IN THE

Supreme Court of the State of Delaware

QUADRANT STRUCTURED PRODUCTS COMPANY, LTD., Individually and Derivatively on Behalf of Athilon Capital Corp.,

Plaintiff Below-Appellant,

v.

VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALEZ, BRANDON JUNDT, J. ERIC WAGONER, ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENT ADVISORS LLC, and EBF & ASSOCIATES, LP,

Defendants Below-Appellees.

No. 338, 2012

COURT BELOW:

THE COURT OF CHANCERY OF THE STATE OF DELAWARE, C.A. NO. 6990-VCL

APPELLEE EBF'S ANSWERING BRIEF

SEITZ ROSS ARONSTAM & MORITZ LLP
Collins J. Seitz, Jr. (No. 2237)
Garrett B. Moritz (No. 5646)
Eric D. Selden (No. 4911)
Anthony A. Rickey (No. 5056)
100 South West Street, Suite 400
Wilmington, Delaware 19801
(302) 576-1600

Attorneys for Defendant Below-Appellee EBF & Associates, LP

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NATURE OF PROCEEDINGS

Athilon Capital Corp. ("Athilon"), a credit derivative product company, is a wholly owned subsidiary of Athilon Group Holdings Corp. ("AGH" or "Holdings"). In August 2010, AGH Acquisition Partners ("AGHAP") acquired 100% of AGH. EBF & Associates, LP ("EBF") is alleged to indirectly own 100% of Athilon's equity through AGHAP.

Quadrant Structured Products Company, Ltd. ("Quadrant") purchased Athilon notes in May and July 2011. On July 8, 2011, Quadrant sent Athilon a purported derivative demand alleging breach of fiduciary duty and proposing that Quadrant replace Athilon-affiliated servicer Athilon Structured Investment Advisors LLC ("ASIA") in exchange for an annual $5 million servicing fee. Athilon refused. Quadrant then filed this noteholder suit against Athilon, ASIA, Athilon's directors (collectively, the "Athilon Defendants"), and EBF. With respect to EBF, Quadrant alleged breach of fiduciary duty, an alternative claim for aiding and abetting fiduciary breach, fraudulent transfer, intentional interference with contract, unlawful constructive dividend, and civil conspiracy. At its core, Quadrant's complaint is based on the theory that Athilon's solvency must be determined by comparing the present value of assets on hand to the future value of debts not due for decades.

Quadrant's complaint attempts to portray EBF, Athilon's purported ultimate parent, as wrongfully siphoning off cash at the expense of creditors. But that is belied by the complaint's own allegations. For example, while the indentures permit Athilon to defer interest payments on all of its notes for up to five years, to date Athilon has not exercised any of those rights. And while Athilon has continued paying service and licensing fees to its affiliate ASIA under contracts entered before AGHAP's acquisition of AGH, the complaint acknowledges that those fees decreased in 2011 under the new owners' stewardship.

On February 15, 2012, the defendants moved to dismiss under Court of Chancery Rules 12(b)(6) and 23.1. The defendants argued that Quadrant's suit was barred at the threshold by Quadrant's failure to comply with the no-action clauses contained in the relevant indentures. Defendants also asserted multiple other grounds for dismissal. The Court of Chancery granted the motions to dismiss in light of the no-action clauses. The trial court did not reach any of the other grounds asserted for dismissal. This is Quadrant's appeal from the judgment.

SUMMARY OF ARGUMENT

1. Denied. As set forth in the Athilon Defendants' Answering Brief ("Athilon Br.") at Section I.C.3-.4, the Vice Chancellor correctly dismissed Quadrant's claims for failure to comply with the no-action clauses. If the no-action clauses apply, they bar Quadrant's claims against EBF even though EBF did not itself issue the relevant notes, because a no-action clause "applies equally to claims against non-issuer defendants as to claims against issuers." *Feldbaum v. McCrory Corp.*, 1992 Del. Ch. LEXIS 113, at *25 (Del. Ch. June 1, 1992).

2. Denied. As set forth in the Athilon Defendants' Answering Brief at Section I.C.5, a no-action clause can apply to derivative claims.

3. Denied. As set forth in the Athilon Defendants' Answering Brief at Section I.C.6, the Court of Chancery did not construe the no-action clauses as a "blanket waiver" of remedies outside the indenture. To be sure, no-action clauses do impose additional procedural requirements that make it more difficult for one noteholder to bring unmeritorious claims that are unpopular with other noteholders. But that is not a "blanket waiver" of remedies.

4. Even if this Court disagrees with the trial court's rationale for dismissing Quadrant's complaint, this Court should still affirm the dismissal of Quadrant's claims against EBF. EBF presented the trial court with independent alternative grounds for dismissal. This Court may affirm based on those alternative grounds even though the trial court did not address them. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1390 (Del. 1995).

a. Quadrant's derivative claims against EBF should be dismissed. First, Quadrant's claim for fiduciary breach against EBF is premised on EBF's alleged status as indirect 100% stockholder of Athilon. But "[w]holly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations" and "a parent corporation does not owe fiduciary duties to its wholly-owned subsidiaries or their creditors." *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 173, 191 (Del. Ch. 2006), *aff'd sub nom. Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007) (Table). Because Athilon is a wholly owned subsidiary, Quadrant should not be able to assert a breach of fiduciary duty claim against Athilon's alleged ultimate parent.

