IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

KFC NATIONAL COUNCIL AND ADVERTISING COOPERATIVE, INC.,	)	
Plaintiff,	)	
v.	)	C.A. No. 5191-VCS
KFC CORPORATION,	)	
Defendant.	)	

MEMORANDUM OPINION

Date Submitted: November 13, 2010
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STRINE, Vice Chancellor.

I. Introduction

Defendant Kentucky Fried Chicken Corporation ("KFCC") and its franchisees are at odds over the authority the KFC National Council and Advertising Cooperative ("NCAC") has to determine the national advertising strategy for the KFC brand. KFC is, of course, the moniker inspired by Colonel Harland Sanders' famous creation, Kentucky Fried Chicken.[1]

The NCAC[2] is a non-stock corporation that was founded over forty years ago and is licensed and authorized to serve as the advertising arm for the KFC brand in the United States, deploying advertising funds raised from KFC franchisees as part of their franchise agreements with KFCC. In lieu of a board of directors, the NCAC Committee (the "Committee") serves as the NCAC's governing body and consists of seventeen members, thirteen franchisee representatives and four KFCC representatives. The NCAC has at least two major functions relevant to this dispute: the generation of advertising plans for the KFC brand and the approval of specific KFC advertisements. Central to the current dispute is a disagreement between KFCC and its franchisees about who has the authority

[1] As a matter of reality, Kentucky Fried Chicken draws its distinctive qualities not simply from the Colonel's secret blend of eleven herbs and spices, but also from the fact that Kentucky Fried Chicken is fried under pressure. In the late 1930s, the Colonel was introduced to a "new-fangled gizmo," the pressure cooker. At the demonstration of the pressure cooker, the Colonel witnessed green beans perfectly cooked in just minutes and thought that he might be able to adapt the pressure cooker so that it could fry chicken under pressure (i.e., make the pressure cooker a pressure fryer). He succeeded, and to this day, although there are several different kinds of cookers used to make Original Recipe chicken, they all fry under pressure and are the reason that the breast meat of Kentucky Fried Chicken remains moist. *See* http://www.kfc.com/about/pressure.asp.

[2] The predecessor organization to the NCAC, the National Cooperative Advertising Program, was referred to as the "NAC." For purposes of this opinion, I will use "NCAC" to refer to both the current National Council and Advertising Cooperative and its predecessor, the National Cooperative Advertising Program.

over the first of those two major functions at the NCAC — the generation of advertising plans for the KFC brand.

KFCC claims that the NCAC certificate of incorporation (the "Certificate") creates a power sharing arrangement between itself and the franchisee-dominated NCAC. In KFCC's view, it has the sole authority to develop advertising plans and present them to the Committee for its approval. KFCC concedes that the NCAC Committee has the authority to accept or reject those plans in total, but says that the NCAC Committee may not amend those plans over KFCC's objections and implement the amended plan. Rather, as KFCC sees it, if KFCC and the NCAC disagree, a stalemate results and KFC advertising will cease until KFCC and the NCAC overcome their differences. Put simply, in KFCC's view, the NCAC certificate reflects a joint venture between the NCAC and KFCC in which each has an equal say.

By contrast, the franchisees (who appear before this court as the plaintiff NCAC, using their majority control of the Committee to cause the NCAC to bring this action)[3] argue that the NCAC is, in large measure, a corporation like any other. As a consequence, the franchisees argue that the NCAC Committee, like any other corporate board, retains the ultimate authority to manage the corporation. In the case of the NCAC, the major function of the corporation is to determine the advertising plans and strategy for deploying the funds raised from franchisees to promote KFC. Although the

[3] Because this dispute over how the NCAC should operate is one between two of its member-constituencies, KFCC and the franchisee-designated members of the Committee, I refer to the plaintiff NCAC as the franchisees in terms of describing the parties' arguments. In reality, this case is a dispute between KFCC, as franchisor, and its franchisees.

franchisees concede that KFCC bargained for the sole authority to hire, fire, and direct KFC's national advertising firm, they argue that KFCC's singular authority stops there. Although as a practical matter, the franchisees concede that KFCC's proposals and plans will be extraordinarily influential in the process of finalizing the NCAC's annual advertising plans, the franchisees argue that the NCAC Committee has the authority to modify KFCC's proposals, consider alternatives proposed by the NCAC Committee members and NCAC staff, and to implement by majority vote an advertising plan that KFCC does not approve.

In December 2009, KFCC and the franchisees came to an impasse over certain advertising issues, with the Committee purporting to adopt plans over the objections of its KFCC-designated members. When the parties were unable to resolve their differences, the franchisees caused the NCAC to bring this suit. Each party now seeks declaratory relief determining that the NCAC's affairs should be governed as it wishes.

To support their divergent perspectives, KFCC and the franchisees introduced at trial decades of parol evidence relating to the drafting of the NCAC's Certificate and to the parties' course of performance under that Certificate. Because the NCAC's Certificate is ambiguous and was the product of actual negotiation between KFCC and the franchisees, that evidence must be considered in determining which side prevails. After considering the words of the Certificate and the parol evidence, I find that the franchisees' position is the more convincing one.

Although the language of the NCAC Certificate is ambiguous, the reading given that language by the franchisees is the more natural one. Likewise, although the parol

evidence is itself more Mississippi mud brown than Menemsha blue in clarity, that evidence on balance supports the franchisees' position. The NCAC has never functioned in the rigid manner that KFCC advocates, and the NCAC Committee has on several occasions modified KFCC proposals over KFCC's objections. Finally, in coming to my conclusion, I also give weight to the notion that a corporate charter will not be easily read to disenfranchise the corporation's electorate, or in this case by analogy, its franchisee constituents who control a majority of the corporation's governing body — i.e., the NCAC Committee. In a situation where a particular stockholder or member of a corporation, such as KFCC, seeks to retain veto authority over the corporation's ability to manage its own affairs, the stockholder or member seeking veto authority should obtain clear language in the certificate to that effect. Although I have considered the parol evidence in this case because the NCAC Certificate was the product of specific, arm's length bargaining, the interpretative principle disfavoring disenfranchisement has residual relevance. Unless the parol evidence clearly and convincingly supports the disenfranchising reading, the court should avoid giving effect to such a reading. To do otherwise would defeat the reasonable expectations of the corporation's electorate, which should not face disenfranchisement in a situation where the certificate can reasonably be read either way and where the bargaining and performance history do not clearly and convincingly deny the electorate, or in this case, the electorate's governing board, the authority to decide the matter.

Here, both the language of the Certificate and the parol evidence incline in the franchisees' favor, and KFCC seeks an interpretation that would deny the NCAC

Committee the typical authority belonging to a corporate board. As a result, I will enter a declaratory judgment in favor of the NCAC as the franchisees seek.

II. An Overview Of KFCC's Relationship With The NCAC

The current dispute has its roots in the early days of Kentucky Fried Chicken. Like many fast food restaurant chains, KFC depended on franchising as the means by which to expand its sales and markets. What franchising means in simple terms is that local operators apply to become KFC franchisees and to own and operate particular KFC stores under contracts with KFCC. Franchise contracts set forth the benefits and burdens the parties will bear under the contract, such as the responsibility to share revenues and, in the case of KFC, to put certain funds toward advertising that would benefit the KFC brand nationally.

Although this case is about the interpretation of the NCAC Certificate, the fundamental question is the extent to which the NCAC Certificate constitutes a contract whereby the NCAC subjected its own freedom of action to a veto by KFCC in exchange for the overall benefits that franchisees reap from their relationship with KFCC, as the franchisor and as the entity that provides the energy behind the creation of new KFC products and the promotion of KFC as an international brand.

The importance of the franchisor-franchisee relationship to KFCC is easily grasped by considering the way KFCC conducts its affairs. KFCC is a subsidiary of Yum! Brands, Inc.[4] and oversees approximately 15,000 Kentucky Fried Chicken

[4] Yum! also owns Pizza Hut and Taco Bell among other brands, and is the world's largest restaurant company with over 37,000 restaurants worldwide and nearly $11 billion in revenue in

restaurants in 109 countries around the world that serve more than 12 million people a day. But, in the nation relevant to this case, the United States, KFCC does business mainly as a franchisor, operating only about 900 of its approximately 5,100 domestic locations, with the remaining 4,200 operated by 650 franchisees. KFCC is planning to further reduce the number of U.S. stores that it owns, planning on owning only about 250 stores ultimately.[5]

As a result, KFCC derives the bulk of its revenues in the United States from its contractual entitlement to a share of the gross revenue of its franchisees. Under the agreements that it has with franchisees, KFCC receives a percentage (4%) of the gross revenue of each franchise.[6] But with the risk-reduction and flexibility that comes with franchising come burdens. Because franchisees make important, long-lasting investments of their own, they also seek contractual protections of their own.

The NCAC is a manifestation of that franchisor-franchisee give and take. The NCAC is a Delaware non-stock corporation[7] funded by a mandatory contribution of 3% of total sales from every domestic KFC store (including the KFCC-owned stores). Currently, that assessment yields an annual budget approaching $150 million. The lion's share of that budget is used to purchase national advertising for the KFC brand. The

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2009. *See* http://www.yum.com/company/ourbrands.asp. For those who sometimes indulge in guilty pleasures, the combined KFC/Taco Bell drive thru lanes that emerged after Yum consolidated Taco Bell and KFC constitute one of the more easily inhaled, if not digested, examples of a transactional synergy. The Colonel? A burrito? Why choose when you can have both! Another note on Yum, I hereafter drop the "!" from Yum. For attentive readers, the constant appearance of false exclamation is dispiriting, enervating, misleading, and optically annoying.

[5] Tr. at 1396 (Novak).

[6] JX-180 Ex. F ("1976 (5P) KFC Franchise Agreement") at KFC0013888.

[7] Pre-Tr. Stip. at 1.

NCAC is licensed to use the KFC brand in its advertising, so long as that use is in "good taste and consistent with the then current Bylaws of the NCAC."[8]

The very fact that the NCAC exists demonstrates that KFCC either did not have or did not use the leverage to dictate that its franchisees pay it 3% for KFCC to use in its discretion to advertise the KFC brand. Instead, the NCAC was rather obviously formed because the franchisees demanded, and KFCC accepted, a large role for them in determining how the funds they were providing for national advertising were used. And the current form of the NCAC Certificate was specifically negotiated as part of the resolution of a larger dispute about franchisor-franchisee relations. That negotiated resolution was consummated in 1997 and refined, but did not create in the first instance or eliminate the NCAC's central role in KFC advertising.

Rather, the 1997 compromise left the NCAC and therefore the franchisees with an important role in shaping KFC advertising strategy. In resolving the current dispute, it is useful to understand what cannot be fairly disputed about the respective roles of the NCAC and KFCC in national advertising of the KFC brand.

For starters, the franchisees determine a super-majority of the seats on the NCAC's governing body. The board of directors of the NCAC is called the "Committee," and consists of seventeen voting members.[9] Of the seventeen Committee members, four are appointed by KFCC, twelve are elected by the franchisees by region, and one is the President of the Association of Kentucky Fried Chicken Franchisees, Inc.

[8] DX-2334 (Trademark Agreement Between KFCC and NCAC (November 1, 2004)).
[9] Pre-Tr. Stip. at 2.

("AKFCF"), who serves *ex officio*. The breakdown of votes on the seventeen person Committee, therefore, is thirteen to four in favor of the franchisees.

This Committee composition is, of course, not the entire story. For KFC advertising to actually air, a lot of planning and other work has to be done. As a matter of business reality, this makes the NCAC and franchisees heavily dependent on KFCC for expertise and staff work. Traditionally and currently, the NCAC has a bare-bones staff, which would not be capable of doing all the work necessary to develop and implement a national advertising program for a major brand like KFC.

KFCC also is the entity where product development and refinement primarily occur. Although franchisees can decline to offer some products that KFCC offers, KFC franchisees may not sell products not authorized for sale by KFCC. This is not to say that franchisees do not come up with useful ideas. They do and have, coming up with ideas such as the signature "bucket," but KFCC is the entity where dedicated staff exists to refine existing product offerings and develop new ones.

