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IN THE SUPREME COURT OF THE STATE OF DELAWARE

KATHERINE D. CROTHALL *et al.*, Defendants Below/Appellants/Cross-Appellees, and ADHEZION BIOMEDICAL LLC, a Delaware limited liability company, Nominal Defendant Below/Appellant/Cross-Appellee, v. ROBERT ZIMMERMAN, Plaintiff Below/Appellee, - and - THE WILLIFORD FIRM, LLC and EVAN O. WILLIFORD, Intervenors Below/Appellees/Cross-Appellants.	)	No. 608, 2013

ANSWERING BRIEF OF INTERVENORS BELOW/APPELLEES, AND OPENING BRIEF OF CROSS-APPELLANTS, <u>THE WILLIFORD FIRM, LLC AND EVAN O. WILLIFORD</u>

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NATURE OF PROCEEDINGS

The Board of Directors of nominal defendant Adhezion Biomedical LLC implemented a number of financing transactions on increasingly worse terms to Adhezion without soliciting or receiving the approval of the common members. Two venture capital firms, Originate Ventures, LLC and Liberty Advisors, Inc., along with associated persons including William Graham (the "VC Investors"), together control Adhezion. Plaintiff Robert Zimmerman engaged Evan O. Williford, Esquire, ultimately with The Williford Firm LLC (together, "TWF"), to bring a direct and derivative suit in the Court of Chancery alleging breaches of Adhezion's operating agreement and of fiduciary duty.

TWF vigorously prosecuted the case, filing three motions to compel and largely defeating a summary judgment motion, while Adhezion's Board continued to implement these transactions without common approval.

After a three-day trial, the Court issued a Post-Trial Opinion in which plaintiff prevailed on his breach of contract claim. The Court ruled that the Operating Agreement required approval by the common unitholders of all transactions increasing the number of authorized units, and thus that the Board had breached the operating agreement in approving each of the challenged transactions without the required approval and plaintiff was entitled to a declaratory judgment.

Plaintiff petitioned for an award of attorneys' fees. Further potential proceedings included the petition, an appeal of adverse rulings in the Post-Trial Opinion, and challenges to more recent financing transactions. In the face of these risks, VC Investor William Graham contracted to buy out all of plaintiff Robert Zimmerman's units [redacted].

The contract mistakenly did not reference all of Zimmerman's shares. Proving that the motive for the Buy-Out was to halt the litigation, Graham promptly procured a supplemental agreement with Zimmerman. The Court of Chancery noted a plausible inference that the Buy-Out was motivated by a "desire to enable the Company to flout this Court's ruling in the future." Ex. A at 24 n.57.

TWF moved to withdraw; and intervene solely to pursue its attorneys' fees petition. Defendants moved to dismiss arguing that plaintiff lacked standing under the continuous ownership rule. The Court granted both motions, awarding TWF $300,000 for the corporate benefit to Adhezion of the ruling requiring common approval for such transactions in the past and going forward.

SUMMARY OF ARGUMENT

1. Denied. The Court's dismissal of the action below for lack of standing precludes an appeal by Defendants on the merits. In any event, the Court logically determined consistent with the record that the Operating Agreement and extrinsic circumstances required approval of the Challenged Transactions by the common.

2. Denied. The Court did not abuse its discretion in ruling, after plaintiff prevailed on the related claims in the Post-Trial Opinion, that the ruling was a corporate benefit, following the well-established Delaware caselaw that attorneys' fees should not be denied where the benefit is not capable of an absolute valuation. The ruling materially benefits Adhezion and its common unitholders – defendants implemented four Challenged Transactions without the required common approval, then two more unchallenged ones, then bought plaintiff out in what the Court stated was a possible attempt to "flout" its post-trial decision. Ex. A at 24 n.57.

3. Denied. The Court of Chancery did not clearly abuse its discretion is setting the amount of the fee award. That amount, discussed in a lengthy Memorandum Opinion, was less than TWF requested and even less than its lodestar. The Court held that TWF skillfully presented a case with complex subject matter, and its ruling had a real benefit in protecting Adhezion and its common unitholders from defendants continued denial of their voting rights.

4. The Court's dismissal of the action for lack of standing below precludes any appeal (by Appellants or Appellees) of the merits. Alternatively, the Court erred in failing to use the appropriate test from this Court's decision in *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004) – a "particularly close or intimate personal or business affinity" – in determining the independence of director defendant Steven Bryant, who has spent most of his adult life working closely with CEO defendant Molinaro, whom the Court assumed was not independent. If Bryant is independent, then that clause to all intents and purposes has no meaning.

5. Alternatively, the Court erred in ruling that the VC Investors did not control Adhezion, after its own summary judgment opinion acknowledged the mountain of evidence that it did. The Court improperly limited Delaware court jurisprudence on when fiduciary duties will be imposed on two or more parties that combine to exert control over an entity to cases involving a "blood pact" or voting agreement.

STATEMENT OF FACTS

A. Appellants Implement Funding Transactions Without Approval Or Knowledge Of Common Unitholders.

Nominal defendant Adhezion Biomedical LLC is a medical device company that develops and commercializes surgical, wound management, and infection-prevention technologies. Ex. A at 2.