Second, even assuming that a parent corporation can owe fiduciary duties to a wholly owned subsidiary or that subsidiary's creditors, the fiduciary breach claim against EBF fails as a matter of law because (1) Quadrant does not meet Rule 23.1's "contemporaneous ownership" requirement for conduct occurring before May 2011, the date Quadrant first acquired Athilon notes, (2) the complaint does not adequately plead insolvency, which is required to give creditors standing to sue derivatively, and in any event does not adequately allege insolvency until September 30, 2011 at the earliest, and (3) the limited allegations regarding post-May 2011 or September 30, 2011 conduct do not state a claim. Quadrant's alternative claim against EBF for aiding and abetting should also be dismissed, as should the constructive dividend and civil conspiracy claims that Quadrant alleged both directly and derivatively.

b. Quadrant's direct claims against EBF should be dismissed:

i. As set forth in the Athilon Defendants' Answering Brief at Section II.C, the complaint fails to adequately allege insolvency, an element of a claim for fraudulent transfer, among other things. The fraudulent transfer claim against EBF should therefore be dismissed.

ii. Because Quadrant's underlying contract claim against Athilon for breach of the implied covenant of good faith and fair dealing fails to state a claim, the intentional interference claim against EBF should also be dismissed. And even if the implied covenant claim somehow survives dismissal, the interference claim against EBF should still be dismissed because, in Section 13.01 of the indentures, Quadrant expressly "waived and released" any claims against "any … direct or indirect stockholder" of Athilon "under or upon any … covenant … contained in the indenture" by purchasing the Athilon notes.

iii. Quadrant's claim alleging that Athilon's payment of contractual service and licensing fees should be recast as an unlawful "constructive dividend" in violation of 8 *Del. C.* §§ 170, 173 and 174 is without basis and has never been recognized by a Delaware court.

iv. Quadrant's civil conspiracy claim against EBF is duplicative of its aiding and abetting claim and should be dismissed for the same reasons. In any event, because Quadrant has failed to allege a predicate underlying wrong, its civil conspiracy claim should be dismissed.

STATEMENT OF FACTS[1]

A. The parties

Defendant Athilon is a credit derivative product company. Athilon is a Delaware corporation with its principal place of business in New York. A21 (Am. Compl. ¶ 4). It was created, among other things, to provide credit protection to counterparties through credit default swaps on portfolios of reference entities and, in certain cases, reference securities. A22 (¶ 12). Individual defendants Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, and J. Eric Wagoner are members of Athilon's Board. A21-22 (¶¶ 7-11).

Defendant ASIA is a Delaware limited liability company with its principal place of business in New York. A21 (¶ 5).

Defendant EBF is a Delaware limited partnership with its principal place of business in Minnesota. A21 (¶ 6).

Plaintiff Quadrant is a Cayman Islands limited liability company with a principal place of business in Norwalk, Connecticut. A21 (¶ 3). Quadrant purchased its Athilon notes in May and July 2011.[2]

B. AGHAP acquires all of Athilon's equity.

The complaint alleges that "on or about August 10, 2010," "EBF used a special purpose vehicle known as AGH Acquisition Partners, LLC [('AGHAP')] to acquire control of 100% of the Company's equity." A30

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[1] For purposes of its motion to dismiss and this appeal therefrom, EBF assumes the truth of the complaint's well-pleaded factual allegations.

[2] Quadrant's initial verified complaint alleged that it "acquired notes of each of the foregoing series in May, 2011, and in July, 2011 acquired additional Senior Subordinated Notes." B2 (¶ 3). Quadrant's amended complaint replaced this specific allegation with a vague statement that Quadrant "has held each of the foregoing series at all relevant times herein." A21 (¶ 3). Because a May 2011 acquisition date has adverse consequences for Quadrant's derivative claims, EBF respectfully submits that Quadrant should be held to the date stated in its original verified complaint, as it has made no representation that the original complaint was erroneous.

(¶¶ 48-49). The complaint also alleges that EBF "purchas[ed] all of the Company's Junior Notes" sometime in 2010 but does not specify a date. A30 (¶¶ 46, 48).

The complaint acknowledges that EBF does not directly hold Athilon's equity, which is owned by AGH, which is in turn owned by AGHAP. A21, A31-32 (¶¶ 4, 53). Moreover, the complaint's allegation that EBF "owns all of the shares of Holdings" (A21 (¶ 6); *see also* A46-47 (¶ 139)) is not correct or even consistent with the complaint's other allegations that reflect AGHAP as owning AGH's shares (A31-32 (¶ 53)).[3]

C. After AGHAP's acquisition, Athilon reduces the fees it pays to its affiliate, ASIA, under pre-existing agreements.

In December 2004—more than five years before AGHAP's acquisition and before Athilon issued the relevant notes—Athilon entered into "a services agreement with ASIA … pursuant to which ASIA provides day-to-day management for the two companies." A37 (¶ 81). Also before the acquisition, Athilon "entered into a software licensing agreement with ASIA," under which "the Company and Athilon Acceptance are required to pay ASIA a yearly fee." A39 (¶¶ 93, 94).