As we shall see, one of the factors driving the current dispute is a disagreement about how best to position KFC for growth in today's market. As trends and tastes change, consumers may come to view an old favorite as not fitting their current preferences or as not addressing their decision to try to change their preferences in favor of more healthy alternatives. KFCC as an entity has a large number of professionals looking at KFC's product offerings with a view toward keeping KFC competitive, relevant, and growing. KFCC also has professionals in various areas, charged collectively with charting a direction for KFC's future, not just as a U.S. brand, but as an

international one. In that mix as an important ingredient, of course, is how one uses advertising not only to drive current sales but to create an image of KFC as a restaurant chain with products that meet the diverse needs of current consumers. In the same vein, KFCC has managers who are well-positioned to retain and oversee the performance of the advertising firms that do the ultimate creative work in producing advertisements of various kinds for KFC. By contrast, the NCAC has a total of six staff members, who lack the collective capacity to perform the necessary work to prepare and finalize a top-class advertising program for KFC.

In their more measured moments, the franchisees' arguments acknowledge that KFCC, as a practical matter, has to play a leading role in developing and implementing the NCAC advertising program. But they say that is accomplished by imposing on KFCC the role, or in stronger terms the duty, to provide the NCAC Committee with input on program development and implementation, while leaving to the NCAC Committee the ultimate authority to determine the elements of that program. By contrast, KFCC argues that its unique expertise and interest as the actual owner of the KFC brand gives it the ability to block any advertising program proposed by the NCAC Committee that it does not support.

To address the current rift, one more background issue is useful to note. Without going into precise detail about all the many parts required to develop and implement KFC's annual advertising strategy, suffice it to say that the parties agree that KFCC plays the major staff role in bringing to the Committee, and we shall see, its subcommittees, various budget and calendaring and creative proposals that, when finalized, result in the

annual advertising plan. There are myriad decisions that go into this, and the plan when finalized is subject to alteration to meet evolving business conditions. For now, what is crucial is that to move forward the Committee must approve the plan and any amendments to it.

To determine the ultimate question of whether the Committee may approve a plan KFCC does not endorse, one must begin where any contract case does, with the basic dispute giving rise to the case and then a consideration of the relevant contractual text.

A. The Emergence Of The Current Dispute

In the fall of 2009, the relationship between KFCC and the NCAC soured as KFCC and its franchisees clashed over the course the KFC brand should chart in the face of increased competition and sluggish sales. The divergence in views that led to the current conflict began in the middle of 2008.

In May 2008, KFCC named Roger Eaton its new President, replacing Gregg Dedrick. Eaton, a self-described consensus builder, had spent the previous eight years as the head of operations for the South Pacific Division of Yum.[10] After beginning his new job at KFCC, Eaton was involved in two important decisions that caused the relationship between the franchisees and KFCC to deteriorate and ultimately led to the filing of this lawsuit.

First, along with Yum Chairman and former KFCC President David Novak, Eaton spearheaded the introduction of Kentucky Grilled Chicken. Second, Eaton led an effort to restructure and streamline the NCAC's subcommittees.

[10] Tr. at 1053 (Eaton).

1. The Introduction Of Kentucky Grilled Chicken

When Eaton took over as President, KFCC had fallen on rough times. KFCC's share of the fast food restaurant industry[11] had decreased nearly ten percent in the last decade,[12] and its share of the chicken segment of that market had decreased even more.[13] KFCC identified three core reasons why it believed that sales were flagging: concerns about the healthiness of KFC products; the value consumers received for their money; and the ability of consumers to easily eat KFC products while driving in their cars (i.e., portability).[14] Both Novak and Eaton saw the launch of the new Kentucky Grilled Chicken as a crucial part of KFCC's attempt to address consumers' health concerns by introducing to the market a chicken product that tasted like Original Recipe Kentucky Fried Chicken but that was lower in calories, cholesterol and fat.[15] To that end, KFCC and its franchisees expended large amounts of resources in connection with the launch of Kentucky Grilled Chicken.[16]

The launch of Kentucky Grilled Chicken was successful,[17] and the franchisee members on the NCAC Committee initially supported the product, approving a Kentucky Grilled Chicken-focused advertising plan beginning in May 2009.[18] The franchisees

[11] The parties have used the Orwellian term "quick serve" restaurant industry, supposedly to emphasize that although the food is quickly served, it is not necessarily made "fast." I adhere to the common nomenclature.
[12] PX-1168 at KFC0131658.
[13] *Id.*
[14] Tr. at 1068 (Eaton); DX-2538 at NCAC0075835.
[15] Tr. at 1382-83 (Novak); *id.* at 1068 (Eaton).
[16] Tr. at 1371 (Novak).
[17] Tr. at 1103 (Eaton).
[18] JX-237 at NCAC0003760.

praised KFCC for delivering a 2009 advertising calendar that was "common sense logical, operationally linked tactically, and amazingly strategic. . . ."[19]

But the honeymoon period for Kentucky Grilled Chicken was short-lived. By July 2009, sales had started to decline,[20] and the franchisees began to grow restless over what they perceived as KFCC's single-minded approach to pushing grilled chicken to the exclusion of KFC's core product, fried chicken, a mindset they referred to as "grill, baby, grill."[21] Although the franchisees recognized the utility of having a product like Grilled Chicken, many of them were long-time franchisees who believed that, for better or worse, many of KFC's customers were mainly hungry to purchase good old-fashioned Kentucky Fried Chicken, with any deviations from the traditional being more in the direction of Extra Crispy than Extra Healthy. They feared that an obsession over Grilled Chicken could harm sales to core customers.

At the August 25, 2009 NCAC meeting, tension between KFCC and its franchisees over this issue grew. At that meeting, Eaton presented extensive market research about the launch of Kentucky Grilled Chicken and why it was important given the brand's three core problems of healthiness, value, and portability. Eaton's presentation began with the statement that "[t]he KFC business is in serious trouble," and was intended as a wake-up call to the franchisees.[22]

[19] DX-2453 (Email from Pete Wasilevich to members of the NCAC (September 9, 2008)).
[20] Tr. at 1124 (Eaton).
[21] Tr. at 851 (Harris); Tr. at 41 (Neal).
[22] DX-2538 at NCAC 0075833.

The franchisees' reaction to Eaton's presentation was not what KFCC and Eaton had hoped. Instead of sparking dialogue or debate about the future of the brand, Eaton's presentation was met with "very little engagement."[23] In fact, Eaton observed two franchisees sleeping.[24] Following that presentation, KFCC presented a commercial for the "M9 Advertising Window" — M9, module 9, presumably named for September, the ninth month, was set to begin on August 30 —[25] that KFCC had recently instructed the national advertising agency to develop. The topic approved by the NCAC for that M9 window was four $1.99 value boxes and a "snacker."[26] The commercial that KFCC showed to the franchisees at the August 25 meeting, however, featured only one of the value boxes, a Grilled Chicken value box. Eaton explained to the franchisees that KFCC had originally instructed the advertising agency to include all four value boxes and the snacker in the fifteen second commercial but that the result was a mess given the commercial's length.[27] Franchisee members were skeptical of that response and felt like Eaton was pushing Grilled Chicken at the expense of other products the franchisees viewed as appealing.

The Committee therefore refused to approve the commercial for the M9 window that featured only the Grilled Chicken value box. In response, the KFCC representatives left the meeting and the KFC brand was on the brink of "going dark" and having no national advertising on the air for the upcoming M9 window. To avoid that problem and

[23] Tr. at 1108 (Eaton).
[24] Tr. at 1107 (Eaton).
[25] PX-1273 (Minutes of NCAC Meeting (August 27, 2009)).
[26] Tr. at 1018 (Eaton).
[27] Tr. at 1110 (Eaton).

the loss of millions of dollars of already-committed media purchases,[28] the Committee held a telephonic meeting on August 27, 2009 at which it approved KFCC's commercial for airing in the M9 window.[29] But the franchisee Committee members felt ill-used and coerced into that decision, widening the rift between themselves and KFCC.

2. Eaton's Attempts To Restructure The NCAC

The tension over Grilled Chicken was not the only issue dividing the franchisee members of the Committee and KFCC. Certain of the franchisee members place a high value on their role in the NCAC and, I perceive, the power and influence they wield as Committee members. Some of these franchisee members have been in the KFC family for generations, are quite confident in their own sense of what is good for KFC, and enjoy the perquisites and processes that come with being an NCAC Committee member. For lawyer readers, the best analogy is those of our colleagues who spend lots of time ascending the ladder on local and national bar association committees, and who then seek another committee chair when they are mandated to leave the leadership of another. Although their initiative is invaluable, it can also result in a labyrinth of committees and a proliferation of process steps for the organizations they serve.

After taking over as President of KFCC, Eaton became frustrated with what he viewed as the cumbersome bureaucracy of the NCAC and in particular its subcommittee structure. Under the NCAC bylaws, the Vice Chairman, a franchisee representative, had

[28] PX-1273 (Meeting Minutes of Telephonic NCAC Meeting (August 27, 2009)).
[29] *Id.*

the power to create subcommittees.[30] Over the years, various subcommittees had been formed and by the time Eaton took over the reigns of KFCC, the NCAC had twelve subcommittees.[31]

Eaton understandably viewed that unwieldy subcommittee structure as an obstacle to the agile and efficient decision-making necessary to develop, implement, and adapt an effective advertising plan in the competitive fast food restaurant industry.[32] Eaton was frustrated by the fact that KFCC needed to make repetitive presentations to multiple subcommittees that often had overlapping membership. On October 28, 2009, the NCAC Committee met again by phone. At that meeting, Eaton proposed to change the subcommittee system so that KFCC could make one comprehensive presentation to all of the subcommittees involved in advertisement and marketing.[33] Eaton suggested that the NCAC try KFCC's suggestion at the next subcommittee meetings scheduled for November 18 and 19.

At that November 18-19 meeting, KFCC came prepared to present a comprehensive advertising and marketing plan to all of the subcommittees that needed to be involved at once. But, the franchisees had other ideas. The franchisees viewed the meeting as a regular "calendar subcommittee" meeting and refused to entertain or vote on any KFCC proposal that was not related to the calendar subcommittee's normal business.

[30] JX-187 (NCAC Bylaws) § 4.17. The Chairman of the NCAC, a title held by the President of KFCC, also had the power to create subcommittees.
[31] Pre-Tr. Stip. ¶ 12.
[32] Tr. at 1060-61 (Eaton).
[33] Tr. at 1036-37 (Eaton).

In response, KFCC notified the franchisees that it planned to present its proposals to the next full NCAC Committee meeting in December even though the subcommittees had refused to review its proposals.[34] The franchisees reacted to this threat by scheduling various subcommittee meetings before the December NCAC meeting was scheduled to occur.[35]

Those subcommittee meetings were held at the end of November and beginning of December, 2009. At those meetings, the franchisees made changes to KFCC's recommendations and circulated minutes of those meetings reflecting the changes.[36] KFCC was then informed that the franchisees were planning on voting on the changed recommendations at the full NCAC Committee meeting in December.[37]

3. Attempts To Avoid A Showdown And The Filing Of This Lawsuit

Eaton and KFCC felt strongly that the franchisee members should not be permitted a "formal right to recommend over [KFCC's] objection."[38] On December 7, 2009, Eaton met with David Sparks, the Vice Chairman of the NCAC, to try to avoid a showdown and work out a compromise. But Sparks and Eaton were unable to work out a deal at that meeting and Eaton directed KFCC's Chief Legal Officer to deliver a letter from KFCC's outside counsel to the franchisee members of the NCAC threatening legal action if the

[34] Tr. at 1656-57 (McKelvie).
[35] DX-2577.
[36] DX-2577.
[37] Tr. at 1661 (McKelvie).
[38] Tr. at 1138 (Eaton).

franchisees insisted on exercising a formal right to recommend proposals to the Committee different than those that KFCC recommended.[39]

Even after that letter was sent, KFCC and its franchisees continued to meet in an attempt to avoid a meltdown. On December 10, Eaton and Sparks met again and this time it appeared that they were able to strike a deal; Eaton and Sparks agreed in writing that KFCC would put aside the letter from its counsel and compromise on the subcommittee recommendations in exchange for the franchisees presenting a formal process to improve the subcommittees, and made a handshake agreement that the franchisees would not attempt a formal recommendation over KFCC's objection.

