



IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE: APPRAISAL OF THE ORCHARD
ENTERPRISES, INC.

)
) No. 470, 2012
) Court below:
) Chancery Court of the
) State of Delaware
) Cons. C.A. No. 5713-CS
)

PETITIONERS-BELOW, APPELLEES' ANSWERING BRIEF

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NATURE OF PROCEEDINGS

This is an appeal from a statutory appraisal of The Orchard Enterprises, Inc. ("Orchard" or the "Company"). Petitioners-Below, Appellees, Merlin Partners LP, Matthew Giffuni, Christopher Yeagley and Quadre Investments LP, asserted appraisal rights in connection with a merger in which the Company's common stockholders were cashed out at a price of \$2.05 per share (the "Merger") by the Company's controlling stockholder, Dimensional Associates, LLC ("Dimensional"). Trial was held on April 2-3, 2012.

After post-trial briefing and argument, the Chancellor appraised the equity value of the Company at \$36.7 million and held that the fair value of Petitioners' shares of common stock was \$4.67 per share as of the Merger date. A Final Order and Judgment was entered in Petitioners' favor on July 26, 2012, awarding Petitioners in the aggregate \$2,821,249.74, plus interest and costs (the "Judgment"). The Chancellor set forth his reasons for the Judgment in a 55-page opinion dated July 18, 2012 (the "Opinion" or "Op.").

On appeal, Respondent does not challenge the appraised value of the Company. Rather, Respondent challenges how the equity value of the Company was allocated between the preferred and common stock. Specifically, Respondent asks this Court to reverse the Chancellor's valuation of the Company's preferred stock on an "as-converted" basis. Instead, it asks this Court to ignore the clear terms of the preferred stock's Certificate of Designations (the "Certificate of Designations"), and instead treat the stock's liquidation preference as a "debt" of the Company. Id. at 2. But there is no basis in law

or fact to warrant such treatment. Under the plain terms of the Certificate of Designations, the liquidation preference payment was not a current liability of the Company; but rather contingent on future events uncertain to occur. Indeed, at trial, Respondent proffered no evidence that the liquidation preference would ever be paid by the Company and Respondent's contention that such a speculative element of value should be considered in an appraisal proceeding is flatly contradicted by decades of precedent.

Accordingly, the Chancellor did not abuse his discretion, and correctly valued and allocated the equity value of the Company. In sum, the Chancellor's appraisal of Petitioners' shares rests upon unchallenged findings of fact and well-settled principles of Delaware law and the Judgment should be affirmed.

SUMMARY OF ARGUMENT

In response to Appellant, Respondent-below:

1. Denied. The only “specific, non-speculative contractual right” preferred stockholders had was to share in the Company’s cash flows on an as-converted basis, under ¶ 4 of the Certificate of Designations, which is the value the Chancellor used. Shiftan v. Morgan Joseph Holdings, Inc., 2012 WL 120196, at *9-*10 (Del. Ch.). Respondent proffered no evidence of when (if ever) the liquidation preference would be paid. Thus, the Chancellor properly found that “[w]hether the liquidation preference would ever be triggered in the future was entirely a matter of speculation as of the Merger date.” Op. at 2.

2. Denied. The preferred stockholders’ had no right to the liquidation preference except upon future events uncertain to occur. Thus, there was no basis to allocate the value of the preference to the preferred stockholders. The Chancellor correctly rejected Respondent’s market approach valuation of the Company’s common stock and appropriately awarded Petitioners their pro rata share in the going concern value of the Company.

3. Denied. The Chancellor correctly found that, as of the Merger date, the Company had no obligation to pay the liquidation preference and that any future payment of the preference was entirely contingent upon the preference being “triggered by unpredictable events.” Op. at 2. The liquidation preference payment was not a “liability” of “the common stockholders,” but rather a contractually defined preference expressly contingent upon future events uncertain to occur.

4. Denied. The Chancellor did not hold that the preferred stockholders waived their rights to the liquidation preference. To the contrary, the Chancellor found that the preference was "left in place, that Dimensional continued to own it, and as a matter of contract [it] remains payable in the event that one of the triggering events in the Certificate of Designations occurs in the future." Op. at 10. The Chancellor's appraised value of the Company was not affected by the form of transaction. Rather, the value allocated to the preferred stock was affected appropriately by the terms of the Certificate of Designations.

5. Denied. The Chancellor appropriately applied well-settled Delaware law in holding that the value of the preferred stock is based on the contractual preferences to which the preferred stock is entitled.

6. Denied. The Chancellor properly denied the Company's controlling stockholder a premium to what it was entitled to under the plain contractual terms of the preferred stock.

7. Denied. The Chancellor correctly applied well settled Delaware law in awarding Petitioners their pro rata share of the going concern value of the Company.

STATEMENT OF FACTS

The Chancellor's findings of fact "are not the basis for this appeal." Resp't Opening Br. at 14. Thus, the following findings of fact are undisputed.