Adhezion has a five-member Board consisting of its CEO, Peter Molinaro; two venture capital firm representatives, Katherine D. Crothall and Michael J. Gausling; Molinaro's best friend who has worked with him for most of his adult life, Steven R. Bryant; and Robert Toni. *Id.* at 2. Adhezion is controlled by a group of preferred unitholders, led by the two venture capital firms, Originate Ventures, LLC and Liberty Advisors, Inc., and including associated investor William Graham (the "VC Investors").

In a July of 2009 financing transaction, the VC Investors (who almost exclusively participated in these transactions) received promissory notes convertible into Series A Preferred units at approximately [REDACTED] *Id.* at 9. In December of 2009, the VC Investors received additional promissory notes plus warrants.

In February of 2010, the Company approved the issuance of a new series of units, the Series B Preferred. The price was cut almost in half to [REDACTED], and

Id. at 14. In January of 2011, the VC Investors received promissory notes convertible into Series B Preferred units plus warrant coverage (together, the "Challenged Transactions").

B. The Challenged Transactions Increased The Units Adhezion Could Issue Without The Required Approval Of The Common Unitholders.

Section 3.1(b) of the Second Amended Operating Agreement (the "Operating Agreement") sets forth specific numbers of classes or series of units Adhezion is authorized to issue. A164-65. Adhezion could issue

Each of the Challenged Transactions purportedly increased or relied upon an increase to these numbers. Ex. A at 23 n.95. In the July 2009 Issuance

Operating Agreement Section 15.11 provides that it is amendable only with the "vote" of "a Majority-in-Interest of the Common Members, voting together as a single, separate class," along with a preferred class vote, "[e]xcept as otherwise provided in Section 3.8 hereof with respect to the issuance of additional Units".

A198-99. Section 3.2 gave the preferred members veto power over certain actions, including to "create, authorize or reserve" or "issue, sell or grant" any units. A165. Section 3.8 provided that "[s]ubject to the provisions of Section 3.2" the Board could issue additional units or create additional classes or series of units. A169.

None of these actions were approved by the common unitholders.

C. Plaintiff Discovers Certain Challenged Transactions And Litigates The Below Action Represented By TWF.

Plaintiff Robert Zimmerman was a holder of common units in Adhezion and is a former CEO and a co-founder. After discovering certain of the Challenged Transactions, he retained Evan O. Williford, Esquire, ultimately at The Williford Firm LLC (together, "TWF").

Plaintiff Zimmerman filed suit in the Court of Chancery in late 2010, alleging that the Challenged Transaction were a breach of the individual defendants' fiduciary duties and violated the Operating Agreement. Ex. A at 3. TWF vigorously litigated the case against determined opposition by Defendants and four law firms.

The Court granted Plaintiff's motion to amend the complaint to add additional defendants and claims concerning the January 2011 Issuance. The parties took discovery and held depositions; plaintiff litigated three motions to compel. Defendants did not file a motion to dismiss the complaint; plaintiff was

largely successful in opposing a motion for summary judgment with the exception of certain duty of care claims.

D. Plaintiff Prevails On His Breach Of Contract Claim And Seeks Fees.

Trial took place on April 23-25, 2012. After pre- and post-trial briefing, the Court issued its Post-Trial Opinion. Ex. A. The Court held that plaintiff was entitled to a declaratory judgment that the Board had breached the Operating Agreement in approving the Challenged Transactions.

Plaintiff subsequently petitioned for an award of attorneys' fees.

E. The VC Investors Buy Plaintiff Out.

In early 2013, TWF moved to withdraw as counsel for Zimmerman and to intervene for the limited purpose of securing attorneys' fees. Thereafter Zimmerman entered into an agreement to sell certain of his units to Graham. OB Ex. A at 4, 5-6 n.7. After realizing that the agreement did not cover all of Zimmerman's units, Zimmerman and Graham executed an amended agreement in which all of the units were sold (the "Buy-Out").

F. Defendants Move to Dismiss; Court Grants Both Pending Motions.

Defendants then moved to dismiss the action, arguing that the Buy-Out had eliminated plaintiff's standing to continue to prosecute his claims.

In a lengthy Memorandum Opinion, the Court granted both pending motions. The Court held that that TWF's efforts had conferred a "significant

corporate benefit on the Company and its unitholders". OB Ex. A at 21. The Post-Trial Opinion had "recognized and validated an existing right of the Class A Common unitholders that the Board had by pattern and practice ignored based upon a misreading of Adhezion's Operating Agreement." *Id.* at 24. The Court also noted, "The additional fact that the Company did not seek or obtain the approval of the Class A Common unitholders for the two later Unchallenged Transactions that TWF focused on in their fee request [after January 2011 and long after the lawsuit was filed] demonstrates the continuing importance of the Court's ruling." *Id.*

TWF sought a fee award of $400,000; its fees and expenses incurred while at TWF were $337,359.59. The Court determined to award $300,000. It complemented "Mr. Williford's skillful presentation of Zimmerman's case and the complexity of the subject matter involved". *Id.* at 31.