But that deal proved short-lived. KFCC and its franchisees on the NCAC were unable to agree on a compromise advertising proposal and at the NCAC Committee meeting on December 15, the franchisee members of the Committee brought a motion to change a recommendation to a KFCC proposal over KFCC's objection.[40] Eaton threatened to go "nuclear" if the franchisees insisted on pressing the motion and the franchisees backed down.[41]

Following that meeting, on December 18, 2009, the NCAC's outside counsel sent KFCC a letter outlining the franchisees' position that the NCAC Certificate did not grant KFCC the "sole authority" to make recommendations to the Committee.[42] On January 7, 2010, KFCC's outside counsel responded with another letter stressing the importance of

[39] PX-1304.
[40] Tr. at 1155 (Eaton).
[41] Tr. at 1156-57 (Eaton).
[42] PX-1308.

the issue to KFCC and KFCC's belief that the franchisees were violating the terms of the NCAC's Certificate by insisting on a formal right to recommend.[43] That same day, the NCAC filed this lawsuit.

4. The Parties' Positions

The parties disagree about KFCC's role at the NCAC. The essence of KFCC's position is that no advertising plan can be implemented without KFCC's consent. In other words, KFCC argues that it possesses an effective veto over the NCAC's advertising programs. KFCC's argument that it possesses a veto stems from its reading of the Certificate as granting KFCC the sole right to make recommendations to the NCAC and that the NCAC's authority is limited to either: 1) approving KFCC's recommendation; or 2) refusing to approve the recommendation, at which point KFCC would have to make another recommendation to attempt to achieve compromise and avoid having no national advertising on the air. On the other hand, the franchisees claim that the Committee of the NCAC can consider recommendations from any of its members and that those recommendations can be approved by a majority vote of the Committee regardless of whether KFCC made the recommendation or supports the recommendation.

III. Analysis

A. The Terms Of The NCAC's Certificate

The key provisions of the NCAC's Certificate are found in §§ 3.3 and 3.4. Those sections address the roles of KFCC and the NCAC Committee. Specifically, §§ 3.3 and 3.4 provide:

[43] PX-1313.

3.3 KFC Corp. Authority. Notwithstanding the foregoing provision of this Article III, KFC Corp. shall:

(a) have the sole authority to hire and fire the national advertising agency and public relations firm; to direct the national advertising agency in the creative development and production of commercials; and to direct the public relations agency to develop programs consistent with the Committee's strategic and calendar approval. Before hiring or firing the advertising agency or public relations firm, KFC Corp. will consult with and seek the endorsement of the Committee. KFC Corp. will explain its reasons, but Committee endorsement is not required, and the decision will be made by KFC Corp. at its discretion;

(b) develop national advertising, public relations and media plans and strategy, including advertising and media calendars and budget, and submit such plans for the approval of the Committee;

(c) recommend any changes in the advertising and media calendars and budget which it deems appropriate, which changes can only be implemented with the approval of the Committee;

(d) consistent with the advertising calendar approved by the Committee, develop all creative and produce all commercials within the Corporation's annual budget limits and submit accounting documentation for such development and production costs for the Committee's review; and

(e) manage the purchase of media for the placement of all national advertising, including schedule maintenance and media replacements, consistent with the media plan approved by the Committee.

3.4 Committee Authority. The Committee has the following authority:

> (a) to evaluate and approve all advertising, publicity and promotion programs of NCAC (all such programs to be in good taste and consistent and in accordance with the standards set by KFC Corp.) and to establish the fiscal policies relative thereto;
>
> (b) to plan and approve each ensuing year's advertising program within the limits of an estimated budget developed by KFC Corp. working with the Executive Director, based on projected contributions;
>
> (c) to review from time to time the performance of the advertising agencies and public relations firms employed by NCAC; to approve strategic direction, the advertising calendar, the media calendar, and NCAC budget; approve the total production budget; approve campaign strategy; approve national advertising prior to airing; approve all price points, piece counts, and promotions featured in national advertising; and
>
> (d) to perform all acts and functions granted to the Committee by the Certificate of Incorporation as amended or restated from time to time, and by the Bylaws and all acts reasonably related thereto.[44]

1. Section 3.3 And KFCC's Authority

Three of § 3.3's five subsections are not controversial. Section 3.3(a) contains the language giving KFCC the sole authority to hire, fire and direct the national advertising agency — an authority that neither party disputes. Sections 3.3(d) and (e) confer upon KFCC the similarly uncontroversial power to develop the creative aspects of the advertising and manage the media buy.

The remaining two subsections, §§ 3.3(b) and (c) are central to the parties' dispute. Section 3.3(b) mandates that KFCC "develop" advertising plans and submit

[44] JX-184.

those plans for the Committee's approval. Similarly, § 3.3(c) mandates that KFCC recommend any change in that advertising plan to the Committee for its approval. KFCC argues that those mandates preclude the franchisee members of the Committee from submitting plans or making recommendations for changes of their own.

2. Section 3.4 And The NCAC's Authority

Section 3.4 lays out the authority of the NCAC Committee and §§ 3.4(a), (b), and (c) and their relation to §§ 3.3(b) and (c) form the textual basis of the parties' dispute. Sections 3.4(a), (b), and (c) outline the Committee's authority with respect to the advertising program and calendar, and broadly grant the Committee approval rights over the NCAC's advertising programs. The subsections in § 3.4, like much of the rest of the Certificate, are not models of drafting clarity and are at least somewhat repetitive. For instance, §§ 3.4(a), (b) and (c) all use slightly different language to grant the Committee the authority to approve the advertising program. But, § 3.4(b) also grants the Committee the authority to "plan" the "advertising program" of the NCAC. Overall, the franchisees argue that nothing in § 3.4 suggests that the Committee is somehow limited in its ability to evaluate and approve plans that incorporate recommendations of franchisee-Committee members or that the Committee is otherwise restricted to only voting up or down KFCC proposals. In that respect, the Committee also notes that its ability to plan would be compromised if that were the case.

B. The Certificate Is Ambiguous

Certificates of incorporation and bylaws are interpreted using the standard rules of contract interpretation.[45] Thus, my first task is the usual one. I must examine the NCAC's Certificate and determine whether it is ambiguous.[46] If it may only be read in one reasonable way, I must give effect to that reading without considering the parol evidence. I turn to that task now.

A contract is not ambiguous because the parties disagree about its proper construction.[47] Instead, a contract is only ambiguous when "provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings."[48] A court may not look to extrinsic evidence to create an ambiguity in a contract but must instead confine itself solely to an examination of the contractual language itself to determine if an ambiguity exists.[49]

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[45] *Centaur Partners, IV v. National Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990) ("Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply."); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 172 (Del. Ch. 2005).

[46] *Matulich v. Aegis Commc'ns Group, Inc.*, 942 A.2d 596, 600 (Del. 2008) ("The starting point in construing any contract is to determine whether a provision is ambiguous, *i.e.*, whether it is *reasonably* subject to more than one interpretation.") (emphasis in original).

[47] *Rhone-Poulenc Basic Chems. Co. v. American Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992).

[48] *Id.*

[49] *O'Brien v. Progressive N. Ins. Co.*, 785 A.2d 281, 289 (Del. 2001) ("The duty of the courts is to examine solely the language of the contractual provisions in question to determine whether the disputed terms are capable of two or more reasonable interpretations. In so doing, Delaware courts are obligated to confine themselves to the language of the document and not to look to extrinsic evidence to find ambiguity.") (internal citations omitted).

If possible, a contract should be read so as to give effect to every term and not render any terms meaningless or superfluous.[50] In the NCAC's Certificate, the provisions of §§ 3.3 and 3.4, the provisions that bear directly on the division of power between KFCC and the Committee, are, to some extent, internally contradictory and overlapping.

For instance, in § 3.4(a), the Committee is given the authority "to evaluate and approve all advertising, publicity and promotion programs . . . ." This provision is difficult to reconcile with § 3.4(b), which gives the Committee the authority "to plan and approve each ensuing year's advertising program." Giving full effect to § 3.4(b) seems to render much of the language in § 3.4(a) meaningless or confusingly overlapping.

More problematic, § 3.3(b), dealing with KFCC's authority, also seems to conflict with § 3.4(b), which deals with the Committee's authority. Under § 3.3(b) KFCC "*shall* . . . develop national advertising, public relations and media plans and strategy, including advertising and media calendars and budget."[51] This sits uneasily next to § 3.4(b)'s grant of authority to the NCAC to "plan and approve" the advertising program.

Unsurprisingly, therefore, the parties read the key sections very differently.

The franchisees see § 3.3 as giving KFCC special authority in only one, albeit, very important area. The franchisees acknowledge that § 3.3(a) clearly vests KFCC with the "sole authority to hire and fire the national advertising agency and public relations firm; [and] to direct the national advertising agency in the creative development and

[50] *O'Brien v. Progressive N. Ins. Co.*, 785 A.2d 281, 287 (Del. 2001) ("Contracts are to be interpreted in a way that does not render any provisions "illusory or meaningless.").
[51] Emphasis added.

production of commercials . . . ."[52] But they note that the other subsections of 3.3 do not purport to grant KFCC any authority to the exclusion of the Committee. Rather, §§ 3.3(b) and (c), which address KFCC's role in developing and recommending changes to the advertising plans and calendars are written in a manner more suggestive of duty than of dominion. That is, the franchisees argue that those subsections are best read as requiring, or at the most enabling, KFCC to present advertising plans and other related recommendations to the Committee for its consideration. Nowhere, say the franchisees, does § 3.3 say that Committee members, including those from the majority selected by the franchisees, cannot make proposals of their own or suggest amendments to KFCC's proposals for adoption by the Committee. Indeed, because § 3.3(a) is careful to give KFCC "sole authority" as to hiring, firing and directing the national advertising agency, it would be unfaithful to the drafters' evident intent to read § 3.3 as granting a similar role as to KFC in the areas governed by §§ 3.3(b) and (c) where the words "sole authority" or even the word "authority" is not used in reference to the tasks described.

By contrast, KFCC says §§ 3.3 and 3.4 clearly carve out two related, but separate domains, of authority. In § 3.3 are all the functions that are to be exclusively performed by KFCC. The explanation for the use of the words "sole authority" in § 3.3(a), according to KFCC, is that is the one area where KFCC's authority is not subject to a check by the Committee. As to the hiring, firing and direction of the national advertising agency, KFCC is free to act unilaterally. As to the other areas covered by § 3.3, such as the development of advertising plans and calendars, KFCC is only given the singular

[52] JX-184 (Certificate) § 3.3(a).

power to "propose," with the Committee retaining the singular authority to "dispose" — hence, the difference between §3.3(a) and the rest of § 3.3.

Although KFCC admits that there are some words in § 3.4 that can be seen as undermining its position, such as the Committee's power under § 3.4(b) to "plan . . . each ensuing year's advertising program," KFCC says that those words do not obscure the overall clear allocation of functions between KFCC and the Committee. Under § 3.3, the only source of proposals for action by the Committee is KFCC itself. Although the Committee can engage in deliberations and study of KFCC's proposals, and in that sense engage in its own independent planning process, it is ultimately an approving authority under § 3.4. In KFCC's view, the overall allocation is clear and the word approval that is used in §§ 3.4(a), (b) and (c) must be read as limited to the narrow meaning of voting "up or down" on KFCC's proposals.

A close consideration of the language of §§ 3.3 and 3.4 as a whole does not, in my view, rule out either party's interpretation as unreasonable. KFCC's reading of the two contractual sections as creating a system of power sharing, whereby KFCC cannot implement its plans without approval of the Committee, and the Committee cannot impose its views on KFCC without KFCC's assent is plausible. After all, §§ 3.3 and 3.4 are both headed by titles suggesting that each outlines the authority of KFCC and the Committee respectively. Given that the NCAC exists to advertise a brand that is owned by KFCC and not the NCAC itself, a system whereby KFCC has sole power to propose under § 3.3 and the Committee has the sole power to dispose under § 3.4 is commercially sensible in the business context in which the parties operate. Moreover, the overall

linguistic thrust of § 3.4 is one plausibly consistent with this reading, because that thrust overwhelmingly emphasizes the role the Committee plays in approving the various proposals made to it, proposals addressed in § 3.3 as ones that KFCC shall bring forward.