A. Orchard's Capital Structure

Before the Merger, Orchard's capital structure consisted of common stock and preferred stock. Op. at 6. Dimensional owned 42.5% of the common stock, and essentially all of the Company's preferred stock. Op. at 6-7. Dimensional had 53% of the voting power of Orchard's outstanding capital stock because the preferred stock could vote on an as-converted basis. Op. at 7.

B. The Certificate of Designations

The Certificate of Designations sets forth the rights of the preferred stockholders. Op. at 7. The preferred stock has no set dividend rights, but is entitled to participate in any dividend declared by the Company on its common stock on an as-converted basis. Id. Each share of preferred stock is convertible at the option of the holder at any time into 3.33 shares of common stock. Id.

The preferred stock was entitled to a liquidation preference only upon the occurrence of specifically enumerated events in the Certificate. Op. at 7. "These events are limited to: (i) a 'voluntary or involuntary liquidation, dissolution, or winding up' of Orchard; (ii) 'the sale or exclusive license of all or substantially all of [Orchard's] assets or intellectual property,' in which case the company is required to liquidate, dissolve and wind up' as soon as possible thereafter; and (iii) a 'Change of Control' transaction 'in which the stockholders of [Orchard] will receive consideration from an

unrelated third party.'" Id. (citations to record omitted). These events "involve the end of Orchard's existence as a going concern." Id. at 15. Thus, "if Orchard remains a going concern, the preferred stockholders' claim on the cash flows of the [C]ompany (if paid out in the form of dividends) is solely to receive dividends on an as-converted basis." Id. at 16.

C. The Merger

In October 2009, Dimensional informed the Company's board of directors that it was making an offer for the outstanding common shares of the Company that it did not already own. Op. at 8. A special committee was formed and recommended the Merger after receiving a fairness opinion from Fesnak and Associates, LLP ("Fesnak"). Id. At the Company's annual meeting on July 29, 2010, a majority of the minority stockholders of the Company voted in favor of the Merger and the Merger became effective. Id. at 9.

D. The Amendment to the Certificate of Designations

In addition to approving the Merger at the July 29, 2010 annual meeting, the Company's stockholders also approved an amendment to the Certificate of Designations to facilitate the Merger. Op. at 9. As the Certificate of Designations existed prior to the amendment, the Certificate of Designations prohibited all types of "Change of Control Event[s]" other than two events requiring payment of the liquidation preference to the Company's preferred stockholders: (i) a sale of all or substantially all of the Company's assets or (ii) a sale of control to an unrelated third party. Id. The Merger did not fall within either of these exceptions. Id. "The amended language, which was also approved by Orchard's preferred stockholders, allowed Orchard to

enter into a transaction that would constitute an otherwise-prohibited Change of Control Event 'upon the prior vote or written consent of at least a majority of the then outstanding [preferred stock].'" Id. (citations to record omitted). As the Chancellor noted, "[i]n other words, the amendment allowed Orchard to engage in a merger with its majority stockholder, Dimensional, that would have otherwise been barred by the Certificate of Designations." Id.

E. The Value of the Company's Preferred Stock

At trial, the Chancellor was presented with two expert opinions as to the appropriate way to allocate value to the Company's preferred stock. Op. at 12. Respondent's expert opined that the value of the preferred stock should be based on the liquidation preference payment to be made to the preferred stockholders if a "Liquidation Event" as provided for in the Certificate of Designations were to occur. Id. Petitioner's expert concluded that such a payment "was speculative at best" and instead allocated value to the preferred stock on an as-converted basis. Id. The Chancellor rejected Respondent's expert's approach and adopted the approach of Petitioners' expert. Id.

Among the Chancellor's reasons for adopting Petitioners' approach in allocating value to the preferred stock was that the Merger did not provide for any payment to the holders of Orchard's preferred stock. Id. at 9-10. "[T]he preferred stock was left in place, Dimensional continued to own it, and as a matter of contract the liquidation payment remains payable in the event that one of the triggering events described in the Certificate of Designations occurs in the future." Id. at 10. Thus, "[a]s of the date of the Merger, the liquidation

preference had not been triggered, and the possibility that any of the triggering events would have occurred at all, much less in what specific time frame, was entirely a matter of speculation.” Id. at 14.

ARGUMENT¹

I. THE CHANCELLOR'S VALUATION OF THE PREFERRED STOCK RESTS UPON WELL SETTLED PRINCIPLES OF DELAWARE LAW AND UNCHALLENGED FINDINGS OF FACT

A. Question Presented

Did the Chancellor appropriately allocate the equity value of the Company between the preferred and common stock in this statutory appraisal proceeding?