ARGUMENT

I. THE COURT SHOULD NOT REVERSE THE COURT OF CHANCERY'S INTERPRETATION OF THE OPERATING AGREEMENT AND EXTRINSIC CIRCUMSTANCES TO REQUIRE COMMON APPROVAL OF THE CHALLENGED TRANSACTIONS.

A. Questions Presented.

Whether the Court of Chancery's dismissal for lack of standing precludes the Court from hearing Appellants' Argument I. OB Ex. A at 5-7, 10-13.

Whether the Court of Chancery interpreted the Operating Agreement and extrinsic evidence logically and consistently with the record to require approval of Adhezion's Class A Common unitholders for the Challenged Transactions. OB 18.

B. Standard And Scope Of Review.

The effect of the lower court's opinion dismissing the case on standing to appeal the merits is one that has arisen for the first time on appeal; hence this Court reviews it de novo. *Tyson Foods, Inc. v. Aetos Corp.*, 809 A.2d 575, 581-83 (Del. 2002) (dismissing moot appeal).

This Court defers to a trial court's interpretation of a contract where it rests upon findings extrinsic to the contract or inferences drawn from such findings unless the findings are not supported by the record or the inferences are not the product of an orderly or logical deductive reasoning process. *Assiniboia Corp. v. Wilson*, 528 A.2d 415 [TABLE] (Del. 1987).

C. Merits Of The Argument.

1. The Mootness Dismissal Precludes A Merits Appeal.

The primary function of an appellate court is to review "actual controversies that remain adversarial following a trial courts' decisions." *Tyson*, 809 A.2d at 582. "A controversy may become moot either because a party has lost standing to assert its merits or because the dispute is no longer amenable to judicial resolution." *Id.* The controversy "must be between parties whose interests are real and adverse." *Id.*

In this case, after the Post-Trial Opinion Defendants' associate William Graham purchased all of plaintiffs' stock. The Court of Chancery then granted Defendants' motion to dismiss this action as moot under the continuous ownership rule. The Court held that "when he conveyed all his stock to Graham, Zimmerman extinguished his standing to prosecute this derivative action" and "no longer holds any real interest in redressing any harm done to the Company". OB Ex. A at 12-13. At the same time the Court denied the "related motion for entry of a final judgment on the merits of the underlying dispute." *Id.*

This decision is moot, as the Court below determined at the request of Appellants themselves, and there are no longer adverse parties to this case. *Tyson*, 809 A.2d at 582 (when a merger eliminated an adversary's existence after a ruling in a post-trial opinion, this Court declined "to review a moot controversy in which

only one private party has an interest"). This is particularly true given that the continuous ownership rule is regarded in Delaware, as the Court of Chancery noted, as "sacrosanct." OB Ex. A at 10-11.

Relatedly, the matter on which the Court of Chancery was not put in any final judgment. This Court should not reach the merits because they were – at Appellants' own insistence – never reduced to a final order. *Tyson*, 809 A.2d at 579-81.

Moreover, TWF moved to withdraw and intervene in the case for the limited and sole purpose of their motion for attorneys' fees. The Court granted that motion "to allow Movants to intervene to ***pursue the Petition***." OB Ex. D ¶ 1. TWF was not granted the ability to litigate with or oppose Defendants/Appellants on the merits. To "pursue the Petition" does not include defending the merits of the decision below, whether or not disguised as a "defense" to the Petition. The case is moot for this reason as well. *Bryan v. Doar*, 918 A.2d 1086 (Del. 2006) (case was dismissed on lack of standing of intervenor).

2. The Court Of Chancery Interpreted The Operating Agreement Logically And Consistently With The Record To Require The Approval Of The Common Unitholders For The Challenged Transactions.[1]

By the Post-Trial Opinion, the Court of Chancery had a great deal of familiarity with all relevant Operating Agreement provisions. It issued a Memorandum Opinion on summary judgment discussing them at length, then heard a trial and reviewed pre- and post-trial briefing discussing them at length again. OB Ex. C.

The Court noted that four key provisions in the Operating Agreement governed the question of whether approval was needed to amend it to allow for the issuance of more units than it permitted. Ex. A at 23-24. Section 3.1(b) set forth specific numbers of class or series of units the Company was authorized to issue. A164-65. Section 3.2 gave the preferred members veto power over certain actions, including to “create, authorize or reserve” or “issue, sell or grant” any units. A165. Section 3.8 provided that “Subject to the provisions of Section 3.2” the Board could issue additional units or create additional classes or series of units. A169.

Finally, Section 15.11 provided that the Operating Agreement could be amended only with “a Majority-in-Interest of the Common Members, voting

[1] As set forth above, plaintiff Zimmerman no longer has standing to litigate the merits, having sold all of his units, and Intervenor TWF may not appropriately litigate the merits in plaintiff’s stead. TWF has, in the alternative, provided the following discussion defending the Court of Chancery’s ruling below out of respect for and to avoid inconveniencing this Court in the event it should rule otherwise.

together as a single, separate class," along with a class vote of the preferred holders, "[e]xcept as otherwise provided in Section 3.8 hereof with respect to the issuance of additional Units". A198-99. Thus, the Section 15.11 exception would operate only to the extent Section 3.8 in fact "otherwise provided," and even then only with respect to the "issuance" of additional units.