But KFCC's reading is hardly compelled by the text. KFCC's vision of how the NCAC should function is quite rigid. In KFCC's view, neither the Committee nor any subcommittee of the NCAC may consider any item covered by § 3.3 unless that item is formally proposed by KFCC as an entity. Thus, any action by the Committee or a subcommittee must be on an initiative brought by KFCC. Therefore, the agenda of every meeting should largely consist only of items formally proposed by KFCC. If a KFCC motion fails, no action is taken unless KFCC itself reformulates a proposal and makes a new motion. Amendments by any member of the Committee would be out of order. Indeed, if § 3.3 is to be read as KFCC advocates, motions would not be in order through KFCC representatives on the Committee in that formal capacity. Rather, proposals and recommendations would come forth from KFCC as an entity and the KFCC Committee members would simply have a vote on the Committee like the other members.

I would expect such a power-sharing arrangement to be set forth with more specificity than is actually manifested in §§ 3.3 and 3.4. As the franchisees point out, this would be a rather unusual arrangement. By their plain terms, §§ 3.3(b) and (c) do not invest sole authority in KFCC to make proposals for consideration by the Committee. In fact, §§ 3.3(b) and (c) are written more in terms of obligation than power. The one provision of § 3.3 that is written as a singular authority of KFCC is § 3.3(a) and it is written with striking clarity when considered alongside subsections (b) and (c). Although

KFCC's explanation of this as a rare instance of an area where one of the parties — KFCC — has sole dominion and the other party — the Committee — has no role at all is not without force, that force is hardly overwhelming. The more mundane explanation that § 3.3(a) was a special deviation and carved out an area for special treatment, whereas the rest of § 3.3 simply set forth the role that KFCC was to play as the entity with the staff that would take the leading role in bringing forth proposals for consideration by the Committee, is equally if not more compelling. Indeed, as an overall matter, if I were to have to decide this case by only referring to the language of the Certificate, I would rule for the franchisees.

Taken as a whole, §§ 3.3 and 3.4 are best read as a power sharing arrangement that gives KFCC potent, but very limited authority over the business and affairs of the NCAC. KFCC and KFCC alone gets to hire, fire, and direct the national advertising agency. That means that KFCC has the incredibly important authority to dictate what advertising agency is used and to collaborate exclusively with that advertising agency about what specific commercials air. But KFCC's further argument that §§ 3.3(b) and (c) otherwise limit the ability of the Committee to adopt advertising plans different than what KFCC advocates is not supported by the text. Section 3.4 uses words such as "plan," and others that are suggestive that the Committee is expected to think for itself and adopt proposals that it, as a Committee run by majority rule, ultimately believes are best. As important, the composition of the Committee itself represents a power sharing agreement. If that agreement were as KFCC contends, a much more obvious way to implement KFCC's arrangement was available and not used. Section 3.4 could have simply made clear that

no action of the Committee in areas addressed by § 3.3 could be taken without the assent of the KFCC representatives. In fact, the drafters of the Certificate used exactly that approach elsewhere in the Certificate. Article X of the Certificate describes the procedures for amending the Certificate and requires the affirmative vote of a majority of the franchisee members *and* a majority of the KFCC members to amend certain provisions, including those found in §§ 3.3 and 3.4. The fact that §§ 3.3 and 3.4 are devoid of any similar requirement that a majority of KFCC members must assent to advertising programs is therefore striking.

Although on balance, I believe that the language of the Certificate tilts in the franchisees' favor, I cannot conclude that the Certificate is unambiguous. Therefore, I must consider the parol evidence.

C. The Interpretative Rules Normally Applicable Specifically To Certificates Of Incorporation Do Not Apply With Their Normal Force

Having determined that the NCAC Certificate is ambiguous, I now must determine the process by which I am to resolve that ambiguity. KFCC and the franchisees, as they have with virtually all issues that have arisen in the case from the mundane to the compellingly important, warmly contest this question. The franchisees say that KFCC is advancing an interpretation that disables a majority of the NCAC Committee from acting with the usual authority on behalf of the corporation and that invests in a separate corporation, KFCC, a veto over all action of the NCAC. If the Certificate's language does not clearly support on its face this serious curtailment of majority power, the franchisees argue that the ambiguity must be resolved against such a curtailment, without

any consideration of parol evidence. For its part, KFCC says that the NCAC Certificate was a specifically negotiated bilateral accord between itself and the franchisees, and that if the parol evidence tips equipoise at all in its favor, KFCC should prevail, notwithstanding that its reading subjects any action of the NCAC Committee on the most important business of the corporation to approval by KFCC.

I do not adopt either party's position in whole. In the case of entities whose governing instruments were not the product of bilateral negotiation, parol evidence is typically not relevant in resolving any ambiguities.[53] The reasons for that are understandable and powerful. When, for example, stockholders of a public corporation buy shares, they will usually have had no role in negotiating the terms of the certificate of incorporation or bylaws.[54] In that situation, when a corporate instrument can be read reasonably in two different ways, but one way would limit the ability of stockholders to decide the matter for themselves, our law requires that the instrument be interpreted in

[53] *See, e.g.*, *DeLucca* v. *KKAT Management, L.L.C.*, 2006 WL 224058, at *6 (Del. Ch. Jan. 23, 2006) (noting when interpreting an advancement provision of an LLC's operating agreement that "rarely is resort to parol evidence appropriate or even helpful, as corporate instruments addressing advancement rights are often crafted without the involvement of the parties who later seek advancement and often with little negotiation between any contending parties at all."); *In re Nantucket Island Assocs. Ltd. P'ship Unitholders Litig*, 810 A.2d 351, 361 (Del. Ch. 2002) (noting that in the case of limited partnerships agreements "there is usually no drafting history that could shed light on the shared intentions of the contracting parties – the general partner and the limited partners.").

[54] *See* Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 860-61 (2008) (observing that certificates of incorporation drafted by the initial incorporators who then seek to sell stock in an initial public offering are akin to contracts of adhesion and that potential investors will factor the certificate's existing terms into the price they are willing to pay for the corporation's stock); *cf. In re Nantucket Island Assocs. Ltd. P'ship Unitholders Litig.*, 810 A.2d 351, 361 (Del. Ch. 2002) (noting that "limited partnership agreements are drafted almost exclusively by their founding general partners").

favor of the stockholders' ability to act. By this means, our law protects the rights of equity holders and requires that any restrictions on their rights be made clear.[55] For similar reasons, our law does not favor reading corporate instruments as vesting special powers or rights in certain board members or stockholders, and where corporate instruments are ambiguous, the ambiguity will be resolved against finding that such special powers or rights exist that diminish the authority that would, by operation of default law, traditionally vest in a majority of stockholders acting concertedly or in a board majority, as the case may be.[56] In both these instances, the idea is that departures from regular order that impinge on the rights of stockholders and those they elect to exercise their traditional legal authority should be clear and that any failures in clarity should be resolved in favor of regular order.[57] By this means, equity investors can more safely entrust their capital to Delaware entities.

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[55] *Centaur Partners IV v. National Intergroup, Inc.*, 582 A.2d 923, 927 (Del. 1990) (noting that voting requirements that give minority shareholders special powers in derogation of majority rule "must be clear and unambiguous.").

[56] *Centaur Partners IV*, 582 A.2d at 927 ("When a provision which seeks to require the approval of a supermajority is unclear or ambiguous, the fundamental principle of majority rule will be held to apply.").

[57] It is also a well established principle of contract law that ambiguities in contracts should be construed against the drafter. *See, e.g.*, 11 WILLISTON ON CONTRACTS § 32:12 (4th ed. 2010) ("Since the language is presumptively within the control of the party drafting the agreement, it is a generally accepted principle that any ambiguity in that language will be interpreted against the drafter."). Delaware courts have applied this general principle to the more specific situation of corporate documents. *See, e.g., Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996) (finding that in the case of a Certificate of Designations when "the ultimate purchaser of the securities is not a party to the drafting of the instrument which determines her rights, the reasonable expectations of the purchaser of the securities must be given effect."). As we shall see, however, the drafting of the NCAC's Certificate was more akin to a bilateral arms-length negotiation in which neither the franchisees nor KFCC could properly be considered the "drafter" against whom ambiguities would be resolved.

The franchisees urge that these principles should apply to my interpretation of the NCAC's Certificate and foreclose any consideration of parol evidence because the Certificate imposes a "supermajority" voting requirement on Committee action and improperly delegates the core Committee function of advertising development to KFCC.[58] I do not agree, for the following reasons. As the franchisees' own evidence demonstrates, the process by which the NCAC Certificate came into existence is quite dissimilar from that of a typical corporation, whose initial promoters craft the certificate unilaterally and later sell shares of stock in the corporation to those who had no role in drafting. Here, the franchisees bargained vigorously over the relevant terms of the Certificate, have had the representation of qualified counsel through not just the NCAC itself but also through the AKFCF not only during the bargaining process but throughout the course of NCAC's performance under the Certificate, and have controlled a majority

[58] The franchisees argue that because under KFCC's reading of the Certificate, the KFCC members of the Committee would need to support a recommendation in order for that recommendation to pass, the Certificate creates a "supermajority" voting provision. KFCC counters that the Certificate does not create any such "supermajority" voting requirement but rather delegates to KFCC only the sole authority to *propose* plans for the Committee to then vote on by normal majority rule. KFCC's argument has some initial appeal, but only that. Under the formalistic operation that KFCC suggests, whether the KFCC *members* of the NCAC Committee support a proposal or not is irrelevant, and it is only the fact that KFCC *as an entity* has the sole power to make proposals to the Committee that results in the emergence of KFCC's functional veto. That said, the KFCC "proposes" Committee "disposes" dichotomy that KFCC suggests is perhaps even more antithetical to the regular order of majority rule by the corporate board than any "supermajority" voting requirement. Under KFCC's reading of the Certificate, the Committee is only allowed to consider proposals put to it by KFCC and can only vote "up or down" on those proposals. KFCC argues by analogy that corporate boards often rely on management to conduct the core functions of the business and that therefore delegation of the development of the advertising program to KFCC is not atypical. But KFCC's analogy is flawed. In a typical corporate setting, even though the management might be charged with developing many if not all of the proposals that corporate boards consider, the board always remains free not only to modify those proposals but to consider proposals from other sources including board members.

of the NCAC Committee throughout its history. This situation is therefore different from the one that pertains when outside investors in a public corporation duel with insiders over the meaning of a charter. Here, the NCAC Certificate is in many ways more akin to a joint venture agreement, bargained for between KFCC, as one venturer, and its franchisees, through the AKFCF and the NCAC itself, as the other venturer. In this circumstance, parol evidence cannot in fairness be ignored, as the franchisees are not equitably positioned to foist on the KFCC a reading of the Certificate that is clearly inconsistent with the parties' understanding, once the parol evidence is considered.[59]

That said, I believe that the policy behind our common law interpretative principles disfavoring readings of corporate instruments that would disenfranchise stockholders (or in this case, the members of a non-stock corporation) or grant special rights to certain directors or constituents at the expense of the powers that would usually be wielded by the majority of the board or the stockholders still has bite in this context. As noted, those principles are motivated by a desire to ensure that those who entrust their capital to Delaware entities have their reasonable expectations met and that departures from regular order are set forth with clarity. Simply because a certificate is negotiated does not mean that important interest goes away. Where a specifically negotiated charter is ambiguous and the parol evidence does not demonstrate clearly and convincingly that the parties intended the certificate to mean X, a reading that departs from the norm that a majority of the board may act, rather than Y, a reading that adheres to that norm, the

[59] *Harrah's Enter. Inc. v. JCC Holding Co.*, 802 A.2d 294, 313 (Del. Ch. 2002).

court should give effect to meaning Y.[60] In that situation, the burden of the resulting ambiguity that exists even after consideration of the parol evidence should be borne by the party seeking to have the corporation act in a manner contrary to majority rule. Put bluntly, ambiguous drafting plus ambiguous parol evidence should not support disenfranchisement, even in the bilateral negotiating context. Only when the ambiguity in drafting is made clear by the parol evidence should that result obtain.