Historically, Athilon has paid fees to ASIA under these agreements. As the complaint acknowledges, "[i]n 2009, prior to EBF's acquisition, fees under the Services Agreement amounted to approximately $14 million." A37 (¶ 83). The same year, "the License Agreement fee was $1.25 million." A39 (¶ 94).

In 2010, "the Company's annual services fees jumped to $23.5 million." A38 (¶ 86). The complaint also alleges that the licensing fee increased by $250,000 to $1.5 million in 2010. A39 (¶ 94). The complaint does not break out what portion of those fees preceded AGHAP's September 2010 acquisition. The complaint does allege, "[o]n information and belief," that "those [services] fees included an annual, unjustified $2.5 million 'services' fee paid directly to EBF." A38 (¶ 86).

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[3] Even the complaint's allegation that EBF owns AGHAP is incorrect. *See* Athilon Br. 6 n.3. But assuming for purposes of this appeal that EBF is Athilon's ultimate parent—which it is not—the trial court's dismissal should still be affirmed.

The complaint acknowledges that "[a]ccording to the Company's unaudited financial statements for the first nine months of 2011, fee payments to ASIA in 2011 have diminished from 2010 levels …." A38 (¶ 87). It nonetheless alleges that despite the decrease, the fees "still substantially exceed market rates." *Id.* The complaint contains no specific allegations about ASIA's fees after the first nine months of 2011.

D. Athilon declines to defer interest on all its long-term debt.

All of Athilon's long-term debt issuances provide that Athilon has an option to defer interest payments for five years. A36 (¶ 74). The complaint alleges that Athilon "has had the right and power to defer the payment of current interest without penalty on the Junior Notes held by EBF," but to date has not done so. A36 (¶ 73). The complaint alleges that "[t]he Company and its creditors, viewed as a whole, would benefit greatly from deferral of interest on the Junior Notes" and that "[t]he Individual Defendants have failed and refused to exercise the deferral power, intentionally circumventing the intended order of capital return to creditors in runoff, in order to benefit insider EBF." A36-37 (¶¶ 77, 79). Athilon could also defer interest on other tranches of its long-term debt, but to date has not done so for any of the tranches.

E. Athilon allegedly pursues a riskier business strategy.

The complaint also alleges that Athilon has recently begun to take on increased risk, asserting "[o]n information and belief" that "the Individual Defendants have caused the Company to abandon the prudent investment approach originally embodied in the Operating Guidelines, in favor of speculative investments for the benefit of EBF." A40 (¶ 103). According to the complaint, "[r]emoving previous investment restrictions enables EBF to gamble with the Company's capital, at no risk to EBF's current, out-of-the-money position, and at high risk to stakeholders who hold debt that currently is expected to be paid at least in part (the Subordinated Notes) or in full (the Senior Subordinated Notes)." *Id.* According to the complaint, the allegedly riskier investments constitute "[a] departure from the original business purpose set out in the Athilon Charter and Operating Guidelines." A41 (¶ 107). As set forth in the Athilon Defendants' Answering Brief at pp. 28-30, the suggestion that Athilon has violated its charter is contradicted by the document itself.

F. Athilon's alleged insolvency

The complaint repeatedly recites in conclusory terms that Athilon is insolvent. *See, e.g.*, A30 (¶ 46) ("the Company was widely viewed to be insolvent"); A32 (¶ 54) ("in August, 2010, the Company had been insolvent for some time"); A33 (¶ 60) ("each of the Company and Athilon Acceptance is insolvent"); A37 (¶ 78) ("an insolvent entity"); A49 (¶ 160) ("at the time the interest and fees were paid, the Company was insolvent"). Despite these repeated incantations of insolvency, Quadrant's insolvency theory is based entirely on Athilon's September 30, 2011 Consolidated Statement of Financial Condition (the "CSFC") (A32-33 (¶ 56))—*i.e.*, a financial statement dated *after* most of the conduct challenged in the complaint.

Moreover, a careful review of the complaint in conjunction with the CSFC itself—which is deemed incorporated into the complaint—reveals that Quadrant has not adequately pled Athilon's insolvency even as of the September 30, 2011 CSFC. *See* Athilon Br. 26-27.

G. Quadrant purchases the Athilon notes and initiates this litigation.

Quadrant bought an unspecified number of Athilon notes in May and July 2011. Note 2, *supra*. On July 8, 2011, Quadrant's counsel sent a purported derivative demand letter alleging that "[t]he Board has failed to maximize the value of Athilon during a period of continued insolvency, and has pursued a number of self-interested transactions, for the benefit of EBF, and to the detriment of Athilon's creditors." A65. The demand letter proposed that Quadrant "provide the same services that are today provided by ASIA, in consideration of a servicing fee of $5 million per year (excluding third party audit, tax, rating agency, and legal costs which are estimated to be an additional $2 million a year.)" A67. Quadrant's self-interested offer provides the sole basis for the complaint's conclusory allegation that ASIA's services fees exceed market rates. A38 (¶¶ 88-90).