The Court noted that the Operating Agreement, like the Delaware General Corporation Law, contemplated units being "authorize[ed]". Ex. A at 25. Indeed, the Court noted that Christopher Miller, Esquire, testifying on behalf of Defendants, conceded that "we went through a process to authorize those units." *Id.* at 27. Thus, his testimony – the only extrinsic evidence argued by Appellants to support their position – ***expressly supports*** the Court's decision.

The Court concluded that "the most reasonable interpretation of the Agreement is that the parties intended the authorization of units to be accomplished by an amendment to the Operating Agreement." *Id.* at 28. That agreement has a specific provision – Section 3.1(b) – providing a ceiling to the number of units of a specific kind the Company was authorized to issue. A164-65.

The Court noted that "Under the DGCL, the amount of authorized capital stock acts as a ceiling on the amount of stock a corporation may issue without seeking a charter amendment to increase that amount." Ex. A at 27. The Court also noted that the drafters of the Operating Agreement used "a number of well-

understood terms relating to corporate stock including the three terms relevant here: create, authorize, and issue." *Id.* at 22-23. Appellants should not be heard to complain that the Court interpreted one of these terms in accordance with that well-understood meeting.

Having concluded that units had to be authorized via an Operating Agreement amendment, the Court then concluded that the relevant provisions interpreted together required Common unitholder approval to increase the number of units the Company was authorized to issue. For instance, the Court noted that Section 3.2 "expressly requires the consent of the Series Preferred members to create, authorize, and issue units, among other things."[2] *Id.* at 30. The Court noted that the parties could have expressly provided the Board with authority to "authorize" units, but instead only gave it the authority to "issue and create" additional units. The Court noted that the exception at the beginning of Section 15.11 "relates only to the Board's authority in Section 3.8," which did not extend to unilaterally authorizing additional stock above the ceiling permitted by the Operating Agreement.

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[2] This observation rebuts Defendants' argument that Section 3.8 is meaningless if the Class A unitholders have a veto power. OB at 25. As set forth above, the preferred unquestionably have a veto right in any event. No one disputes that the Board's involvement was necessary (as opposed to sufficient) if any units were going to authorized, created or issued. Defendants' argument that if the Board could not solely authorize the transactions it had no power is illogical and rebutted by the preferred unitholders' own parallel veto power.

The Court then concluded that the Challenged Transactions breached the Operating Agreement because no requisite units had "properly had been authorized for issuance." *Id.* at 34-38. The Court noted that if Defendants had wanted the position they took at trial to govern, they could have sought to draft the Operating Agreement differently. *Id.* They did not.

Defendants' position at trial ran into the stark problem that the Operating Agreement only authorized them to issue a specified number of shares, yet they were arguing that they had the right to do so without amending the Operating Agreement.

Appellants' Opening Brief demonstrates their lack of a cohesive, common sense position on this issue, which argues that the lower court "ERRONEOUSLY CONCLUDED THAT THE OPERATING AGREEMENT IS AMBIGUOUS," immediately afterwards arguing that "Because it held that Adhezion's Operating Agreement was ambiguous, the Chancery Court correctly" ruled on the burden of proof. OB 19.

In any event, the plain meaning of the language in question unambiguously required Common unitholder consent. Defendants' argument that common unitholder approval was not required is proven wrong by a specific provision limiting the amount of units that could be issued, and the lack of any provision giving anyone else unilateral authority to authorize any additional shares.

Defendants criticize the Court's opinion for noting that the Operating Agreement refers to both "creating" and "authorizing" units in Section 3.2, giving rise to the logical inference that when only one of those terms was used in Section 3.8, the other was not meant. OB 21. Defendants argue that the Court erroneously considered the language of the Operating Agreement, the very meaning of which the parties were contesting. The Court appropriately took into account the provisions in the language of the document it was interpreting, the plaint meaning of which requires Common unitholder approval.

Defendants mischaracterize Miller as explaining "why there was no separate reference to 'authorizing' units in Section 3.8," OB 22, but cite testimony in which Miller states that authorization "is subsumed within the act of amending the agreement."[3] A407. That of course is subject to Section 15.11, which provides for a Common unitholder approval requirement.

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[3] The Opening Brief's quotation of Miller omits two portions of his testimony. Correctly cited in the Court of Chancery's opinion and recorded in Appellants' appendix, Miller admits that the parties looked to corporate law to fashion the Operating Agreement, which law supports the Court of Chancery's ruling:

> First of all, this is a limited liability company. Under both Delaware law as well as this operating agreement, a limited liability company is not required to have units authorized prior to their issuance. That is a corporate concept.
>
> ....
>
> Same in the corporate statutes. If you look at corporate statutes, you won't anywhere see either the board or the stockholders given the power to authorize shares. Corporate statutes say how do you amend your certificate of

Defendants criticize the Court of Chancery for noting that investors who possessed A Common would have understood the Operating Agreement as placing a limit on the amount of dilution they would face before the Board was required to obtain their consent. OB Ex. B at 37-38. The Court of Chancery wisely took into account the reasonable expectations of investors in relying upon protections plainly set up in the Operating Agreement to prevent their stock from being diluted.