In sum, the Certificate must be interpreted using principles of contract interpretation but without blind adherence to interpretive maxims developed for resolving disputes about qualitatively different corporate charters. I turn now to the process of interpreting the Certificate.

D. The Negotiation History And The Extrinsic Evidence

Because I have determined that the Certificate is ambiguous, "'all objective extrinsic evidence is considered.'"[61] The use of extrinsic evidence, however, does not change the fact that Delaware adheres to the objective theory of contracts.[62] The goal in reviewing the extrinsic evidence is to determine if there is a meaning of the Certificate

[60] *See Harrah's Enter, Inc. v. JCC Holding Co.*, 802 A.2d 294 (Del. Ch. 2002) (stating that when charter or bylaw provisions are ambiguous, "unless the evidence clearly and convincingly supports the conclusion" that the charter or bylaws departed from the regular order, then limitations should not be read into those documents); *cf. Airgas, Inc. v. Air Products and Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010) (quoting *Centaur Partners*, 582 A.2d at 928) ("If charter or bylaw provisions are unclear, we resolve any doubt in favor of the stockholders' electoral rights. . . .") (internal citations omitted).

[61] *In re Explorer Pipeline Co.*, 781 A.2d 705, 714 (Del. Ch. 2001) (quoting *Bell Atlantic Meridian Systems v. Octel Commc'ns Corp.*, 1995 WL 707916 (Nov. 28, 1995)).

[62] *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 835 (Del. Ch. 2007) ("The Court must emphasize here that the introduction of extrinsic, parol evidence does not alter or deviate from Delaware's adherence to the objective theory of contracts.").

such that an "objectively reasonable party in the position of either bargainer would have understood the nature of the contractual rights and duties to be."[63]

In 1989, KFCC's franchisees, through their national organization, the AKFCF, filed a class action lawsuit against KFCC in the Federal District Court for the Western District of Kentucky alleging violations of KFCC's franchise agreements (the "AKFCF Litigation"). The NCAC's current Certificate emerged as the result of the settlement of the AKFCF Litigation in 1997. KFCC argues that during the negotiation of that settlement it secured for itself not only the exclusive right to hire, fire, and direct the national advertising agency, but critically a veto power which prevented the NCAC Committee from approving or indeed even considering advertising proposals that KFCC did not recommend and endorse. KFCC claims that it was necessary to secure these concessions in order to streamline the advertising process because it was critical that there not be "too many cooks in the kitchen."[64]

By contrast, the franchisees claim to only have ceded to KFCC the sole right to hire, fire, and direct the national advertising agency, and that KFCC did not secure the broad veto power that it now claims to have obtained. The franchisees argue that the essence of the bargain struck in 1997 was that the franchisees would receive sought after changes to their franchise agreements in exchange for the franchisees giving KFCC sole authority over the national advertising agency and the franchisees' agreement to collapse the National Franchisee Advisory Council ("NFAC") into the NCAC. Implicit in the

[63] *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 835 (Del. Ch. 2007) (quoting *U.S. West, Inc. v. Time Warner, Inc.* 1996 WL 307445, *10 (Del. Ch. June 6, 1996)).
[64] Tr. at 1324 (Novak).

NCAC's argument is that before the new Certificate was agreed upon in 1997, the NCAC possessed the authority to make recommendations that it now claims and that because that authority was not specifically granted to KFCC in the course of negotiating the new Certificate, the NCAC retained that authority.

1. The NCAC Before The AKFCF Litigation

The NCAC held its first meeting on July 16, 1964 in Louisville, Kentucky.[65] That first meeting was informal and the purpose was for KFCC and the franchisees to "sit down and put our heads together and find out an effective way to take advantage of the potential advertising publicity and the most intelligent way of spending our National Cooperative Advertising money."[66]

In November 1967, the NCAC adopted its first bylaws.[67] Under those bylaws, the Committee was to have thirteen members, nine of whom were franchisee representatives and four of whom were KFCC representatives. The Committee was to "plan each ensuing year's advertising program within the limits of an estimated budget . . . ."[68] At its inception, therefore, it was clear that the Committee was in charge of planning KFC's national advertising and that the Committee was controlled by the franchisees.

[65] JX-1 (NCAC Meeting Minutes (July 16, 1964)).
[66] *Id.* at NCAC0027764.
[67] JX-3 (First Bylaws of the NCAC (November, 1967)).
[68] *Id.*

In 1980, the NCAC did not have many of the subcommittees that it has today.[69] By the end of the decade, however, changes in the advertising industry forced changes to the NCAC's operations.

Through the 1980s, the advertising for KFC was primarily "generic branding advertising."[70] Rather than focus on specific products, prices, or piece counts, the advertising focused on the brand more generally and normally featured the Colonel and a tagline such as "I do chicken right."[71] Because the advertisement was so general, there was less room for controversy.[72]

In 1988, the advertising for KFC began to change. That year, the NCAC launched its first national tactic promotion, a "Scrooge" themed commercial aimed at selling fried chicken over the holidays.[73] In 1989, the NCAC launched KFC's first national advertising to feature a price point.[74] Although franchisees were not obligated to sell at the advertised price point, the fact that the price was shown on national network television provided a strong incentive to the franchisees to follow the price. [75]

In the early 1990s, national advertising for KFC products continued to change. During that time, KFC began introducing new products such as hot wings and various sandwiches.[76] By the early 1990s, therefore, national advertising for KFC had moved

[69] Tr. at 69 (Neal).
[70] *Id*. at 70.
[71] *Id*.
[72] *Id*.
[73] *Id*.
[74] *Id*.
[75] *Id*. at 71.
[76] *Id*. at 72.

away from the "generic branding advertising" of the previous decades and involved planning promotional tactics and pricing for an array of products.

In response to these changes in the national advertising landscape, John Neal, the then chairman of the NCAC, created subcommittees of the NCAC such as the Calendar Subcommittee to serve as a forum in which the franchisees and KFCC could discuss and work out ideas about the upcoming advertising focus and then present those pre-vetted ideas to the full NCAC Committee.[77]

2. KFCC's Relationship With The NCAC Before The Settlement Negotiations

As a fallback argument to KFCC's assertion that it secured a new veto power during the AKFCF Litigation settlement negotiations, KFCC argues that the pre-settlement status quo already embodied the limitation on the NCAC's actions that it now advocates. But the evidence does not support that conclusion for the following reasons. First, KFCC concedes that until the late 1980s when KFC advertising began to change, the NCAC Committee played the leading role in KFC national advertising and that KFCC did not have a major role.[78] Second, even after KFCC was more involved in shaping the NCAC's approach to advertising, the record does not support the notion that the Committee was limited to approving, "up or down," proposals submitted to it by KFCC. Evidence of Committee action taken on recommendations made by franchisee

[77] Tr. at 73 (Neal).
[78] Def. Op. Post-Tr. Br. at 14 ("As advertising became more focused on new products, [KFCC] assumed a larger role in connection with the [NCAC]-funded advertising . . . .").

members exists,[79] as does credible testimony indicating that there was no understood limitation on the Committee's ability to determine NCAC's advertising strategy by simple majority vote.[80] At best, the record reflects the fact that the NCAC Committee and KFCC commonly acted by consensus. But that reality does not rationally reflect any understanding that the NCAC Committee was somehow powerless to adopt, by majority vote, advertising plans that KFCC did not support. Finally, the premise that KFCC already had the power to prevent the NCAC from implementing plans over its objections is in tension with KFCC's argument that it bargained to obtain such power in the later settlement of the AKFCF Litigation.

3. The AKFCF Litigation

At the same time that changes in KFC advertising were forcing changes to the NCAC's role and structure, KFCC and its franchisees fought over KFCC's franchise agreement. In 1989, the franchisees filed a lawsuit against KFCC in the form of the AKFCF Litigation. The dispute arose after PepsiCo, the then parent corporation of KFCC, allegedly undertook unilaterally to change the contract it was using with its

[79] *See, e.g.,* PX-1006 (Minutes of NCAC Meeting (February 26, 1990)) (recording an instance in which a franchisee recommended that a deal be changed to include different items at a different price point and that the Committee then voted on and approved that recommended change); PX-1010 (Minutes of NCAC Meeting (November 30, 1993)) (recording an instance in which a franchisee's compromise motion was passed after a KFCC proposal and a franchisee's proposal had both failed to garner a majority of votes).

[80] *See, e.g.,* Tr. at 621 (Chambers) (stating that that if KFCC was on the losing side of a vote, the Committee would 'move on with what [it] voted on.'); *see also* Willson Dep. at 195 (stating that before the 1997 settlement, the Committee had the authority to make changes and modifications to recommendations); Tr. at 75-75 (Neal) (explaining that the Committee would modify and change KFCC proposals).

franchisees — a contract known as the 1976 contract.[81] At the heart of AKFCF's concerns was the so-called "fifth P"[82] in the franchise agreements, a provision that guarantees franchisees exclusive territory within 1.5 miles of their stores.

In August 1994, when PepsiCo hired Novak to be the new president of KFCC, the AKFCF Litigation was still pending in the Western District of Kentucky.

When Novak became president, KFC's sales numbers had been slumping for the previous five years.[83] As Novak worked to turn the business around, he decided to try to settle the AKFCF Litigation with the franchisees.[84]

4. An Uncertain Settlement

Less than a year after taking over as KFCC president, Novak succeeded in jumpstarting settlement talks in the AKFCF Litigation. Novak wanted to create a win/win situation in which KFCC would give a lot to the franchisees but also get a lot.[85] To that end, Novak created what he described as the "Breakthru Proposal."[86] In his short time at KFCC, Novak had come to the conclusion that part of KFCC's struggles could be traced to what he viewed as a dysfunctional relationship with the NCAC.[87] Restructuring the operations of the NCAC, therefore, became one of Novak's goals in the settlement

[81] Tr. at 59 (Neal).
[82] The other four "P"s were: 1) a cap on royalty payments at 4%; 2) a cap on advertising contributions at 5%; 3) the ability to transfer or assign the franchise agreement; and 4) the ability to successively renew the franchise agreements every ten years on a new form developed by KFCC. JX-77 (letter from John Neal to Southeastern KFC Association members (June 13, 1995)).
[83] Tr. at 1322 (Novak).
[84] *Id.* at 1325-26.
[85] *Id*. at 1327.
[86] *Id*.
[87] *Id*. at 1322-25.

negotiations he was about to kick off. Further, Novak thought that the current system under which the franchisees were represented not only by the NCAC but also the NFAC was inefficient. The NFAC acted in an advisory role with respect to franchisee operational issues. Novak insisted that "you can't do operations and advertising without talking about both of them at the same time."[88] Therefore, Novak viewed the existence of the two committees, the NFAC and NCAC, as duplicative and inefficient.

On June 1, 1995, Novak met with representatives of the franchisees at the Jefferson Club in Louisville, Kentucky to present his Breakthru Proposal.[89] At that meeting, Novak presented a deck to the franchisees that outlined a proposed resolution to the AKFCF Litigation.[90]

The Breakthru Proposal revived negotiations that had been languishing for years. The meeting was the subject of much testimony at trial. KFCC claims that Novak's proposal made clear not only that the NFAC would be collapsed into the NCAC but also the division between KFCC's exclusive role as proposer and the Committee's role as approver. It is this bifurcation of "propose" and "approve" that KFCC says vests in it a veto power over NCAC action that it does not support. If KFCC does not support a proposal, the argument goes, then that proposal would never be presented to the Committee for its consideration and KFCC would thereby posses veto power. The franchisees, on the other hand, stress that nothing in the Breakthru Proposal indicates that KFCC would become the sole source of recommendations to the NCAC or obtain a veto

[88] JX-69 at JN_E_04071.
[89] Tr. at 78 (Neal).
[90] JX-63 (Novak's Breakthru Proposal presentation (June 1, 1995)).

over advertising proposals that KFCC did not support. Instead, the franchisees argue that the essence of the Breakthru Proposal was that KFCC would agree to add the "fifth P" to the franchise agreements in exchange for combining the NFAC and NCAC into one committee and KFCC receiving the sole right to hire, fire and direct the national advertising agency.