B. Scope of Review

This Court reviews appraisal decisions by the Court of Chancery for abuse of discretion. Cede & Co. v. Technicolor, Inc., 884 A.2d 26, 35 (Del. 2005). In the context of an appraisal, this is an even more "formidable standard" in which this Court "accord[s] Court of Chancery determinations of value a high level of deference on appeal." Golden Telecom, Inc. v. Global GT LP, 11 A.3d 214, 219 (Del. 2010). This is given because the Court of Chancery "has developed an expertise in cases of this type." Id. (quoting In the Matter of the Appraisal of Shell Oil Co., 607 A.2d 1213, 1219 (Del. 1992)). So long as the Court of Chancery's determination of value is based on the application of recognized valuation standards, its acceptance of one expert's opinion to the exclusion of another will not be disturbed. Id.; accord Kahn v. Lynch Commn'ns Sys., Inc., 669 A.2d 79, 87-88 (Del. 1995). Moreover, the Court of Chancery is entitled to draw its own conclusions from the evidence when faced with differing

¹ Respondent fails to divide its argument into appropriate headings and fails to appropriately identify the questions it presents to the Court on appeal in accordance with Rule 14, and generally fails to organize its brief in an intelligible and coherent manner.

methodologies or opinions. Golden Telecom, 11 A.3d at 217; Kahn v. Household Acquisitions Corp., 591 A.2d 166, 175 (Del. 1991).

"To the extent [the Court of Chancery's] decision implicates the statutory construction of DGCL §262," this Court's standard of review is de novo. Golden Telecom, 11 A.3d at 216-17. However, Respondent's appeal is not based on statutory construction. Rather, it is based on the dubious claim that the Chancellor did not give sufficient weight to a liquidation preference payment that was "entirely a matter of speculation." Op. at 14. Thus, the abuse of discretion standard applies.

C. Merits of Argument

The Chancellor properly considered each of the contractual preferences of the preferred stock and valued the stock based on all non-speculative elements of value. The Chancellor's valuation of the Company's preferred stock rests upon well-settled principles of Delaware law and unchallenged findings of fact.

1. The Relevant Valuation Standard

The valuation standard in an appraisal proceeding is well-settled. "Section 262(h) unambiguously calls upon the Court of Chancery to perform an independent evaluation of 'fair value' at the time of a transaction." Golden Telecom, 11 A.3d at 217. For purposes of Section 262, "fair value" means the value of the company to the stockholder as a going concern. M.P.M. Enters., Inc. v. Gilbert, 731 A.2d 790, 795 (Del. 1999). This Court has long recognized that "the failure to value the company as a going concern may result in an understatement of fair value." Gonsalves v. Straight Arrow Publishers, Inc., 701 A.2d 357, 362 (Del. 1997); Cede & Co. v.

Technicolor, Inc., 684 A.2d 289, 299 (Del. 1996). The Court of Chancery should consider “all relevant factors known or ascertainable as of the merger date that illuminate the future prospects of the company.” Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983). However, “any synergies or other value expected from the merger giving rise to the appraisal proceeding itself must be disregarded.” Global GT LP v. Golden Telecom, Inc., 993 A.2d 497, 507 (Del. Ch. 2010), aff’d, 11 A.3d 214 (Del. 2010). Also, “speculative elements of value should be excluded from the valuation calculus.” Gonsalves, 701 A.2d at 362. “Determining ‘fair value’ through ‘all relevant factors’ may be an imperfect process, but the General Assembly has determined it to be an appropriately fair process.” Golden Telecom, 11 A.3d at 217. Accordingly, the Court of Chancery is given broad discretion to determine fair value. Technicolor, 684 A.2d 299.

It is well-settled that stock preferences must be clearly stated and are “strictly construed.” Waggoner v. Laster, 581 A.2d 1127, 1135 (Del. 1990); accord Matulich v. Aegis Commun. Essar Invs., Ltd., 942 A.2d 596, 600 (Del. 2008) (“Any rights, preferences . . . of preferred stock that distinguish that stock from common stock must be expressly and clearly stated.”); Rothschild Int’l Corp. v. Liggett Group Inc., 474 A.2d 133, 136 (Del. 1984) (same). “Unlike common stock, the value of preferred is determined solely from the contract rights conferred upon it in the certificate of designations.” In re Appraisal of Metromedia Int’l Group, Inc., 971 A.2d 893, 900 (Del. Ch. 2009). Thus, a preferred stockholder’s “right to be paid the amount due in the event of a liquidation or redemption arises only in the

circumstances specified in the preferred stock terms.” Id. at 906 (quoting 1 Lou R. Kling & Eileen T. Nugent, Negotiated Acquisitions of Companies, Subsidiaries and Divisions §4.12, 4-189 (2008)). Moreover, the value of any such right of payment under the preferred stock terms that is contingent upon “a future event that is not certain to occur, and that has not occurred as of the appraisal date” is speculative. Id. at 905; Shiftan, 2012 WL 120196 at *9. Consequently, to the extent such elements of value are not “known or susceptible of proof as of the date of the merger” they may not be considered in an appraisal proceeding. Weinberger, 457 A.2d at 713; Gonsalves, 701 A.2d at 362.