Defendants criticize the lower court's ruling that the result was also justified by the "stronger bargaining position" Defendants had. Had Defendants wanted the Operating Agreement to have the construction they argued at trial they were in a position to revise it to do so clearly, yet they did not. OB 23-24; Ex. A 36 & n.122 (citing Restatement (Second) of Contracts § 206 (1981) ("In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds.")).

Defendants cite *Sodano v. Am. Stock Exchange LLC*, 2008 Del. Ch. LEXIS 92 (Del. Ch. July 15, 2008). In that case, the Court of Chancery rejected an

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> incorporation? What are the steps you need to follow? And in an amendment to the certificate of incorporation, that is where shares are authorized.
>
> *That was the same intent here, was that units would be authorized through an amendment to the agreement.*

Ex. A at 27 (emphasis in original) (citing A407).

attempt by a corporation to have the doctrine applied against its former CEO and Chairman with respect to an indemnification provision in an employment agreement when the corporation chose to hire him. *Id.* at *8. Here, by contrast, the Court applied the doctrine in favor of investors and non-controlling unitholders and against Defendants would be financing Adhezion and hence had the upper hand in negotiations.

Defendant argues that while the DGCL does not permit a corporate board to issue more shares of stock than are authorized in its charter, there is no such provision in the LLC Act. OB 26 n.2. The drafters of the Operating Agreement, however, chose to use corporate concepts, including adopting a provision expressly limiting the number of shares of a particular class or series which the Board was authorized to issue.

Defendants argue that the Court's ruling leads to the preferred veto right in Section 15.11 being superfluous as compared with Section 3.2. OB 27. The inclusion of a preferred veto right in Section 15.11 serves an independent purpose of preventing any argument that otherwise Section 15.11 was meant to override Section 3.2 and grant only the common unitholders a veto right upon amendment of the Operating Agreement. Furthermore, the two veto rights do not overlap completely as the preferred unitholders have a veto right under Section 3.2 were

Adhezion to “issue, sell or grant any Units,” which they do not have under Section 15.11 because of the carveout at the beginning of that section.

II. THIS COURT SHOULD NOT REVERSE THE COURT OF CHANCERY'S DETERMINATION THAT ITS RULING IN PLAINTIFF'S FAVOR AFTER TRIAL WAS A CORPORATE BENEFIT TO ADHEZION.

A. Question Presented.

Whether the Court of Chancery abused its discretion in finding that its memorandum opinion holding in favor of the derivative plaintiff that the Challenged Transactions and similar future transactions required approval by the common unitholders conferred a corporate benefit on Adhezion and its unitholders for purposes of an award of attorneys' fees.

B. Standard And Scope Of Review.

An award of attorneys' fees is reviewed for abuse of discretion. *Wm. Penn P'ship v. Saliba*, 13 A.3d 749, 758 (Del. 2011). This Court does not substitute its "own notions of what is right for those of the trial judge if that judgment was based upon conscience and reason, as opposed to capriciousness or arbitrariness." *Id.*

C. Merits Of Argument.

It is well established in Delaware caselaw that attorneys' fees may be awarded for a litigation benefit to others even if its value cannot be precisely measured. *Tandycrafts Inc. v. Initio Partners*, 562 A.2d 1162, 1165 (Del. 1989). The Court of Chancery has done so on a number of occasions. *E.g. San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171, at *10, *12 (Del. Ch.

Oct. 28, 2010) ("unquantifiable" benefits of disabling continuing director provisions in debt instruments); *Kaufman v. Beal*, 1983 WL 21020, at *2 (Del. Ch. Dec. 27, 1983) (new bylaw providing for an employee benefit committee of outside directors).

In particular, "Vindication of the shareholder franchise is a major public policy objective; as a core value in corporate governance, steps undertaken to protect the stockholder franchise may be recognized as having a very real, even if unquantifiable, benefit." *Bradbury*, 2010 WL 4273171, at *13 ("[A]chieving all of the benefits produced required Plaintiff's Counsel to litigate this matter vigorously and completely, a somewhat unusual occurrence in a therapeutic benefit case.").

The Court released a Memorandum Opinion devoted largely to considering the petition. It noted that in the Post-Trial Opinion, it had held that plaintiff was entitled to a declaratory judgment that Defendants had breached the Operating Agreement by authorizing new shares in the Challenged Transactions without the required approval by the common unitholders. OB Ex. A at 22 (citing Ex. A). The Court held that the ruling arguably represented "the type of 'benefit' that our courts would recognize as fitting within the corporate benefit doctrine" and rejected defendants' arguments to the contrary. *Id.* at 22-29.

The benefit at issue, the ruling of the Court favorable to plaintiff in the Post-Trial Opinion, was solely in response to this litigation. Accordingly, a causal relationship between this litigation and this result is unquestionable.

Defendants argue that because the declaratory judgment was never entered (though the Post-Trial Memorandum was released and is publicly available, and was the express basis for a final order awarding attorneys' fees), no award can be made, citing *Thorpe v. CERBCO*, 1997 Del. Ch. LEXIS 18, at *13-14 (Del. Ch. Feb. 6, 1997). Defendants based their argument on their associate Graham's Buy-Out of Zimmerman after the Post-Trial Opinion was released and the attorneys' fees petition was filed.