Quadrant's letter then demanded, among other things, that Athilon's Board: (1) "cause the Company to defer interest payments on the Junior Subordinated Notes, and take appropriate action to recover … the interest payments previously paid"; (2) "[d]esist from wasting significant corporate assets through overcompensation of the servicer [ASIA] and its affiliates"; (3) "[a]bide by all terms of the original

Operating Guidelines reviewed and approved by the rating agencies"; (4) "[d]isclose all related party transactions and holdings regarding EBF or any of its affiliates and prohibit any affiliate transactions"; (5) "[d]isclose the EBF-related entities that hold Athilon debt or equity"; and (6) "[r]epay Athilon's debt at the maturity of the last credit default swap in 2014 or earlier in accordance with the contractual waterfall of payments set forth in all relevant Bond Indentures." A67-68.

On August 22, 2011, Athilon rejected Quadrant's demand. A44 (¶ 121). Quadrant filed an initial complaint on October 28, 2011. On January 6, 2012, Quadrant filed an amended complaint asserting ten total claims, five of which name EBF:

- **Count II:** A derivative claim against EBF alleging breach of fiduciary duty to Athilon or, in the alternative, a claim for aiding and abetting the individual defendants' alleged breaches of fiduciary duty. A46-47 (¶¶ 137-148).
- **Count IV:** A direct claim against EBF and ASIA alleging that (1) interest paid to EBF on its junior notes and (2) "excessive service and licensing fees paid to ASIA" constitute fraudulent transfers under 6 *Del. C.* §§ 1304(a)(1) & 1305(b). A48-49 (¶¶ 155-162).
- **Count VIII:** A direct claim against EBF alleging intentional interference with contractual relations for allegedly "caus[ing] the Company to breach the implied covenant of good faith and fair dealing implied in the 2004 and 2005 Indentures." A54-55 (¶¶ 198-202).
- **Count IX:** A derivative and direct claim against EBF and the individual defendants alleging that payment of "exorbitant fees to ASIA" constituted unlawful "constructive dividends" in violation of 8 *Del. C.* §§ 170, 173 & 174. A55-56 (¶¶ 203-212).
- **Count X:** A derivative and direct claim against EBF and ASIA alleging "civil conspiracy" to "benefit EBF at the expense of Athilon and its creditors." A56-57 (¶¶ 213-217).

ARGUMENT

I. ALL OF QUADRANT'S CLAIMS ARE BARRED BY THE NO-ACTION CLAUSES.

A. Question Presented

Did the Court of Chancery err in holding that all of Quadrant's claims are barred by the no-action clauses? This question was raised below (B65-71, B149-51) and considered by the Court of Chancery (Quadrant's Opening Brief, Ex. A).

B. Scope of Review

"The decision of the Court of Chancery granting a motion to dismiss under Court of Chancery Rule 12(b)(6) is reviewed by this Court *de novo*." *Feldman v. Cutaia*, 951 A.2d 727, 730 (Del. 2008).

While "[t]his Court … is required to accept the well-pled allegations of the [complaint] as true and draw reasonable inferences in favor of the plaintiff, …. conclusory allegations need not be treated as true, nor should inferences be drawn unless they truly are reasonable." *Id.* at 731. Moreover, a court "may … decide a motion to dismiss by considering documents referred to in a complaint." *In re General Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168-69 (Del. 2006).

C. Merits of Argument

As set forth in the Athilon Defendants' Answering Brief at Section I.C, Quadrant's claims are barred by the indentures' no-action clauses.

This includes all of Quadrant's claims against EBF. While EBF is not the issuer, courts have held that a no-action clause "applies equally to claims against non-issuer defendants as to claims against issuers." *Feldbaum v. McCrory Corp.*, 1992 Del. Ch. LEXIS 113, at *25 (Del. Ch. June 1, 1992). "The policy favoring the channeling of bondholder suits through trustees mandates the dismissal of individual-bondholder actions no matter whom the bondholders sue." *Id.* at *26; *see also Peak Partners, LP v. Republic Bank*, 191 F. App'x 118, 126-27 (3d Cir. 2006) (similar); *McMahan & Co. v. Wherehouse Entm't, Inc.*, 859 F. Supp. 743, 746, 749 (S.D.N.Y. 1994) (holding that no-action clause barred claims against a company that had acquired the issuer by merger), *rev'd in irrelevant part*, 65 F.3d 1044 (2d Cir. 1995).

II. QUADRANT'S BREACH OF FIDUCIARY DUTY CLAIM AGAINST EBF SHOULD BE DISMISSED (COUNT II).

A. Question Presented

Even if this Court finds that Quadrant's claims are not barred by the no-action clauses, should Quadrant's derivative claim against EBF for breach of fiduciary duty nonetheless be dismissed? This question was raised below (B151-58) but was not addressed by the trial court.

B. Scope of Review

"[T]his Court may affirm on the basis of a different rationale than that which was articulated by the trial court" and "may rule on an issue fairly presented to the trial court, even if it was not addressed by the trial court." *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1390 (Del. 1995).

C. Merits of Argument

Even assuming that the complaint could somehow survive the no-action clauses, Quadrant's breach of fiduciary duty claim against EBF would still fail to state a claim for multiple independent reasons.