2. The Chancellor Correctly Found that Allocating Value to the Preferred Stock Based on its Liquidation Preference Was Inconsistent with a Going-Concern Valuation of the Company

The Chancellor correctly found that allocating value to the preferred stock based on its liquidation preference was inconsistent with a going-concern valuation of the Company. Respondent does not challenge the going-concern valuation standard. Indeed, in valuing the Company, Respondent’s expert assumed the Company would continue to operate as a going concern. A676 (“[t]his calculation assumes that the Company will continue to operate as a going concern”). In applying the well-settled going-concern valuation standard, the Chancellor held that:

[I]n this case, if Orchard remains a going concern, the preferred stockholders’ claim on the cash flows of the company (if paid out in the form of dividends) is solely to receive dividends on an as-converted basis. That is, in the domain of appraisal governed by the rule of Cavalier Oil, the preferred stockholders’ shares of Orchard’s going concern value is equal to the preferred stock’s as-

converted value, not the liquidation preference payable to it if a speculative event . . . that Cavalier Oil categorically excludes from consideration occurs.

Op. at 16.² As the Chancellor further explained, "Allocating the value of the liquidation preference to Orchard's preferred stockholders would be tantamount to valuing the company on a liquidation basis or presuming a sale of the company, because it is only in those circumstances that the preference would be triggered." Op. at 18. The holding appropriately applies well-settled law to value the Company on a going-concern basis. See, e.g., Technicolor, 684 A.2d at 298; Rapid-Am. Corp. v. Harris, 603 A.2d 796, 802-03 (Del. 1992); Bell v. Kirby Lumber Corp., 413 A.2d 137, 141-42 (Del. 1980).

Under the well-settled valuation standard and Respondent's own expert's valuation assumption, the liquidation preference would never be paid. Respondent disagrees and contends that accounting for the liquidation preference "merely takes into account how the market valued [the Company] as a going concern." Resp't Opening Br. at 19. It is well-established, however, that a stock price is not representative of a stockholder's pro rata share in the Company on a going-concern basis. Technicolor, 684 A.2d at 301; Rapid-Am. Corp., 603 A.2d 806. Indeed, this Court rejected the same argument Respondent advocates in Cavalier Oil. When reduced from its rhetoric, Respondent's position is simply that the value of Petitioners' shares should be based upon their market value. Respondent "misperceives the

² Cavalier Oil Corp. v. Hartnett, 564 A.2d 1137 (Del. 1989).

nature of the appraisal remedy." Cavalier Oil, 564 A.2d at 1145. As this Court explained twenty-three years ago:

[T]he appraisal process is not intended to reconstruct a *pro forma* sale but to assume that the shareholder was willing to maintain his investment position, however slight, had the merger not occurred. Discounting individual share holdings injects into the appraisal process speculation on the various factors which may dictate the marketability of minority shareholdings. More important, to fail to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result.

Id. Delaware courts consistently reject such "market based" arguments in appraisal proceedings, and Respondent's should be rejected here. Moreover, Respondent did not proffer any evidence at trial to establish that the Company's stock price was a reliable indication of fair value for the Company or even its stock. There is simply no basis in fact or law to use the "market price" of the Company's common stock to assign a "liquidation preference" value to the preferred stock. The Chancellor's decision not to do so is well reasoned and fully supported by the record, and should be affirmed.

3. The Chancellor Correctly Found that the Value of the Liquidation Preference Was Speculative

The Chancellor also correctly found that even if the liquidation preference could be considered on a going-concern basis, the value of the preference was entirely speculative because Respondent offered no factual basis as to when the preference would be paid. See Op. at 14 ("But as of the date of the Merger, the liquidation preference had not been triggered, and the possibility that any of the triggering events would have occurred at all, much less in what specific time frame, was

entirely a matter of speculation."); compare Shiftan, 2012 WL 120196 at *3 (liquidation preference was automatically required to be paid on specified date of "July 1, 2011").

The Chancellor explicitly reviewed the terms of the Company's preferred stock. Op. 6-7. The Chancellor explicitly found that the Merger "was not an event triggering the payment of the liquidation preference." Op. at 14. The Chancellor explicitly found that "as of the date of the Merger, the liquidation preference had not been triggered, and the possibility that any of the triggering events would have occurred at all, much less in what specific time frame, was entirely a matter of speculation." Op. at 14. Respondent does not dispute the Chancellor's findings of fact with respect to the terms of the preferred stock. Resp't Opening Br. at 14. Thus, there is simply no basis in the record at all to assume the liquidation preference would ever be paid. As stated, the factual record is apiece with Respondent's own expert's assumption that the Company would continue as a going concern into perpetuity, and that the liquidation preference would never be paid. A676 at ¶15. Accordingly, the Chancellor's factual finding that the liquidation preference was speculative is firmly established by the record, and should be affirmed.

4. Respondent's Conclusory Assertions Through-out Its Opening Brief that the Liquidation Preference Was "Nonspeculative" Are Without Foundation

Respondent maintains through-out its opening brief that the liquidation preference is "non-speculative" without reference to a single salient fact to support that the preference will ever be paid.