The Court noted that this argument only "strengthens the plausible inference that the purchase by another Adhezion investor of all of Zimmerman's units [redacted] , in fact, may have been motivated solely by a desire to enable the Company to flout this Court's ruling in the future." OB Ex. A at 24 n.57.

The Court discussed and rebutted this argument and *Thorpe*'s relevance to this case at length. *Id.* at 24-27. The Court in *Thorpe* noted that "extracting a 'rule of law' from its previous decisions would be a 'highly speculative endeavor.'" *Id.* at 25 (quoting *Thorpe*). That is not true in this case: the issue involved was "quite narrow" and the ruling called for entry of a "very specific declaratory judgment."

Id. In *Thorpe* the Court specifically found that there was "no threat of recurrence of the breach found originally." *Id.* at 25; *Thorpe* at *4. Here by contrast "every Challenged Transaction at issue in this litigation, as well as the two later Unchallenged Transactions, followed a process that I have held contravened the Agreement." *Id.* at 26. Thus, the court concluded that (unlike *Thorpe*) "it is likely that the wrong in question in this case will recur." *Id.* Defendants' associate's actions not only do not rebut the finding of a corporate benefit, they only further demonstrate why the ruling benefitted to Adhezion and its common unitholders.

In any event, the Court noted in its opinion that "this Court's Post-Trial Opinion serves as the basis for my decision in this Memorandum Opinion to award attorneys' fees to TWF over Defendants' objections." *Id.* Thus, the Court entered a final order "reflecting that decision and my reliance on that portion of the Post-Trial Opinion regarding the Class A Common unitholders' rights of approval." *Id.* (referencing OB Ex. D). That opinion may "have issue-preclusive effect in a future case." *Id.*; *see also Chrysler Corp. v. New Castle County*, 464 A.2d 75, 83-84 (Del. Super. 1983) (Christie, J.) (imposing collateral estoppel against a party to a prior Court of Chancery decision interpreting the meaning of operative words in a contract at issue).

Defendants cite no authority for their argument the Court has no equitable authority to award attorneys' fees. To the contrary, the Court ruled that regardless

of the issue preclusive effect of its ruling it has that authority, as "fee shifting is an equitable device . . . not properly confined to rigid, predictable circumstances." *Id.* at 27 (quoting *In re First Interstate*, 756 A.2d 353, 362 (Del. Ch. 1999)). In the circumstances of this case, "it is more fair to require [the Company] to pay a fee to plaintiffs' counsel than to deny them any fee at all." *Id.* The Court's considered and thoughtful Post-Trial Opinion, publicly reported after a lengthy previous summary judgment decision on the subject and a trial, validating rights protecting the Adhezion common unitholders has inarguable and highly valuable practical benefits to them and Adhezion in any future dispute, whether or not it reaches the court system again. *See Zimmerman v. Crothall*, 62 A.3d 676 (Del. Ch. 2013). It would constitute *stare decisis* as to the common unitholders' voting rights in the Court of Chancery in the State of Delaware in which Adhezion is domiciled. *See Account v. Hilton Hotels Corp.*, 780 A.2d 245, 248 (Del. 2001) (stare decisis operates to fix a specific legal result to facts in a pending case based on a judicial precedent directed to identical or similar facts in a previous case in the same court or one higher in the judicial hierarchy). Other United States courts, necessarily applying Delaware law as to Delaware entity Adhezion's internal corporate governance, would be bound by this on-point precedent. *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1116 (Del. 2005) (citing *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987)).

The result Defendants urge is, moreover, contrary to the public policy of rewarding legal advocates who achieve success on behalf of an entity or a group of others. It would encourage stock buyouts of successful plaintiffs in an effort to purchase with money what defendants could not achieve in litigation.

Alternatively, any defect of which Appellants complain may be simply remedied by a remand to the Court of Chancery with instruction to enter final judgment on its ruling. Nothing whatsoever remains for that Court to do other than to enter a final judgment.

The continuous ownership rule is a matter of caselaw, not statute. *Lambrecht v. O'Neal*, 3 A.3d 277, 284 (Del. 2010) (Jacobs, J.) ("creature of common law"). Its purposes are not implicated here. *See Feldman v. Cutaia*, 956 A.2d 644, 660-61 n.64 (Del. Ch. 2007) ("to prevent strike suits" and "to ensure that a derivative plaintiff is acting in the corporation's best interests by litigating a claim"). Defendants have not cited an on-point case in which a Delaware court has refused to enter a final order required by its post-trial opinion completely resolving all merits issues in the action, where the final order determines no new substantive issues. Even if the rule applied ab initio it has exceptions for issues that are demonstrably likely to reoccur and for fraud, and the Court's opinions describe in detail why the first and possibly the second is applicable.

III. THE AMOUNT OF THE COURT OF CHANCERY'S ATTORNEYS' FEES AWARD WAS NOT A CLEAR ABUSE OF ITS DISCRETION.

A. Question Presented.

Whether the Court of Chancery clearly abused its discretion in awarding $300,000 in attorneys' fees for TWF's success in the below litigation in procuring, after trial against determined opposition in a complex matter by four law firms, an unquantifiable corporate benefit, where TWF's lodestar was $337,359.59.