In considering this issue, it is useful to start with an important reality. The Breakthru Proposal deck itself does not contain any indication that only KFCC can make recommendations or that the NCAC could not modify KFCC's proposals as part of the approval process.[91] Rather, the closest the proposal itself comes is on a page listing NCAC activity in which it states that "KFCC develops" and the "Committee approves" various advertising related items.[92] But Don Parkinson, a KFCC representative, admitted at his deposition that the Breakthru Proposal "says [KFCC] develops, [but] it does not say [KFCC is] the only source for the development of that calendar."[93]

In attendance at the Breakthru Proposal meeting was franchisee member of the NCAC, Neal. Not only did Neal take hand written notes at the meeting, he also surreptitiously audio recorded the meeting and later transcribed that recording with the help of his secretary. Like the slide deck of the Breakthru Proposal itself, Neal's transcript of the Breakthru Proposal meeting contains no reference to KFCC having sole authority to make proposals.[94]

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[91] JX-63 (Breakthru Proposal Presentation (June 1, 1995)).
[92] *Id.*
[93] Parkinson Dep. Vol. II at 10-11.
[94] JX-69.

In fact, the transcript of the recording reflects that Novak spoke of the win/win he was proposing as the franchisees getting the "fifth P" in exchange for KFCC getting the right to hire, fire and direct the national advertising agency and that the Committee "approves the strategic direction, calendar, and budget."[95] Importantly, Novak also stated that the approval process would be "as it [is] today."[96] This point is driven home when Neal asks Novak if the franchisees would still have the ability to make changes such as selling pot pies in October instead of September and Novak responds that they would.[97] Importantly, it must be noted that Neal's actual tape recording of the Breakthru Proposal meeting somehow did not survive, despite his proven pack rat propensities. Rather, the evidence is now in the form of a transcript of that audio tape made by Neal and his assistant and that multiple versions of the transcription were made.[98] The transcript, therefore, must be treated with some skepticism.

But Neal's handwritten notes from the meeting are consistent with Novak's deck and also reflect the fact that if Novak was asking for the sole authority to make recommendations he was not clearly conveying that to the franchisees.[99] Rather, as the deck does, Neal's notes suggest that the heart of the deal was KFCC obtaining the sole control over the national advertising agency and collapsing the NFAC into the NCAC in exchange for giving the franchisees the "fifth P."[100] Others present at the meeting also

[95] JX-69 at JN_E_04074.
[96] JX-69 at JN_E_04075.
[97] JX-69 at JN_E_04083.
[98] Tr. at 203-04 (Neal).
[99] JX-67.
[100] JX-67 at JRN_NCAC015132-33.

recalled that KFCC's focus was on obtaining control of the national advertising agency in exchange for including the "fifth P" in the franchise agreements.[101] In fact, Novak himself testified at his deposition that at the Breakthru Proposal meeting he never explained that the Committee's approval rights would be limited to voting "up or down" on KFCC proposals.[102] That is consistent with the proposal itself, which is at best silent on that question.

After the Breakthru Proposal meeting, there were communications both among the franchisees and between KFCC and the franchisees that again support the idea that the heart of the Breakthru Proposal was not a change in KFCC's authority to make recommendations to the Committee but KFCC obtaining the right to control the national advertising agency.

On June 13, Neal sent a letter to a group of franchisees summarizing the Breakthru Proposal meeting. In that letter, Neal states that other than KFCC now having the sole authority to hire and fire the advertising agency and direct the creative development of commercials, "[y]our National Advertising Cooperative would retain its other existing responsibilities . . . ."[103] In a memorandum the next day, KFCC said that Neal's letter "capture[d] the essentials" of the Breakthru Proposal.[104]

Over the next months, Novak continued to meet with franchisee leaders about his Breakthru Proposal and a possible resolution of the AKFCF Litigation. The

[101] Tr. at 581-82 (Chambers).
[102] Novak Dep. Vol. I at 82-83.
[103] JX-77.
[104] JX-79.

contemporaneous notes from these meetings again suggest the parties' bargain centered on KFCC assuming exclusive control of the advertising agency. On September 26, 1995,[105] Novak met with franchisee representatives and Neal again took handwritten notes of the meeting in which he recorded the fact that Novak said that KFCC was getting "one committee,"[106] "hire and fire," and "direct creative."[107] On October 31, 1995, the parties held a "Summit Meeting." Neal's notes from that meeting again reflect that Novak portrayed the deal as "you get the 5Ps; we get (1) hire fire — no questions asked; (2) direct agency to develop."[108]

On September 27, 1995, Novak sent a video address to the entire KFC franchisee system outlining where the negotiations stood. Novak thought that it was important for the franchisees to see that he wasn't "Darth Vader" and to hear "straight from the horse's mouth" what was being negotiated.[109] In that video address, Novak tells the franchisees that "*[y]our control of the marketing calendar stays exactly the same*."[110]

In early 1996, Novak's efforts embodied in the Breakthru Proposal paid off and the parties struck an agreement in principle. That agreement was memorialized in two documents which the parties refer to as the "Chicken Stamp" documents.[111] In fact, one

[105] In their briefing, the parties state that this meeting occurred on September 29, 1995. But, the handwritten notes from the meeting taken by Neal are dated September 26, 1995.
[106] The reference to "one committee" reflected the fact that as part of the settlement the separate NFAC would be collapsed into the NCAC to form one Committee.
[107] PX-1021 at JRN_NCAC015212.
[108] JX-120 at JRN_NCAC015398.
[109] Tr. 1368 (Novak).
[110] JX-109 (emphasis added).
[111] The parties referred to the documents as the "Chicken Stamp" documents because Novak stamped each page of the documents with a stamp of a rubber chicken that had been given to him by Neal. *See* Tr. at 112-13 (Neal); *id.* at 506 (Selden).

document was titled "Contract Settlement Guidelines" and dealt with issues related to the franchise agreement, and the other document was titled "National Council and Advertising Cooperative Guidelines" and dealt with issues related to the NCAC.[112] Those documents once again stated that "to vote on the national advertising related activity the [NCAC] will vote as now done by the [NCAC]."[113]

After the Chicken Stamp documents were agreed to, a framework was in place to settle the AKFCF Litigation that had been pending for the better part of a decade. But the Chicken Stamp documents were only guidelines, more formal documents outlining the changes to the NCAC needed to be negotiated and drafted. Specifically, the NCAC's Certificate and bylaws needed to be amended and restated to reflect the changes that KFCC and its franchisees had agreed upon.

To that end, on February 1 and 2, 1996, KFCC and its franchisees met in Louisville to finalize a draft of the NCAC's new Certificate and bylaws.

5. The Drafting Of The NCAC Certificate

The changes made to the draft NCAC Certificate at the February 1 and 2, 1996 meeting suggest that the NCAC's reading of the Certificate is proper and that the Committee retained the power to make and modify recommendations that it had enjoyed before the settlement. Indeed, if the draft certificate that KFCC had proposed at the meeting had been adopted, the Certificate would better support KFCC's position on its

[112] JX-128 ("Contract Settlement Guidelines"); JX-129 ("National Council and Advertising Cooperative Guidelines").
[113] JX-130 at NCAC0067018.

face. But there were important changes made to that draft certificate. Crucial language that KFCC proposed was removed at the insistence of the franchisees.

Critically, the franchisees insisted on changing language in the Certificate that suggested that only KFCC would be or could be making recommendations to the Committee. For instance, KFCC wanted to include the word "all" in what would become § 3.3(b) of the Certificate so that that section would mandate that KFCC "develop *all* national advertising, public relations and media plans and strategy. . . ."[114] The franchisees insisted that the word "all" be removed from § 3.3(b) so that the section would read that KFCC "shall . . . develop national advertising, public relations and media plans and strategy. . ." rather than "all national advertising . . . ."[115] Similarly, KFCC wanted to include the words "recommended by KFCC" in what would become § 3.4(c) of the Certificate so that that section in KFCC's original draft gave the Committee the authority "to approve the [NCAC's] advertising calendar, media calendar and advertising campaign strategy, and any changes thereto *recommended by KFCC*."[116] Again, the franchisees insisted that the words "recommended by KFCC" be deleted from § 3.4(c)[117] so as to make clear that what the NCAC was "approving" had not necessarily been recommended by KFCC. Similarly, the KFCC draft granted the Committee the authority to "approve all *recommended* price points, piece counts and promotions featured in any

[114] *See* PX-1028 (KFCC Draft Certificate (January 9, 1996)) (emphasis added).
[115] Tr. at 374-75 (Zingman).
[116] PX-1028 (emphasis added).
[117] Tr. at 1524 (Hinshaw).

national advertising . . . ."[118] The franchisees again insisted that the word "recommended" be removed from the draft so that in § 3.4(c), the final Certificate gave the Committee the authority to approve "all price points, piece counts, and promotions featured in national advertising"[119] without any reference to those items being recommended.

Finally, in addition to insisting on the removal of language that inclined in the direction of suggesting that KFCC possessed the sole authority to develop recommendations for the Committee's approval, the franchisees also demanded another important change to the KFCC draft of the Certificate aimed at preserving their role in the advertising planning process. Specifically, the franchisees insisted that the word "plan" be included in § 3.4(b) so that the Committee had the authority to "plan and approve" the advertising program rather than to just approve.[120] KFCC had proposed deleting the language in the NCAC bylaws that had historically given the Committee the power to "plan each ensuing year's advertising program within the limits of an estimated budget . . . ."[121] KFCC now argues that the "plan" language was included because it was carried over from older NCAC bylaws.[122] But, Chet Hinshaw, who represented KFCC during the negotiation, testified that the word "plan" was put back in in response to questioning by Ed Zingman, the counsel for the AKFCF during the negotiation.[123] In

[118] PX-1028 (emphasis added).
[119] JX-184 (Certificate).
[120] Tr. at 179 (Neal); Tr. at 1523-24 (Hinshaw).
[121] JX-3 (Bylaws of the NCAC (November 1967)).
[122] Def. Op. Post. Tr. Br. at 23 n.6.
[123] Tr. at 1523-24 (Hinshaw).

fact, the franchisees vehemently opposed the removal of the word "plan." Neal's handwritten notes from the February 2 meeting indicate: "No way to strike 'plan.'"[124] At trial, Neal explained that "plan" was a "major word" and was important to keep because the franchisees were "hanging on to the rights that [they] knew [they] had."[125] Zingman also recalled the importance of the word plan, testifying that at the drafting meetings, Neal "made it very clear and obvious" that removal of the word "plan" was a "deal breaker."[126]

The franchisees' rejection of these KFCC bargaining proposals supports the franchisees' contention that during the AKFCF Litigation settlement negotiations the Committee did not cede KFCC the exclusive authority to make proposals to the Committee, limiting the Committee to accepting or rejecting those proposals in whole.

6. The NCAC's Questions About The Draft Certificate And The April 19, 1996 Meeting

Although the parties to the AKFCF Litigation considered the settlement a "done deal" after the February 1 and 2 meeting,[127] the NCAC still had to be looped into the process and sign off on the changes being proposed to its Certificate and Bylaws. The first step in that process was for Ed Zingman, counsel for the AKFCF, to send the draft Certificate from the February meetings to Ed Perry, counsel for the NCAC, and to the "Bylaws Subcommittee" of the NCAC for review.

[124] PX-1032 (Neal's Handwritten Notes (February 2, 1996)) at JRN_NCAC014256.
[125] Tr. at 132 (Neal).
[126] Tr. at 359 (Zingman).
[127] *See, e.g.*, PX-1032 (Neal's notes from February 2 meeting (February 2, 1996)).