Petitioners have challenged Respondent repeatedly through-out this litigation on this lack of foundation and Respondent has done nothing but repeatedly dodge the challenge. The very issues Respondent has rehashed on appeal were briefed below ad nauseam. As Petitioners' state in their Post-trial Reply Brief:

Petitioners have repeatedly argued with supporting authority that because the "when" of any payment of the liquidation preference is undefined, the value of the liquidation preference is speculative. This point has been lost on Respondent. Respondent seems to purposefully obfuscate. . . . Petitioners have **consistently** argued. . . . that the value of the liquidation preference was speculative before the Merger, upon consummation of the Merger, and continues to be speculative after the Merger. Why? Because there is no evidence it will ever be paid. . . . Respondent simply relies on the \$55.70 per share stated in Section 2(a) of the Certificate of Designations as if it was money in the bank. But Respondent concedes that it does not even know how much the preferred stockholders would be paid if the liquidation preference were someday triggered. It is impossible to value a future contingent payment without evidence of how much would be paid and when the payment is likely to be made.

B100-101 (Petitioners' Post-Trial Reply Brief at 4-5); see also B26-27 (Petitioners' Pre-Trial Opening Br. at 22-23); B42-44 (Petitioners' Pre-Trial Answering Br. at 6-8); B69-71 (Petitioners' Post-Trial Opening Br. at 11-13; compare Metromedia, 971 A.2d at 904-05 (finding liquidation preference to be speculative when based on the occurrence of future events uncertain to occur) with Shiftan, 2012 WL 120196, at *6 (valuing the preferred stock based on the liquidation preference that provided for a specific future "harvest date"). Respondent's appeal brings nothing new to this dispute.

If anything, Respondent's position on appeal only underscores that the Chancellor's characterization of Respondent's arguments below ("ever-evolving yet constantly confused," Op. at 12) was no

exaggeration. First, Respondent contends that the liquidation preference is non-speculative because upon completion of the Merger, the liquidation preference simply became “a vestigial obligation” by Dimensional to pay itself if it “so elected.” Resp’t Opening Br. at 20. That is, in Respondent’s mind the preference was a “paper debt from the preferred stockholder to itself.” Id. at 2. This contention has no support in Delaware law. See Norte & co. v. Manor Healthcare Corp., 1985 WL 44684, at *3 (Del. Ch.) (“[T]he corporation is the legal owner of its property and the stockholders do not have any specific interest in the assets of the corporation.”); Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1265 (Del. 2012) (“No stockholder, including the majority stockholder, has a claim to any particular assets of the corporation.”).

Second, Respondent contends that the liquidation preference is non-speculative because “[n]o value could come to the common stock outside the market price for their shares without payment of this preference first to the preferred stockholders.” Resp’t Opening Br. at 20. This is false. As the Chancellor concluded, just like the preferred stock, the value of the common stock is to “share in the [future] cash flows of Orchard” assuming “the [C]ompany remained a going concern.” Op. at 16. This is precisely the assumption Delaware law requires. See, e.g., 8 Del. C. §262 (h); Golden Telecom, 11 A.3d at 217 (“this Court has defined ‘fair value’ as the value to a stockholder of the firm as a going concern”); accord, M.P.M. Enters., 731 A.2d at 795; Technicolor, 684 A.2d at 298; Cavalier Oil, 564 A.2d at 1144; Tri-Continental Corp v. Battye, 74 A.2d 71, 72 (Del. 1950).

Third, Respondent claims the liquidation preference is non-speculative by attempting to distinguish this case from Metromedia. According to Respondent, the ruling in Metromedia had something to do with available exit strategies to common stockholders that are not available to the Company's common stockholders here. See Resp't Opening Br. at 21 ("No such exit strategies were available to the holders of Orchard's common stock."). Metromedia had nothing to do with common stockholders. At issue in Metromedia was the appraisal of certain convertible preferred stock. 971 A.2d at 895. The discussion of "exit strategies" in Metromedia concerned the extent to which one has to speculate to value preferred stock based on future events uncertain to occur. Id. at 904-05. Chancellor Chandler was providing examples as to why petitioners' view that awarding an appraisal value based on "hypothetical" scenarios (i.e., "what the preferred holders would have been entitled to had their stock been redeemed or had there been a liquidation event") is "based on a fundamental misconception of the contractual obligations imposed by the certificate." Id. at 904. Indeed, as the Chancellor noted below, this case is very much like Metromedia. Op. at 14-15.

Fourth, and perhaps most curious, Respondent contends that the Chancellor misunderstands Shiftan, a decision the Chancellor penned just six months prior to his decision in this case. According to Respondent, if the Chancellor properly applied Shiftan here, he would have agreed that the liquidation preference was non-speculative. Resp't Opening Br. at 21-22. Apparently, no matter how much ink is spilled on the issue, Respondent is incapable of understanding the

difference between a case like Shiftan, where the certificate of designations gave the preferred stockholders a put right on a specific date in the future, and the case at bar, where Dimensional had no such right. Op. at 16.

Finally, Respondent wrongly contends that the Chancellor imposed a “bright-line test” where a liquidation preference can never be considered in valuing preferred stock “because it had not been triggered.” Resp’t Opening Br. at 23. All the Chancellor did here, however, was require Respondent to meet its burden at trial by demonstrating that the value of the liquidation preference payment was known or susceptible of proof as of the date of the Merger. Respondent failed to do that.

