speculative contention rests entirely on a series of emails between Kalbfleisch and Overland CEO Eric Kelly, and between Kalbfleisch and BDT's negotiator Holger Rath, discussing BDT's need for shares "tradable immediately," rather than Overland's shares, in return for its cash investment in Overland as part of the settlement of the Patent Litigation. (Hampson Aff. In Opp., Exh. T.) In the emails, Rath proposed postponement of the closing of the settlement until early October

[16] Kalbfleisch and Cunningham testified at their depositions that Overland was not aware of BDT's financial condition in 2010, when DLA Piper's presentation was generated. (Kalbfleisch Dep., at 45-47; Cunningham Dep., at 53-55.)

2014, after the expected merger of Overland with Sphere 3D "will have been realized . . . and tradable shares are available." (Id.) Kalbfleisch opposed the delay in closing the settlement as "problematic," but set forth a proposal for selling BDT shares of Sphere 3D and, in the event the Sphere Transaction did not take place, providing for Overland to issue registered shares to replace the Sphere 3d shares. (Id.)

The emails do not on their face refer to the Purchase Agreement or to any potential liability on the part of Overland to the Funds. Moreover, although the Funds had the opportunity to depose the parties to the emails, they do not submit any testimony or documentary evidence to show that the discussion of the Sphere Transaction in the emails related to anything other than BDT's need for immediately tradable shares, or that Overland's responsive proposal was designed to avoid a Specified Transaction and any payment to the Funds.[17] It is noted that the emails were exchanged several weeks after the execution of the Settlement Agreement, and that the Sphere Transaction did not ultimately close until December 2014, two months after the postponement proposed by BDT.

The Funds' opposition to Overland's prima facie showing that it exercised good faith in settling the Patent Litigation ultimately amounts to nothing more than speculation based on the

[17] In response to BDT's email informing Overland that it needed immediately tradable shares, Kelly informed Kalbfleisch as follows:

> "We need to get back to them with the following:
> 1. This needs to be done in order to close out the litigation. 2. We should structure the agreement so they take the S3D shares instead. We will just have to deal with the strategic positioning took around the partnership. Find out when we need to announce the transaction. If we are not required to announce the transaction [sic]. If we can push it to October we will be fine because we will be announcing the tape deal which will be much more strategic." (Hampson Aff. In Opp., Exh. U.)

The Funds characterize this email as one in which "Kelly directed Kalbfleisch to press on with the BDT settlement quickly 'in order to close out the [Funds'] litigation.'" (Pls.' Memo. In Opp. To Def.'s Motion, at 25 [emphasis in original].) This reading is not defensible in the context of the entire email chain. Kelly's statement can only refer to the Patent Litigation, not the Funds' claims against Overland, which are not mentioned anywhere in the chain.

timing of the settlement in relation to the closing of the Sphere Transaction. Absent any evidence that the settlement lacked adequate consideration, the Funds fail to raise a bona fide issue of fact for trial. The third cause of action, for breach of the implied covenant of good faith and fair dealing, will therefore be dismissed.

The court has considered the Funds' remaining arguments and finds them unavailing. It is accordingly hereby

ORDERED that the motion for summary judgment of plaintiffs Special Situations Fund III QP, L.P., Special Situations Private Equity Fund, L.P., Special Situations Technology Fund, L.P., and Special Situations Technology Fund II, L.P. is denied; and it is further

ORDERED that the motion for summary judgment of defendant Overland Storage, Inc. is granted and the amended complaint is dismissed in its entirety with prejudice; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: New York, New York
September 27, 2017

MARCY FRIEDMAN, J.S.C.