Perry and the Bylaws Subcommittee then began meeting to review the proposed changes to the NCAC Certificate and Bylaws. The result of those meetings was a list of questions that Perry posed to KFCC on behalf of the Bylaws Subcommittee on April 17, 1996.[128]

On April 19, 1996, KFCC met with representatives of the NCAC to discuss the Certificate that had been drafted at the February 1996 meeting and the questions that the NCAC had about the changes. One key concern addressed at that meeting was whether there was a chance that some sort of a "stalemate" could occur at the NCAC that would preclude the Committee from approving national advertising for the KFC brand. KFCC says the discussion of stalemate supports its double veto position, namely, that the NCAC cannot act without the joint consent of both the Committee and KFCC. The franchisees say the discussion, when read in context, actually supports their position.

As the franchisees point out, there are actually two kinds of stalemate that could occur. First, there could be the stalemate that KFCC suggests could exist — a situation in which KFCC and the franchisees could not agree on an advertising plan and KFCC refuses to propose a new one. Second, there could be a stalemate in which KFCC produces a commercial that is in line with the agreed upon advertising plan but that the franchisees do not like and refuse to approve for airing.

As to the first sort of stalemate, the handwritten notes taken by three of the franchisees' representatives at the April 19 meeting all reflect the idea that the Committee could move past a disagreement with KFCC by majority vote. Zingman's notes state that

[128] JX-160.

"approve means chance to negotiate or vote own plan by majority."[129] Neal took handwritten notes on the sheet of typed questions that the franchisees had posed to KFCC. Under the question regarding the possibility of a stalemate if the Committee did not approve of a KFCC plan or strategy, Neal wrote "we can fix our own and vote on it."[130] Ed Perry, counsel for the NCAC, also took notes at the meeting. His notes state that "if [franchisee] members and [KFCC] members cannot agree on plans and strategy, [franchisee members] can put to vote by whole Committee, so [franchisee] members have final approval of plans and strategy."[131]

The fact that three sets of contemporaneous handwritten notes all embody the idea that the NCAC Committee, acting by majority rule, retained the power to short-circuit a disagreement with KFCC over advertising plans and strategy suggests if KFCC was attempting to secure for itself the sole right to make proposals to the NCAC, it was not communicating that effectively to the franchisees.

KFCC argues that despite these contemporaneous notes, two of which were taken by outside counsel for the AKFCF and NCAC and not by the more partisan Neal, the franchisees later admitted that a stalemate could occur during the preparation of a draft information statement that was to be sent to the franchisees in connection with the settlement of the AKFCF Litigation.

Over four months after the April 19 meeting, KFCC and the franchisees were exchanging drafts of an "Information Statement" that was to be submitted to the federal

[129] PX-1047 (Handwritten Notes of Ed Zingman (April 19, 1996)).
[130] PX-1048 (Handwritten Notes of John Neal (April 19, 1996)).
[131] PX-1057 (Handwritten Notes of Ed Perry (April 19, 1996)).

court as part of the AKFCF Litigation settlement and sent to the NCAC members to explain the changes to the NCAC that would occur as part of that settlement. KFCC makes much of the fact that the draft information statement said that "[i]f the advertising plans proposed by [KFCC] are not approved by the Committee, a stalemate could develop."[132] KFCC argues that this draft information statement, which was extensively reviewed by the franchisees,[133] is an admission by the franchisees that a stalemate could occur.

The franchisees do not contest that the draft information statement is clear that a stalemate could occur. Instead, the franchisees insist that the stalemate referred to in the information statement is not a stalemate over elements of the advertising plan such as the marketing or media calendar, but rather that the draft information statement referred to a stalemate over the production of a particular commercial.[134] To support their contention, the franchisees point to the fact that the same paragraph of the draft information statement that includes the reference to a stalemate also discusses the use of an "on the shelf" commercial to resolve the stalemate.[135]

The franchisees' argument is plausible. Although the fact that the draft information statement contemplates a stalemate cannot be ignored and cuts in KFCC's favor, there is more than one kind of stalemate possible. The reference in the draft

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[132] JX-167 (Draft Information Statement (August 30, 1996)) at NCAC0063733.
[133] *See, e.g.*, DX-2129 (August 6 Draft Information Statement); DX-2131 (August 19 Draft Information Statement); DX-2146 (August 27 Draft Information Statement); DX-2153 (August 29 Draft Information Statement).
[134] Pl. Ans. Post-Tr. Br. at 21.
[135] *See* JX-167 at NCAC0063733.

information statement to an "on the shelf commercial" to be used as a solution to a stalemate suggests that the stalemate in question resulted from a conflict over a particular commercial and not over the advertising plan more generally. This inference is strengthened by the contemporaneous notes from the April 19 meeting that all indicate that a more general stalemate over the advertising plan could not occur because the Committee could adopt a revised plan by majority vote. At best, this evidence of a stalemate discussion provides some weak color to KFCC's position. But, given the plausibility of the franchisees' position, the support it has in three sets of contemporaneous notes, and the lack of *any* KFCC notes bearing on the subject,[136] this evidence does little, it anything, to meet KFCC's burden to demonstrate by clear evidence that the Committee's authority to govern the NCAC was constrained in the manner KFCC advocates.

7. The Finalizing Of The New NCAC Certificate

Because the new Certificate created duties for KFCC, on October 29, 1996, KFCC and the NCAC entered into a letter agreement whereby KFCC agreed to perform the duties that the Certificate required and the two parties jointly moved for dismissal of the AKFCF Litigation.[137]

[136] A good deal of time has passed since the mid 1990s and the non-existence of KFCC notes on the key meetings in 1995 and 1996 is not, I suppose, that unusual. But, given KFCC's attempt to prove that it retains a veto over the power of the NCAC Committee to act, the absence of notes supporting its view of these discussions necessarily undermines KFCC's efforts to meet its burden of showing by clear evidence that majority rule does not pertain to the NCAC.
[137] JX-175.

On January 21, 1997, Judge Russell of the United States District Court for the Western District of Kentucky held a fairness hearing on the proposed settlement of the AKFCF Litigation. At that hearing, the franchisees again expressed their understanding that the changes to the Certificate did not fundamentally alter the traditional authority that the NCAC Committee enjoyed. Darlene Pfeiffer testified on behalf of the AKFCF and when asked if, in her judgment, the settlement continued the relationship in which the NCAC was "in charge [of] or controls . . . all the advertising [and] marketing . . . for the Kentucky Fried Chicken system, Pfeiffer replied "yes."[138] KFCC's counsel at the settlement hearing did not follow up with any questions to clarify Pfeiffer's response.[139] The next day, Judge Russell filed a Final Judgment and Order approving the settlement and dismissing the AKFCF Litigation.[140]

On January 27, 1997, the NCAC filed its restated Certificate of Incorporation with the Delaware Secretary of State.[141]

8. The Parties' Course Of Performance Under The Current Certificate

The parties expended a large amount of energy at trial addressing the question of whether over the past thirteen years, the franchisee members of the NCAC have exercised the power they now claim to make recommendations to the NCAC and modify KFCC recommendations. In considering this issue, I note that KFCC's view of how the NCAC should operate is a highly formal one. KFCC *as an entity* proposes and the NCAC

[138] JX-182 (Transcript of Fairness Hearing (January 21, 1997)) at NCAC0064144-45.
[139] *Id.* at NCAC0064145.
[140] JX-183.
[141] JX-184.

Committee disposes.[142] If the Committee rejects a KFCC proposal, KFCC must propose again until its proposal gains acceptance. Only through this formal process of rejection does consensus emerge. Notably, KFCC concedes that this is not how the Committee has ever operated. KFCC thus reverts, as we shall see, to contending that the Committee's more traditional approach of considering motions by all of its members, including franchisee representatives, always was done with KFCC's approval as an entity and that any deviations from KFCC's proposals were somehow, despite the paper record, "approved" by KFCC. That concession undermines KFCC's case, as does the weight of the evidence regarding course of performance under the Certificate.

That evidence supports two important conclusions. First, the franchisee members of the NCAC made proposals to the Committee that the Committee then voted on without KFCC objecting to the procedure. Second, the Committee approved advertising proposals over KFCC's objection — i.e., with the KFCC members of the Committee voting "no." Both of these types of occurrence undermine KFCC's position that *only* KFCC could make proposals for the Committee's consideration and that nothing could be approved without KFCC's consent.

The record evidence of the NCAC meetings since 1997 contains numerous occasions on which the Committee considered franchisee motions to change the

[142] Note that if KFCC says that its designated members on the Committee simply must approve, KFCC creates a conflict with its reading of § 3.3, which addresses KFCC as an entity. Also such a reading raises the question why § 3.4 was not written to require the affirmative support of the KFCC-designated Committee members for the approval of advertising calendars and programs (i.e., all the relevant items in §3.4). After all, the support of the KFCC-designated Committee members is required for any amendment to Article III of the Certificate. *See* JX-184 (Certificate) Article X (requiring the approval by a majority of the franchisee members and a majority of the KFCC members of the Committee to amend Articles III, VII, X, or XIII or the Certificate).

advertising program. These include both occasions on which the Committee approved the franchisee proposals with the KFCC representatives voting in favor, and occasions in which the Committee considered but then rejected franchisee proposals with the KFCC representatives voting against the proposals. In both of these types of case, the result is not as important as the fact that KFCC's representatives on the Committee did not object to the fact that it was a franchisee member's proposal that was being considered by the Committee.

At the June 21, 2000 NCAC meeting, KFCC presented its recommendations for the four calendar windows between September 2000 and January 2001.[143] After "lengthy discussion," a franchisee member moved that an alternative calendar be implemented for those advertising windows. After a second by another Committee member, without any objection from KFCC, the motion to implement the alternative calendar was defeated with three franchisee members voting in favor.[144]

At the September 11, 2002 meeting, Wasilevich, a franchisee member of the Committee, made a motion to approve the provisional "Straw Dog" calendar for 2003 "with the change of starting the Wings window on January 20 instead of January 13."[145] Another franchisee member then moved to make an additional change to the calendar by swapping out BBQ Wings from the September window. Without any objection from

[143] JX-197 (Minutes of NCAC Meeting (June 21, 2000)).
[144] *Id.*
[145] JX-206 (Minutes of NCAC Meeting (September 11, 2002)).

KFCC, the Committee then voted on both motions, rejecting the second motion but approving Wasilevich's motion.[146]

At the June 3, 2004 meeting, KFCC recommended that the July 5-25 window feature a "Roasted Twister, wedges, diet Pepsi for $2.99."[147] A franchisee member of the Committee made a motion to do a $1.99 Roasted Twister with an in-store trade-up to a flex-priced combo for the July 5-25 window instead. The franchisee motion was passed fourteen to three, with three franchisees voting against.[148]

At the February 15, 2005 calendar subcommittee meeting, a franchisee member moved to change the price for an eighteen piece boneless wings promotion from $8.99 to $8.79. The motion passed at the subcommittee level despite being opposed by KFCC.[149] At the full NCAC Committee meeting on February 20, 2010, the recommendation of the calendar subcommittee with the $8.79 price, a recommendation that was made by the franchisees at the subcommittee level, not KFCC, was approved unanimously by the full Committee.[150] Again, KFCC did not object to the fact that the recommendation being considered was not a KFCC recommendation and was in fact a recommendation that KFCC had opposed at the subcommittee level.

At the December 6, 2007 NCAC meeting, the Committee was discussing the "Brand Campaign Launch Plan" and the proper allocation of spending between television and internet advertising. A KFCC representative on the Committee moved to transfer

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[146] *Id.*
[147] JX-210 (Minutes of NCAC Meeting (June 3, 2004)).
[148] *Id.*
[149] JX-222 (Meeting Minutes of Calendar Subcommittee Meeting (February 15, 2005)).
[150] JX-223 (Meeting Minutes of NCAC Committee Meeting (February 20, 2005)).

$850,000 away from internet marketing for the Brand Campaign Launch Plan and place it instead in the Toasted Wrap promotional window.[151] That motion was defeated eight to nine. A franchisee member of the Committee then made a motion to launch the new Brand Campaign with the $850,000 originally earmarked for internet advertising and to move advertising away from the Toasted Wrap promotion to compensate. That motion was then unanimously passed by the Committee.