1. A parent corporation does not owe fiduciary duties to its wholly owned subsidiaries or their creditors.

a. Count II is premised on the assumption that "[a]s the only shareholder of Holdings, which in turn is the only shareholder of the Company, EBF … therefore owes fiduciary duties of good faith, care and loyalty to the Company and derivatively, to its creditors." A46-47 (¶ 139). While not entirely clear on the point, Delaware law appears to provide an independent basis to dismiss Quadrant's breach of fiduciary duty claim against EBF—even before reaching the still further grounds for dismissal set forth in Argument II.C.2, *infra*—on the grounds that a parent owes no duty to its wholly owned subsidiary, or to the subsidiary's creditors.

b. Outside of insolvency, Delaware courts have long held that "a parent does not owe a fiduciary duty to its wholly owned subsidiary." *Anadarko Petrol. Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988).

The result should not be different in insolvency. In *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), *aff'd sub nom. Trenwick Am. Litig. Trust v. Billett*, 931 A.2d

438 (Del. 2007) (Table), a case involving financially troubled companies, the court explained that "[w]holly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations" and that "[p]arent corporations do not owe such subsidiaries fiduciary duties." *Id.* at 173. The court noted that "[t]hat is not to say that Delaware law leaves the creditors of subsidiaries without rights …. Delaware has a potent fraudulent conveyance statute enabling creditors to challenge actions by parent corporations siphoning assets from subsidiaries. And Delaware public policy is strongly supportive of freedom of contract, thereby supporting the primary means by which creditors protect themselves—through the negotiations of toothy contractual provisions securing their right to seize on the assets of the borrowing subsidiary." *Id.*

While stressing that fraudulent conveyance law and negotiated contractual provisions protect creditors of wholly owned subsidiaries, the *Trenwick* court stated the opposite as to fiduciary duties: "Under settled principles of Delaware law, a parent corporation does not owe fiduciary duties to its wholly-owned subsidiaries or their creditors." *Trenwick*, 906 A.2d at 191.

c. Other authorities are in accord. *See ASARCO LLC v. Americas Mining Corp.*, 396 B.R. 278, 415-16 (S.D. Tex. 2008) (declining to hold that subsidiary's insolvency imposed fiduciary duties on wholly-owning parent, because to do so would "*create* a duty [between the parent and a creditor] where one did not previously exist, instead of merely adding beneficiaries to a pre-existing duty" (emphasis in original)); J. Haskell Murray, "*Latchkey Corporations": Fiduciary Duties in Wholly Owned, Financially Troubled Subsidiaries*, 36 DEL. J. CORP. L. 577, 582, 616 (2011) (hereinafter, "*Latchkey Corporations*") ("[C]reditors of a wholly owned subsidiary should be rebuffed by the business judgment rule when bringing duty of loyalty claims stemming from actions benefitting the parent corporation.").

d. Quadrant's allegations based on purported fiduciary duties owed by parents to their wholly owned subsidiaries should therefore be dismissed.

2. Even if parents can owe fiduciary duties to creditors of wholly owned subsidiaries, Quadrant's fiduciary breach claim against EBF fails as a matter of law.

Regardless of whether creditors of insolvent, wholly owned subsidiaries have standing to sue the parent for breach of fiduciary duty, Quadrant's claims must be dismissed because Quadrant: (a) fails to meet Rule 23.1's "contemporaneous ownership" requirement as to most of the relevant conduct; (b) fails to adequately allege insolvency; and (c) otherwise fails to state a claim.

a. "Contemporaneous ownership." Quadrant acquired its notes in May and July 2011, after most of the allegedly wrongful transactions. *See* Note 2, *supra*. Quadrant thus does not meet Rule 23.1's requirement that a derivative complaint "shall allege that the plaintiff was a shareholder or member *at the time of the transaction of which the plaintiff complains* or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law …." (Emphasis added); *see also* 8 *Del. C.* § 327. Rule 23.1's requirements—which should apply to creditor derivative plaintiffs, who stand in the shoes of stockholders—apply to derivative claims against parent companies. *See Parfi Holding AB v. Mirror Image Internet, Inc.*, 954 A.2d 911, 937-38 (Del. Ch. 2008) (applying contemporaneous ownership requirement to prevent a derivative action against a majority stockholder). Rule 23.1 thus bars Quadrant from asserting derivative claims against Athilon's owners for transactions occurring before May 2011, including: (1) non-deferral of interest before May 2011; and (2) purportedly excessive fees paid in 2010, including the $2.5 million fee allegedly paid to EBF.

b. Insolvency. Creditors of solvent corporations do not have standing to pursue derivative claims. "[E]quitable considerations," however, "give creditors standing to pursue derivative claims against the directors of an insolvent corporation." *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 102 (Del. 2007). As set forth in the Athilon Defendants' Answering Brief at Section II.C, Quadrant's position that Athilon's solvency must be determined by comparing the present value of assets on hand to the future value of debts not due for decades makes no sense and is not required by Delaware law. Because Quadrant has failed to adequately allege insolvency, all of its fiduciary breach claims should fail—including those against EBF.