B. Standard Of Review.

Appellants agree that the standard of review appropriate of an award of attorneys' fees is "clear abuse of discretion". *Johnston v. Arbitrium (Cayman Islands) Handels AG*, 720 A.2d 542, 547 (Del. 1998).

C. Merits Of Argument.

As set forth above, the Court held that TWF had provided a corporate benefit to Adhezion. It noted that where a benefit is real but unquantifiable courts typically award fees based on a *quantum meruit* basis. OB Ex. A at 30 (citing cases). The Court held that in doing so, it considers "the work the attorneys performed to achieve the benefit and the amount and value of the attorney time required for that purpose, taking into account the experience of counsel and the contingent nature of the case." *Id.* (citing *In re First Interstate*, 756 A.2d 353, 363 (Del. Ch. 1999).

TWF sought $400,000 in attorneys' fees. Its fees and accrued expenses (its "lodestar") totaled $337,359.59. The Court awarded a reduced total of $300,000, more than $100,000 less than TWF had requested and more than $35,000 less than its lodestar. In doing so, the Court cited the following factors:

- "TWF spent 644.2 hours litigating this case from its inception through a three-day trial and post-trial briefing and argument on a contingent fee basis." *Id.*

- TWF sued derivative and "successfully challenged the validity of the Board's actions regarding the issuance of additional classes of stock." *Id.* at 31.

- TWF's success resulted in a significant unquantifiable benefit to Adhezion that was "solely and directly attributable to those efforts." *Id.* at 30. Defendants do not challenge causation on appeal.

- The award yielded an hourly rate for Mr. Williford of $400, reduced from that included in the lodestar.

- The Court praised "Mr. Williford's skillful presentation of Zimmerman's case" particularly in connection with "the complexity of the subject matter involved". *Id.* at 31. The Court had previously thanked both sides in conducting the trial professionally and efficiently. A411 ("I appreciate, obviously, the efforts of both sides in marshaling the evidence. I had the sense that the case was very professionally presented in terms of moving through, and counsel on both sides appreciating what it was that they needed the Court to understand and what the record was that they wanted to create. So I thank you for that, and we'll wait for the next step then.").

Defendants again cite the *Thorpe* case distinguished by the Court and above. As stated by the Court:

> Defendants' reliance on the *Thorpe* case is misplaced, however, because there the attorneys sought some $1.66 million in fees and expenses incurred while litigating to advance a benefit that, ultimately, would have accrued to the company in any event. In contrast, TWF estimates its total fees and costs to be $337,359.59. Moreover, unlike the situation in *Thorpe*, I find that Zimmerman's litigation efforts ***directly*** precipitated the claimed corporate benefit to the Company.

OB Ex. A at 23 n.54 (citations omitted; emphasis in original).

Defendants incorrectly cite TWF as stating that it "believed [it] was entitled to" only $200,000 under the corporate benefit theory. OB 33. What TWF in fact stated to the Court was that "an award of $400,000" "would allocate an award of . . . $200,000" on the corporate benefit theory as well as $200,000 under the common fund theory. A593. The Court declined to accept the common fund theory but agreed that TWF had provided a corporate benefit, and consistent with the caselaw on those kinds of benefits awarded fees on a (reduced) *quantum meruit* basis.

Defendants criticize TWF's efforts to litigate the Common unitholder approval claim. In TWF's view the efforts were appropriate; they achieved victory below. Of course counsel cannot know beyond estimating risk what claims will be successful after a trial, and so must spend appropriate time litigating each without the benefit of hindsight. The fiduciary duty claims that ultimately did not prevail – though the Court rejected a summary judgment motion in detail – were much more

fact intensive than the common unitholder approval claim and appropriate took more effort.

Defendants argue, again based on *Thorpe*, that the award should be reduced because TWF was not successful on all of the claims it brought. OB at 34. Delaware courts have rejected this argument on several occasions. *See La. State Employees' Ret. Sys. v. Citrix Sys., Inc.*, 2001 WL 1131364, at *10 (Del. Ch. Sept. 19, 2001) ("Finally, I note that I have chosen not to attempt to apportion any of the hours worked by LASERS' counsel between the Voting Manipulation Claim and the stayed Disclosure Claim"); *In re First Interstate Bancorp Consol. S'holders Litig.*, 756 A.2d 353, 364 (Del. Ch. 1999) ("In general, I reject the defendants' argument that I should disregard time devoted to any aspect of the litigation that proved to be a dead end."); *San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171, at *12 (Del. Ch. Oct. 28, 2010) (disagreeing that the Court should exclude hours devoted by plaintiff's counsel to fiduciary duty claims); *In re Golden State Bancorp Inc. S'holders Litig.*, 2000 WL 62964, at *5 (Del. Ch. Jan. 7, 2000) (awarding a fee compensating for all hours spent plus at least 25% risk premium multiple when plaintiffs made disclosure and *Revlon* claims but the settlement provided for supplemental disclosures only).

IV. THE COURT OF CHANCERY IGNORED THIS COURT'S CASELAW IN HOLDING STEVE BRYANT TO BE INDEPENDENT.

A. Question Presented.

Whether the Court legally erred in holding in its summary judgment and post-trial decisions that Steve Bryant was independent and did not have a "particularly close or intimate personal or business affinity" with CEO Molinaro when these two close friends had founded a business together and worked together for most of their adult lives.