KFCC responds to these incidents in part by pointing out that KFCC voted in favor of the proposals. Although that might be true, it is beside the point. KFCC claims to have the *sole* authority to *make* proposals in the first instance. The fact that they agree with proposals that the franchisee members make does not undermine the fact that it is the franchisee members, and not KFCC as an entity, that is making the proposals and that KFCC did not object to the practice on any of those occasions.

In fact, in the face of these numerous instances of KFCC voting on franchisee recommendations or modifications, there is only one instance in the record of KFCC objecting to a franchisee's attempt to modify a KFCC proposal. That incident occurred at the December 2, 2004 NCAC meeting. At that meeting, the Committee was discussing a promotion for Flavor Station Wings that featured six wings for $2.99 or eighteen wings for $7.99. A franchisee member of the Committee made a motion to change the price to $8.99 for eighteen wings. After that motion was defeated seven to eight, Gregg Dedrick, the then President of KFCC, voiced his opinion that the motion was inappropriate because the role of the full committee was to "vote up or down on the recommendation of

[151] PX-1161 (Meeting Minutes of NCAC Committee Meeting (December 6, 2007)).

the Calendar Committee as presented."[152] Neal disagreed, stating that Dedrick's view was inconsistent with both the Committee's Bylaws and precedent.[153] There is no evidence that KFCC thereafter pressed the point, which was at odds with the reality reflected in the Committee's past practice.

Although this lone incident supports the notion that KFCC at times viewed itself (or hoped to be accepted) as sole proposer, Dedrick's isolated statement did not elicit any shared acceptance of his view by the franchisees. To the contrary, they disagreed with him and the evidence, as a whole, indicates that franchisee members often made recommendations that the whole Committee would consider without KFCC's objection.

In addition to those incidents in which KFCC did not object to the Committee's consideration of a recommendation or modification of a franchisee, KFCC itself admits that there were three instances in which the Committee approved a course of action over KFCC's objection; that is, three cases in which the Committee approved a measure with KFCC's representatives voting "no."[154]

At the March 18, 2004 NCAC meeting, the calendar subcommittee recommended a Dale Earnhardt, Jr. promotion featuring a two pieces of chicken meal priced at $4.[155] A KFCC representative expressed concerns that the $4 price point was not compelling.[156] A franchisee representative countered that it would be disruptive to consumers'

[152] JX-221 (Meeting Minutes of NCAC Meeting (December 2, 2004)).
[153] *Id*.
[154] Def. Op. Post Tr. Br. at 42 n.20.
[155] PX-1105 (Meeting Minutes of NCAC Meeting (March 18, 2004)).
[156] *Id.*

perception to change the price at that point.[157] After further discussion, the recommendation was passed at the $4 price point by a vote of twelve to five with all four KFCC representatives opposed.[158] At trial, Scott Toop, the then General Counsel of KFCC, explained that the KFCC representatives had voted against the recommendation "out of principle."[159] Toop went on to say that the KFCC representatives agreed with the idea of the promotion except from a "price point perspective" and that it was better to allow a suboptimal proposal to go through than to go "dark" and have no advertising on the air.[160]

During a January 9, 2009 NCAC teleconference meeting, the KFCC representatives on the Committee again voted against a proposal that was approved because they disagreed with the pricing. A franchisee moved to approve the calendar subcommittee recommendation for a promotion featuring seven hot wings for $3.99 and twenty hot wings with no price point. The motion was passed by a vote of thirteen to four with all four KFCC representatives opposed. At trial, Eaton, the President of KFCC, again claimed that KFCC had voted "no in principle" because the price point and piece count were not as important as moving the business forward at that point because time was of the essence.[161]

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[157] *Id.*
[158] *Id.*
[159] Tr. at 1446 (Toop).
[160] *Id.*
[161] Tr. at 1165-67 (Eaton).

During the April 22, 2009 NCAC teleconference meeting, the Committee approved a "$5 Fill-Up Box" promotion.[162] The Committee approved the addition of a fifth promotional magnet that would feature all four promotional options to be used instead of the four individual magnets at stores where space was at a premium. The promotion and addition of the extra magnet were approved by a vote of eleven to six with all four KFCC representatives opposed. At trial, Eaton stated that KFCC believed that it was not a good use of funds to include the extra magnet, but because the magnitude of the expense was so small it was not of great concern and "having voted no, [KFCC] had no further reason to object."[163]

KFCC claims that these "no" votes were on "principle,"[164] but that does not matter. What is important is what KFCC's actions would convey to an objective party in the NCAC's position. As Eaton himself said, KFCC felt that they had no further reason to object after voting "no." But KFCC did have another reason to object, the NCAC was formally implementing proposals that KFCC opposed, and whatever KFCC's internal thoughts were, if KFCC believed that the NCAC could not approve proposals over KFCC's objections then it should have made that clear at the time.

Taken together, the evidence of the parties' course of conduct supports the franchisees' position. That evidence suggests that the parties have never adhered to the strict "KFCC proposes, the Committee approves" bifurcation that KFCC claims was agreed to in 1997. In fact, there are numerous instances in the record in which KFCC

[162] JX-247 (Meeting Minutes of NCAC Meeting (April 22, 2009)).
[163] Tr. at 1164 (Eaton).
[164] *Id.*

entertained recommendations or modification proposals from franchisee members without voicing any concern that the proper procedure was not being followed.

E. The Proper Reading Of The NCAC's Certificate Of Incorporation

As mentioned above, if my consideration of the NCAC's Certificate was limited only to its text, the franchisees' reading would be the more logical way to read the Certificate as a whole. Although this Certificate is not like many certificates of incorporation in that it was bilaterally negotiated, the regular order of majority rule by the corporate board — in this case, the Committee — is an important default public policy principle and departures from that regular order should emerge clearly. But, the NCAC's Certificate is not clear. In fact, the Certificate is ambiguous, opening the door for consideration of the extrinsic evidence.

The extrinsic evidence better supports the franchisees' reading of the NCAC's Certificate than KFCC's. KFCC has not demonstrated through extrinsic evidence that the Certificate means anything other than what it more likely appears to mean on its face — namely, that KFCC has primary responsibility to make recommendations to the NCAC for the Committee's approval but that the NCAC retains the authority to make recommendations of its own or modify KFCC's recommendations and then vote on those recommendations by majority rule.

F. The Business Context And Possible Limits On The Franchisees' Victory

KFCC's strongest argument in favor of its reading of the Certificate is that KFCC's reading is more sensible as a business matter. Specifically, KFCC argues that: the NCAC does not have the capability effectively to plan the advertising for a brand the

size of KFC; KFCC is responsible for maintaining the image of the KFC brand across the world and needs to be able to integrate the United States advertising into a global plan; and KFCC invests millions of dollars into developing and testing products and advertising and could not plausibly be thought to have put itself in the position of being unilaterally outvoted and directed by the NCAC.

KFCC's arguments are not without appeal, and the NCAC's reading of the Certificate leaves KFCC in a compromised position over some of its competitors. But, the result cannot be deemed absurd given the history of the NCAC and that the advertising dollars at issue come from the franchisees themselves. History matters and the current structure of the NCAC is an improvement over the reality KFCC lived with in 1995 and that Novak sought to alter with the Breakthru Proposal. That it is not all that KFCC now wants is not a license for this court to ignore contract interpretation principles and rewrite an agreement that is arguably suboptimal, even for franchisees. KFCC is also free to invest its own dollars in additional advertising if it believes that will grow system revenue and therefore its own take, and there are mitigating profit incentives that rationally limit the franchisees' incentives to act nihilistically.

The franchisees have a strong incentive to be good shepherds of the KFC brand. If the KFC brand is impaired, KFC franchisees stand to suffer as much as KFCC. The franchisees would be foolish to ignore thoughtful plans proposed by KFCC, as foolish as KFCC would be to ignore the views of those who sell directly to KFC customers. In this vein, there is also evidence in previous votes that the franchisees do not play docile sheep

to Neal's Border Collie. KFCC has every opportunity to form a working majority if it proposes viable plans.

Further, KFCC's fears are mitigated by the fact that KFCC remains the owner of the KFC brand and its associated trademarks.[165] The NCAC is able to use the KFCC trademarks in advertising under an "irrevocable, non-exclusive, perpetual, royalty free license."[166] But, the NCAC's use of the KFC marks is not unfettered. Rather, the NCAC is obligated to use those marks "in good taste and consistent with the then current Bylaws of the NCAC."[167]

Likewise, the NCAC's ability to advertise various products is limited by the fact that franchisee members are only permitted to sell items that have been approved by KFCC.[168] That is, there is no way that the NCAC could advertise for a product that KFCC did not wish its franchisees to be selling at all. Together with the "good taste" requirement for using KFCC's marks, the fact that only KFCC approved products can be sold provides a bulwark against the NCAC's power to steer the KFC brand in a direction that KFCC opposes. Moreover, consistent with its bargaining, KFCC retains the sole authority to hire, fire, and direct the national advertising agency. The Committee cannot force KFCC to air a commercial that KFCC believes in good faith to be injurious to KFC. This control over what actually airs itself acts as a check on the Committee. For

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[165] *See, e.g.,* DX-2334 (Agreement Between KFCC and the NCAC (November 1, 2004)) ¶ 3 ("As between KFCC and NCAC, all KFCC Marks and the goodwill associated therewith shall be owned solely by KFCC. . . .").
[166] *Id.* ¶2.
[167] *Id.*
[168] Tr. at 1181 (Eaton).

example, if the franchisees approved an advertising plan premised on an "All Fat, All Fried, All the Time" theme, KFCC would likely retain contractual discretion not to air such a theme. KFCC has exclusive authority to direct the national advertising agency, an authority that must include the ability to consider how KFC advertising positions KFC as a brand in its consumers' minds. As this example indicates, this case will not necessarily answer every possible dispute between the franchisees and KFCC over the NCAC. That reality itself, however, should induce greater, not lesser, cooperation unless the franchisees have been sniffing the secret spice blend in closed spaces.

Ultimately, of course, if KFCC does not like its relationship with the franchisees it can reopen contract negotiations. However painful this is, it might be that current business realities make it impossible to continue applying band-aids to the Colonel's outdated business model. But that is a decision for KFCC. That KFCC does not like the reality that it has long lived with is no excuse for a court to change it.

IV. Conclusion

In their complaint, the franchisees requested a declaration that the "NCAC Committee has the right to engage in a substantive planning, review and approval process with respect to the advertising program of the NCAC . . . and that the Committee is not limited to approving or disapproving KFCC's marketing and advertising proposals in the form recommended by KFCC."[169] For all of the above reasons, the franchisees' reading of the NCAC's Certificate is the more reasonable way to read the Certificate as a whole and I will grant the declaration that the franchisees seek, at least in part. To the extent

[169] Compl. ¶ 27.

franchisees seek, as their complaint also suggests, an affirmation from this court that the "NCAC has the ultimate authority with respect to the advertising programs of the NCAC,"[170] such a declaration must be tempered by the realities outlined above regarding KFCC's continued role in the process and there are many questions moving forward that still must be worked out by the parties in the context of concrete disputes.[171] In sum, the franchisees are entitled to a declaration that the NCAC Committee has the authority under the Certificate to adopt the advertising program of the NCAC by majority rule, and to include in that program, amendments to KFCC's proposals approved by a majority of the Committee. The NCAC's adopted program will necessarily provide guidance to KFCC on what products to feature in the creative advertising process and when, and KFCC has a duty to implement that plan in good faith. But KFCC does not have a duty, if it acts in good faith, to develop with the national advertising agency and air commercials or adopt advertising themes (see "All Fat, All Fried, All The Time") that KFCC and the agency think harmful to the KFC brand. The franchisees shall submit an implementing form of order, upon notice and approval as to form by KFCC, within ten days. IT IS SO ORDERED.

[170] *Id.*

[171] The franchisees also asserted that KFCC has targeted franchisee-members of the Committee for unfair audits of their stores in retaliation for the filing of this suit. The franchisees did not spend much time at trial on this claim and did not present evidence that convinces me that anything of the kind happened.