The record firmly establishes that the Chancellor carefully considered each of the parties’ respective positions and the evidence proffered in support thereof, and rejected Respondent’s baseless contention that he should simply presume that the appropriate value to allocate to the preferred stock was equal to the amount provided for in the liquidation preference set forth in the Certificate of Designations. The Chancellor’s determination was rational and not capricious, and his reasons were fully set forth in the 55-page Opinion. Respondent has offered no basis in law or fact to disturb the Chancellor’s ruling. Accordingly, it should be affirmed.

II. THE CHANCELLOR CORRECTLY REFUSED TO AWARD A CONTROL PREMIUM TO DIMENSIONAL

A. Question Presented

Did the Chancellor properly deny the Company's controlling stockholder a premium to what it was entitled to under the plain contractual terms of the preferred stock in valuing Petitioners' shares?

B. Scope of Review

The scope of review for Argument II is the same as set forth for Argument I.

C. Merits of the Argument

The Chancellor properly denied the Company's controlling stockholder a premium to the preferred stock's value under the plain terms of the Certificate of Designations as required by Cavalier Oil. Cavalier Oil specifically rejected application of a discount at the shareholder level in an appraisal action as "contrary to the requirement that the company be viewed as a 'going concern.'" 564 A.2d at 1145. Here, Respondent asserts that the Chancellor "effectively . . . required the preferred stockholders [i.e., Dimensional] to share the liquidation preference with the common." Id. at 26 (emphasis added). Respondent claims that this placed the "common on par with the preferred and violate[d] the Certificate of Designations." Id. Respondent is wrong in fact and in law.

The Chancellor's ruling does not violate the Certificate of Designations and does not place the "common on par with the preferred." There is nothing in the Certificate of Designations that entitles the preferred stockholders to award themselves the value of the liquidation preference when it has not been (and may never) be

paid. The preferred stockholders are not entitled to the preference payment until "one of the triggering events described in the Certificate of Designations" has occurred. Op. at 10. As of the Merger date, none of those events had been triggered, and the "possibility that any of the triggering events would . . . occur[] at all . . . was entirely a matter of speculation." Id. at 14.

That did not leave the preferred stockholders on par with the common stockholders; it left the preferred stockholders with a right to convert to 3.33 shares of common at their option, which is exactly how the Chancellor valued the preferred stock. Thus, the Chancellor appropriately recognized Respondent's position for what it is: an effort to obtain an unwarranted premium to the contractual rights of the preferred stockholders - i.e., the Company's controlling stockholder - in an appraisal proceeding.

As the Chancellor explains, "[w]hat Orchard is in substance arguing is that Dimensional's majority voting control and the Certificate of Designations gave it power to command the payment of the liquidation preference in a future merger - as Orchard calls it, a 'change of control premium' - and therefore that Dimensional should be treated as having the ability to extract \$25 million as of the date of the . . . Merger as a right of this power position." Op. at 19. The Chancellor rejected this argument because it is "exactly the sort of argument that Cavalier Oil bars in an appraisal." Id.

On appeal, Respondent disagrees and contends that "it is not seeking to alter the value of any shares based on who owned them; it is merely seeking to have the corporation's obligations to all the

preferred stockholders fairly accounted for when valuing all of the common shares.” Resp’t Opening Br. at 26. But, as explained above, the liquidation preference payment was not an obligation due to the preferred stockholders. Op. at 10, 14. It was contingent upon future events uncertain to occur. Id. It is unfathomable that Respondent misapprehends this basic fact.

Unfortunately, however, Respondent’s misapprehension of the law is just as severe. Respondent relies on Tri-Continental Corp. v. Battye, 74 A.2d 71 (Del. 1950) – which was not cited in either Respondent’s pre-trial or post-trial briefs – to present an entirely new, misguided argument on appeal to support its position. A687, A832-33.³ Respondent claims that Tri-Continental supports the use of a discount to devalue the Company’s common stock. But “[t]here was no discount at the shareholder level in Tri-Continental” Paskill Corp. v. Alcoma Corp., 747 A.2d 549, 557, n.49 (Del. 2000). Indeed, to the contrary, “the Tri-Continental decision exemplifies the distinction between applying the discount at the company level against all assets and its use to further devalue a shareholder’s proportionate interest.” Cavalier Oil, 564 A.2d at 1145. The “discount” in Tri-Continental was applied to the corporation’s net asset value to derive the intrinsic value of the company. Tri-Continental, 74 A.2d at 74-75. This Court concluded that the discount was appropriately applied because the “net asset value” of the company at issue in Tri-Continental could only be realized upon the

³ Thus, aside from disregarding Rule 14 as to the form and substance of its brief, Respondent also disregards Rule 8 (“Only questions fairly presented to the trial court may be presented for review”).

liquidation of the company, which ran afoul of valuing the company as a going concern. Id. This Court has noted that the discount in Tri-Continental is similar to the control premium placed at the corporate level in the comparative acquisition approach to valuing a company. Paskill, 747 A.2d at 556; Rapid-American, 603 A.2d at 806. Both are used to derive the going-concern value of a company, not to devalue a minority interest as Respondent advocates. Indeed, as discussed above, Delaware courts have repeatedly rejected the very same argument that Respondent makes here. See, e.g., Cavalier Oil, 564 A.2d 1145.