Even assuming that Quadrant sufficiently pled insolvency as of the September 30, 2011 publication of the CSFC, that date is after most of the transactions at issue. "If a plaintiff seeks to state a claim premised on the notion that a corporation was insolvent…, the plaintiff must plead facts supporting an inference that the corporation was in fact insolvent *at the relevant time*." *Trenwick*, 906 A.2d at 195 (emphasis added). Where the complaint fails to plead specific facts "supporting a rational inference that [the corporation] w[as] insolvent" at the relevant time, "the premise for [a creditor] fiduciary duty claim does not exist." *Id.* Here, the allegation of insolvency is too late as to conduct before the September 30, 2011 CSFC.

c. Remaining claims. If Quadrant's fiduciary claim is limited to transactions occurring either after Quadrant first acquired Athilon notes in May 2011 *or* after the September 30, 2011 CSFC, only three categories of allegations of any relevance to EBF remain: (1) the continued non-deferral of interest on the junior notes; (2) the allegedly excessive fees paid to ASIA; and (3) Athilon's pursuit of a purportedly risky business strategy. Each of these categories of allegations fails to state a claim.

i. Non-deferral of interest on the junior notes. All of Athilon's notes have deferral options, but the notes do not require Athilon to defer interest. A36 (¶¶ 73-74). Quadrant's apparent position that a controlling stockholder breaches its fiduciary duties merely by treating the securities it holds in the same manner as securities held by others is contrary to basic principles of Delaware law.

A controlling stockholder does not commit a fiduciary breach merely by treating itself, in its capacity as stockholder, equally to other stockholders. Indeed, Delaware law goes further—permitting a controlling block of shares to receive preferential treatment over other shares in some circumstances. For example, Delaware cases have long held "that a holder of a substantial number of shares would expect to receive the control premium as part of his selling price." *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964); *see also Abraham v. Emerson Radio Corp.*, 901 A.2d 751 (Del. Ch. 2006) (similar); *In re Sea-Land Corp. S'holders Litig.*, 642 A.2d 792 (Del. Ch. 1993) (similar), *aff'd*, 633 A.3d 371 (Del. 1993) (Table).

The same principles apply to creditor fiduciary claims. Fiduciary duties do not "expand" in insolvency to provide "better" protections to creditors than stockholders would ordinarily receive. *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 794 (Del. Ch. 2004). After all,

"creditors, … unlike shareholders, typically have the opportunity to bargain and contract for additional protections to secure their positions." *Id.* The even-handed decision here not to defer interest on *any* of the notes thus cannot support Quadrant's claim for breach of fiduciary duty.

ii. Claims of allegedly excessive fees to ASIA. "Even though our law stringently reviews interested transactions, a plaintiff must still plead facts that plausibly support an inference that fees received by a controlling stockholder's affiliate were in fact excessive, in the sense that they were more than would have been paid to a comparable firm providing the same services." *Shandler v. DLJ Merchant Banking, Inc.*, 2010 WL 2929654, at *13 (Del. Ch. July 26, 2010); *see also id.* at *13 n.119 (collecting cases). The complaint's allegations regarding "excessive fees" paid to ASIA are focused on the pre-2011 period. With respect to "the first nine months of 2011"—again, before the allegation of insolvency and partly before Quadrant's May 2011 purchase of its notes—the complaint only alleges that, despite an unquantified decrease in the amount of the fees, the fees "still substantially exceed market rates." A38 (¶ 87). With regard to fees after that period, the complaint only alleges that the unspecified level of fees have "continue[d]." A39 (¶ 92). That is not enough to state a derivative claim for excessive fees during the post-May 2011 period.

iii. Claims of alleged mismanagement. Even assuming that Quadrant has pled that Athilon has engaged in riskier investments after May 2011, such claims are barred under Athilon's exculpatory charter provision and 8 *Del. C.* § 102(b)(7). *See* B85-86, B107, B123. If the Athilon directors are exculpated, EBF cannot be sued for breach of fiduciary duty on those claims either. "[A] controlling stockholder cannot be held liable for a breach of the duty of care when the directors are exculpated." *Shandler*, 2010 WL 2929654, at *16 (collecting cases).

Moreover, EBF's interests are aligned with the corporation's. EBF has nothing to gain from Athilon undertaking poor investment strategies. Athilon's owners—as both equity and debt holders—will not benefit unless the corporation benefits. Even without exculpation, taking increased risk is not a breach of fiduciary duty, particularly where equity will not receive a cent unless the senior creditors are paid in full first. We are not aware of any case that supports Quadrant's apparent position that fiduciaries of an insolvent corporation are required to take senior

creditors' interests more seriously than the interests of junior creditors or equity. Indeed, as Quadrant's own counsel has argued elsewhere:

> A rule that where the interests of creditors in enterprise maximization and shareholders in equity preservation diverge, the board should favor the equity-preservation principle, would be more faithful to *Gheewalla*'s reaffirmation of the traditional duty to the shareholder. Under this approach, if a board has identified a business strategy that offers some prospect of return to shareholders, *the board should reject alternatives that will eliminate shareholder value*. It should do so even if it has concluded that the alternatives would more likely maximize the value of the enterprise, and *that the shareholder plan is more likely than not to fail*.

Sabin Willet, *Gheewalla and the Director's Dilemma*, 64 BUS. LAW. 1087, 1104 (2009) (emphasis added); *see also Latchkey Corporations*, 36 DEL. J. CORP. L. at 607 ("[T]he law allows directors of corporations to take risks that benefit shareholders because upon insolvency—but prior to bankruptcy—the creditors do not become the sole residual claimants, but instead share that position with the shareholders."). The allegation that Athilon has undertaken a riskier strategy thus fails to state a claim.

d. Aiding and abetting. If count II is characterized in the alternative as a claim for aiding and abetting the Athilon Defendants' alleged breaches of fiduciary duty, the claim must be dismissed to the extent that underlying fiduciary breach claim is dismissed. In any event, the complaint does not adequately allege EBF's "knowing participation" in the alleged breaches to state a claim for aiding and abetting. Conclusory allegations based only on the parent's presiding atop the corporate structure are not enough. *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 72 (Del. 1995); *Hospitalists of Del., LLC v. Lutz*, 2012 WL 3679219, at *11 (Del. Ch. Aug. 28, 2012); *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1039 (Del. Ch. 2006).[4]

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[4] Quadrant alleges count IX (constructive dividend) and count X (civil conspiracy) as both "derivative and direct." To the extent counts IX and X are characterized as derivative claims, they should fail based on

III. QUADRANT'S DIRECT CLAIMS AGAINST EBF SHOULD BE DISMISSED (COUNTS IV, VIII, IX & X).

A. Question Presented

Even if this Court finds that Quadrant's claims are not barred by the no-action clauses, should Quadrant's direct claims against EBF nonetheless be dismissed? This question was raised below (B86-93, B158-62) but was not addressed by the trial court.

B. Scope of Review

This Court may affirm on any grounds fairly presented to the trial court, even if not addressed by the trial court. Argument II.B, *supra*.

C. Merits of Argument

Quadrant also seeks to allege direct claims against EBF for fraudulent transfer, intentional interference with contractual relations, constructive dividend, and civil conspiracy. Even assuming that the no-action clauses do not apply, these counts should still be dismissed.

1. Fraudulent transfer (count IV)

While the complaint alleges a fraudulent transfer claim solely under the Delaware Uniform Fraudulent Transfer Act ("DUFTA") (A48-49 (¶¶ 155-162)), there is a question whether DUFTA or New York's analogous fraudulent transfer statute applies. But regardless of which State's law is applied, the claim should be dismissed because the complaint fails to adequately allege insolvency, among other things. *See* Athilon Br. Section II.C. The fraudulent transfer claim against EBF should therefore be dismissed.

2. Intentional interference with contractual relations (count VIII)

a. Count VIII alleges that EBF "caused the Company to breach the implied covenant of good faith and fair dealing implied in the 2004 and 2005 Indentures." A54-55 (¶ 200). This claim for interference with

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Rule 23.1's contemporaneous ownership requirement and Quadrant's failure to plead insolvency, discussed above, and should also fail for the substantive reasons discussed at Argument III.C.3 and .4, *infra*.

contractual relations should be dismissed for at least two independent reasons.

b. First, an interference with contract claim requires, among other things, "the defendant's intentional inducement of the third party to breach." *Smartmatic Corp. v. SVS Holdings, Inc.*, 2008 WL 1700195, at *5 (Del. Ch. Apr. 4, 2008). If the Court dismisses the breach claim against Athilon, there would be no breach that EBF could have "caused" and count VIII thus "necessarily fails as well." *Aspen Advisors LLC v. United Artists Theatre Co.*, 843 A.2d 697, 713 (Del. Ch. 2004), *aff'd*, 861 A.2d 1251 (Del. 2004).

c. Second, even if the implied covenant claim against Athilon somehow survives the motion to dismiss, the interference claim against EBF should still be dismissed. Quadrant expressly "waived and released" any claims against "any … direct or indirect stockholder" of Athilon "under or upon any … covenant … contained in the Indenture" by purchasing the Athilon notes. Section 13.01 of the indentures provides:

> Section 13.01. *Stockholders, Members, Officers and Directors of Issuer Exempt from Individual Liability.* No recourse under or upon any obligation, covenant, or agreement contained in the Indenture, or in any Security, or because of any indebtedness evidenced thereby, shall be had against any past, present or future direct or indirect stockholder, member, officer or director, as such, of the Issuer or of any successor, either directly or through the Issuer or any successor, under any rule of law, statute or constitutional provision or by the enforcement of any assessment or by any legal or equitable proceeding or otherwise, all such liability being expressly waived and released by the acceptance of the Securities by the holders thereof and as part of the consideration for the issue of the Securities.

A148, A247. This "no recourse" indenture provision "enjoys general acceptance" and "extends broad immunity to stockholders … of the issuing corporation." *Simons v. Cogan*, 549 A.2d 300, 305 (Del. 1988) (dismissing claim against controlling stockholder for corporation's breach of indenture). The intentional interference claim is "under or upon" Athilon's "covenant … in the Indenture" and has therefore been released.

d. To be sure, certain cases have limited the claims that can be barred by a "no recourse" clause. But whatever those limitations, Section 13.01 should at a minimum bar a claim for interference with the very contract that contains the "no recourse" clause. Otherwise, the "no recourse" provision would be eviscerated.