The Chancellor correctly concluded that the premium Respondent seeks on Dimensional's preferred stock is impermissible in an appraisal proceeding. Op. at 19; Paskill, 747 A.2d at 557; Cavalier Oil, 564 A.2d 1144-1145. The Chancellor's decision is well reasoned, supported by the record, and supported by well-settled Delaware law. Accordingly, it should be affirmed.

III. THE BALANCE OF RESPONDENT'S ASSERTIONS ARE BASELESS

A. Question Presented

Did the Chancellor abuse his discretion in rejecting arguments unfounded in law or fact?

B. Scope of Review

The scope of review for Argument III is the same as set forth for Argument I.

C. Merits of Argument

Respondent's opening brief includes a litany of rehashed, repeated, and generally baseless contentions of fact and law knotted through-out the various subsections of Respondent's "Merits of Argument," some of which refer this Court to material extraneous to the trial record or inappropriately introduced post-trial below. Regardless, none of the contentions has any merit, and to the extent they were presented to the Chancellor below, they were appropriately rejected.

1. Petitioners Have Not Received a Windfall

Dimensional's dismay with the appraisal statute comes on display in Respondent's claim that Petitioners have received a windfall. In Dimensional's view, Section 262 is an "artifice" unfairly used by Petitioners to transfer the going-private value of the Company (or at least Petitioners' pro rata share of it) from its pockets to theirs - "at no cost." Resp't Opening Br. at 35. Respondent claims that the Chancellor has bestowed Petitioners with value they "never could have realized in any other place or time." Id. As discussed above, that is not true. Petitioners were appropriately awarded the value they would have received had they been allowed to maintain their interest in the

going concern value of the Company. That the value Petitioners have been awarded is greater than what Dimensional paid in the Merger is mostly a function of the terms on which Dimensional invested in the Company as set forth in the Certificate of Designations. The outcome here therefore cannot possibly be termed “unfair” and indeed would have been much different had Dimensional invested in a debt instrument of the Company instead of the convertible preferred equity “debt-like” instrument it chose. “The reality is that these preferences don’t always hit.” A824 389:17–18. Dimensional, “a titan of private equity,” id. at 389:12, knew this and accepted the risk.

It is undisputed that the liquidation preference did not “hit” here, and that the value of the preference would continue to remain with the Company as of the Merger date. As dissenting stockholders, Petitioners are entitled to share in that value.

That does not create a windfall and appraisal is not some clever trick. Appraisal is a statutory stockholder right for a judicial determination of the fair value of shares because the stockholders dissent to the transaction. That is the quid pro quo for a stockholder’s common law right to veto a merger. Reynolds Metals Co. v. Colonial Realty Corp., 190 A.2d 752, 755 (Del. 1963) (“When the law was changed to permit a specified majority to override [a dissenter’s] objection, the right of appraisal was given to the dissenter in compensation for the loss of the common law right.”). The legislative intent of the appraisal statute is “to fully compensate shareholders for whatever their loss may be.” Weinberger, 457 A.2d at 714. Thus, this Court “created the appraisal-unique ‘fair value’ standard because

it recognized that appraisal was a unique remedy, created by statute, . . . with unique policy goals.” Union Illinois v. Korte, 2001 WL 1526303, at *7 (Del. Ch.)

Exercising appraisal rights is not free either. “[A]ppraisal is a risky, time-consuming, and burdensome remedy that involves a stockholder tying up its investment in a legal proceeding for several years and having to bear its own cost of prosecution, without any guarantee to receive any floor percentage of the merger consideration.” Op. at 18, n.45. In exchange, dissenting stockholders are entitled to their pro rata portion of the Company valued as a going concern, Paskill, 747 A.2d at 557 (stockholder seeking appraisal is “entitled to receive the fair value of its proportionate interest in that operating entity at the time of the merger without any discount at the shareholder level”); not the value of the Company “in the context of an acquisition or other transaction,” Golden Telecom, 11 A.3d at 217; not the value agreed to by a special committee, and not the value the shares traded at on the market. See, In re Emerging Comm’cns, Inc. S’holders Litig., 2004 WL 1305745, at *22-23 (Del. Ch.) (appraising common stock in going-private transaction at \$38.05 per share despite \$7.00 per share market price, and \$10.25 transaction price purportedly negotiated by a special committee); Harris v. Rapid-American Corp., 1992 WL 69614, at *1, 3 (Del. Ch.) (\$28.00 merger price, representing more than a 62% premium over unaffected trading price of \$17.25, was barely one-third of adjudicated fair value of \$73.29).

Allowing Dimensional to curtail Petitioners' appraisal rights by valuing the Company on a basis other than a going-concern, applying a minority discount or grafting a preference into the Certificate of Designations that simply does not exist is contrary to the long-settled principles of Delaware law and policy regarding appraisal rights of dissenting stockholders. Indeed, as this Court held in Cavalier Oil, Respondent's arguments would improperly permit "majority shareholders" to "reap a windfall from the appraisal process by cashing out [] dissenting shareholder[s]." 564 A.2d at 1145. The Chancellor correctly refused to stray from these well-settled principles of Delaware law and policy in awarding fair value to Petitioners and his Judgment should be affirmed.