This is supported by *Mabon, Nugent & Co. v. Texas Am. Energy Corp.*, 1988 WL 5492 (Del. Ch. Jan. 27, 1988). In *Mabon*, plaintiff debenture holders sued TAO, a wholly owned subsidiary of TAE, for breach of contract, among other things. The plaintiffs also sued the wholly-owning parent, TAE, alleging that "[b]y *causing* [the subsidiary] to fail and refuse to pay interest when due … [the parent] is liable to the Class for the principal amount of all Debentures and all interest accrued thereon." Amended Class Action Complaint in *Mabon, Nugent & Co. v. Texas Am. Energy Corp.*, C.A. No. 8578, at ¶ 75 (Del. Ch. Sept. 16, 1986) (emphasis added). The *Mabon* court dismissed the claim that the parent corporation "caused [the debtor] to default" based on the "no recourse" clause. *Mabon*, 1988 WL 5492, at *2-3. Count VIII—alleging that EBF "caused the Company to breach the implied covenant"—should likewise be dismissed.

3. Constructive dividend (count IX)

Count IX alleges that Athilon's payment of services and licensing fees "in excess of reasonable and market rates constitute, in substance, unlawful dividends" in violation of 8 *Del. C.* §§ 170, 173 and 174. A56 (¶ 208). There is no basis for recognizing such a claim against EBF based on recasting such payments as dividends. *See Horbal v. Three Rivers Holdings, Inc.*, 2006 WL 668542, at *3 (Del. Ch. Mar. 10, 2006) ("No Delaware court has ever recast executive compensation as a constructive dividend …."); *Keenan v. Eshleman*, 2 A.2d 904 (Del. 1938) (refusing to recast a challenged payment of management fees to another company as a dividend). The claim should also fail because Quadrant has failed to adequately allege insolvency. *See* Athilon Br. Section II.C.

4. Civil conspiracy (count X)

a. Count X alleges civil conspiracy between Athilon's directors, ASIA and EBF. The complaint describes the civil conspiracy claim as a "conspiracy to breach fiduciary obligations." A21 (¶ 2). If the fiduciary claims are dismissed, the conspiracy claim also "must be dismissed

because plaintiff has failed to properly allege … an underlying wrong that would be actionable in the absence of a conspiracy." *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872, 892 (Del. Ch. 2009).

Indeed, the claim for "conspiracy to breach fiduciary obligations" alleged here is "functional[ly] indenti[cal]" to Quadrant's alternative claim for aiding and abetting fiduciary breaches, discussed above. *See Allied Capital*, 910 A.2d at 1038-39; *see also Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *11 (Del. Ch. Aug. 26, 2005) ("Claims for civil conspiracy are sometimes called aiding and abetting. However, the basis of such a claim, regardless of how it is captioned, is the idea that a third party who knowingly participates in the breach of a fiduciary's duty becomes liable to the beneficiaries of the trust relationship."). Quadrant's civil conspiracy claim should thus also be dismissed for the same reasons as the alternative aiding and abetting claim. *See* Argument II.C.2.d, *supra*.

b. This Court's analysis should end there, as Quadrant should be held to the complaint's description of the civil conspiracy claim as alleging a "conspiracy to breach fiduciary obligations." A21 (¶ 2). But even if this Court also considers Quadrant's other claims, they cannot provide the predicate "underlying wrong" for civil conspiracy as a matter of law. *See, e.g., Cornell Glasgow, LLC v. LaGrange Props., LLC*, 2012 WL 3157124, at *5 (Del. Super. Ct. Aug. 1, 2012) ("[C]onspiracy cannot be predicated on fraudulent transfer, breach of contract or breach of the covenant of good faith and fair dealing."); *Kuroda*, 971 A.2d at 892 ("a breach of contract cannot constitute an underlying wrong on which a claim for civil conspiracy c[an] be based"); *NACCO Indus., Inc. v. Applica Inc.*, 997 A.2d 1, 35-36 (Del. Ch. 2009) (tortious interference with contract cannot provide underlying claim for civil conspiracy); *Edgewater Growth Capital Partners, L.P. v. H.I.G. Capital, Inc.*, 2010 WL 720150, at *2 (Del. Ch. Mar. 3, 2010) ("[T]he Delaware Fraudulent Transfer Act does not create a cause of action for aiding and abetting, or conspiring to commit, a fraudulent transfer."); *Trenwick*, 906 A.2d at 203 & n.97 (no claim for aiding and abetting a fraudulent transfer under "federal bankruptcy law or Delaware law" and collecting cases); *In re Tronox Inc.*, 429 B.R. 73, 102-03 (Bankr. S.D.N.Y. 2010) (dismissing civil conspiracy claim based on underlying allegations of fraudulent conveyance).

CONCLUSION

For the foregoing reasons, the Court of Chancery's order dismissing Quadrant's claims against EBF should be affirmed.

SEITZ ROSS ARONSTAM & MORITZ LLP

By: /s/ Garrett B. Moritz
Collins J. Seitz, Jr. (Bar No. 2237)
Garrett B. Moritz (Bar No. 5646)
Eric D. Selden (Bar No. 4911)
Anthony A. Rickey (Bar. No. 5056)
100 S. West Street, Suite 400
Wilmington, Delaware 19801
Telephone: (302) 576-1600

Attorneys for Defendant Below-Appellee
EBF & Associates, LP

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