2. The Chancellor Gave Appropriate Weight to the Financial Statements the Company Filed with the SEC

Respondent places significance on the fact that the Company's financial statements set forth the amount the preferred stockholders would be paid if a liquidation event were to occur. Resp't Opening Br. at 29. Notably, the liability carried by the Company on the balance sheet was not the \$24.99 million that Respondent advocates, but rather \$7,015,276, which was approximately their as-converted value. A433; see also A586 (quoting from Form 10-Q for period ending March 31, 2010: "The securities are carried at their face value (representing fair value) because the contingency has not been met and it is not probable. If the redemption were considered likely to occur, the carrying value would be adjusted to its liquidation value.")). This evidence was presented at trial and the Chancellor gave it appropriate weight.

3. The Chancellor Gave Appropriate Weight to Respondent's Untimely Submission of Generic References

Respondent refers this Court to material published by the American Institute of Certified Public Accountants and Mr. Hitchner describing liquidation preferences generally. Respondent's Opening Br. at 31. None of these generic references deal with the actual contractual language at issue. Id.; compare Metromedia, 971 A.2d at 900 ("the value of preferred is determined solely from the contract rights conferred upon it"). Regardless, these generic references were presented below (Respondent presented this material for the first time post-trial) and the Chancellor gave them appropriate weight. See A853-54; see also B99 (Petitioners' Post-Trial Reply Brief at 3). To the extent Respondent refers this Court to venture capital websites, those references are not part of the trial record and, in any event, are as generic as Respondent's other references.

4. The Sky Is Not Falling: the Chancellor Ruled Exactly How Investors Expect Delaware Courts to Rule - Giving Full Force to Contractual Arrangements between Sophisticated Parties

Respondent rings false alarms that the Chancellor's decision in this case will "surprise investors" and that it "may have the unintended consequence of driving venture capital funded start-ups to incorporate in other jurisdiction." Resp't Opening Br. at 29.

Respondent is wrong. What would "surprise investors" (and corporate practitioners alike) is if the Chancellor held that the Certificate of Designations did not mean what its plain terms stated. Under well-settled principles of Delaware law, preferences against the corporation's common stock must be clearly stated, and will be strictly construed. Waggoner, 581 A.2d at 1134-35; see also Elliott

Assocs., L.P. v. Avatex Corp., 715 A.2d 843, 852-53 (Del. 1988); Rothschild Int'l, 474 A.2d at 136. This clear statement rule is an important bulwark to shareholder rights because such preferences "are in derogation of the common law." Waggoner, 581 A.2d at 1134; Gaskill v. Gladys Belle Oil Co., 146 A. 337, 339 (Del. Ch. 1929) ("[O]rdinarily preferred stock is entitled to no preference over other stock, in relation to capital."). This bedrock principle "serves a sound public policy. . . that those who contemplate the acquisition of stock in Delaware corporations may have a sure and certain place to which they may resort for authoritative information touching the capital structure of the concern into which they contemplate buying." Gaskill, 146 A. at 340. Without such clarity, "it is manifest that obscurity of the most aggravated type would envelop all the issues of corporate stocks." Id.

Moreover, "[d]elineating the specific rights and limitations of preferred shareholders is the function of corporate drafters." Matulich, 942 A.2d at 599. Section 151(a) of the DGCL "hand[s] the drafter of the corporate charter a blank slate on which . . . the drafter may parse . . . rights among multiple classes of stock as he or she sees fit." Id. (quoting William W. Bratton, Corporate Finance 486 (6th ed.2008)).

Dimensional was the Company's controlling stockholder and purportedly "infus[ed] most of the concern's capital." Resp't Opening Br. at 1. Like in Shiftan, Dimensional could have negotiated an exit; it could have negotiated a put right setting the date on which the liquidation preference would be paid. It did not. A824 389:10-16.

Dimensional cannot now get the benefit of a right for which it did not obtain. See GRT, Inc. v. Marathon GTF Technology, Ltd., 2012 WL 2356489, at *7 (Del. Ch.) (“Under basic principles of Delaware contract law, and consistent with Delaware's pro-contractarian policy, a party may not come to court to enforce a contractual right that it did not obtain for itself at the negotiating table.”).

The Chancellor’s ruling faithfully applies long-established principles of contract law that corporate drafters rely upon when crafting the preferences of preferred stock by enforcing the plain terms of the Certificate of Designations. The Judgment should be affirmed.

CONCLUSION

For all the foregoing reasons, the opinion and judgment of the Court of Chancery below should be affirmed.

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CERTIFICATE OF SERVICE

I, Ronald A. Brown, Jr., do hereby certify on this 5th day of November, 2012, that I caused a copy of Petitioners-Below, Appellees' Answering Brief to be served via eFiling through LexisNexis File and Serve to counsel for the parties as follows:

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