B. Standard Of Review.

This Court reviews the Court of Chancery's failure to apply the correct principle of law de novo. *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009).

C. Merits Of Argument.

As set forth above, supra Argument I.C.1, further proceedings on the merits cannot occur because plaintiff has lost standing pursuant to the continuous ownership rule. Thus, this Court cannot consider Appellants' Argument I. In the alternative, this and the following arguments on cross-appeal are set forth.

As the Court below recognized, the appropriate standard, from *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004) is that, while allegations of a "mere personal friendship or a mere outside business relationship" are insufficient

standing alone, independence may be doubted when a relationship is one of "a particularly close or intimate personal or business affinity . . . ." Ex. A at 55 n.165.

Bryant has worked with Molinaro for more than two-thirds of Bryant's working career. B30. They both attended Marshall College between 1970 and 1974 in Huntingdon, West Virginia. B18. They both worked for Cilco, in the same building, between 1980 to 1985. B15-16, B25. They founded a business together, Intraoptics. B18-21. In doing so, they of course worked together a lot between 1986 to 1991; according to Bryant there was not a lot of time outside of business back then. *Id.* at B18-21, B26-27.

After the business was sold they worked together at the acquirer Chiron between 1991 and 1993. B26. Later, at Angiotech, formerly Surgical Specialties, they worked together from 1998 to 2007. B27-28 (daily/weekly interactions). They have served together on the boards of Aspen Biomedical from 2005, and of Adhezion from 2008, to the present. B22, B29-30.

Molinaro provided Bryant as a reference when the Liberty Group was considering investing in Adhezion. B24. Molinaro described Bryant at a Board meeting as a friend. B1 (Molinaro to Board: "Steve Bryant is a long time friend and business associate."); B14 (Zimmerman recalled Molinaro saying "he's my very best personal friend"), B23. Their families have vacationed together; they

have hunted and fished together and watched football together. B22-23; B27. The company at which Bryant works, Angiotech, is a customer of Adhezion.

The Court admitted that "Molinaro and Bryant worked closely together and served on the same boards of directors periodically since the 1980s." Ex. A at 55. The Court, however, appeared to ignore it and the appropriate standard.

If this is not a "particularly close or intimate personal or business affinity," it is hard to imagine what would be. This decision reads this clause out of the Court's opinion in *Beam* and greatly dilutes the meaning of what it is to be independent. *See In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 947 (Del. Ch. 2003) (referencing a "social atmosphere painted in too much vivid Stanford Cardinal red for the SLC members to have reasonably ignored it"). The evidence set forth at trial is extensive and specific and nothing akin to the "structural bias" or similar arguments this Court in Beam excluded. *Beam*, 845 A.2d at 1051.

The Court cites *Benerofe v. Cha*, 1996 WL 535405, at *7 (Del. Ch. Sept. 12, 1996). In that case, decided on a motion to dismiss, there were no issues of a disabling personal and business relationship, let alone to the extreme extent presented here. It is not factually relevant.

V. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE VC INVESTORS DID NOT TOGETHER CONTROL ADHEZION.

A. Question Presented.

Whether the Court of Chancery erred in holding that in order to be considered as controlling for purposes of fiduciary duty, unitholders must be involved in a "blood pact" or other similar arrangement. Ex. A at 40.

B. Standard of Review.

This Court reviews the Court of Chancery's failure to apply the correct principle of law de novo. *Gantler v. Stephens*, 965 A.2d 695, 703 (Del. 2009).

C. Merits Of Argument.

It is a venerable principle in the Court of Chancery and in this Court that stakeholders who control an entity, including groups of unitholders, are tasked with a fiduciary duty in exercising that control:

> When, in the conduct of the corporate business, a majority of the voting power in the corporation join hands in imposing its policy upon all, it is beyond all reason and contrary, it seems to me, to the plainest dictates of what is just and right, to take any view other than that they are to be regarded as having placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders. Ordinarily the directors speak for and determine the policy of the corporation. When the majority of stockholders do this, they are, for the moment, the corporation. Unless the majority in such case are to be regarded as owing a duty to the minority such as is owed by the directors to all, then the minority are in a situation that exposes them to the grossest frauds and subjects them to most outrageous wrongs.

Allied Chemical & Dye Corp. v. Steel & Tube Co. of Am., 120 A. 486 (Del. Ch. 1923) (quoted in *Weinberger v. UOP, Inc.*, 409 A.2d 1262, 1265 (Del. Ch. 1979)).

In its opinion on summary judgment, the Court recognized the already-overwhelming evidence that the VC Investors controlled Adhezion. It held that the "VC Investors' parallel interests, in additional to other facts alleged by Plaintiff," supported a reasonable inference that "the VC Investors acted as a controlling shareholder group here:"

> In considering whether Liberty and Originate are controlling shareholders of Adhezion, I begin by noting that, although neither Liberty nor Originate owns a majority interest, the VC Investors collectively own more than [redacted] of the Company's voting shares and control at least two of the five directors on the Board. They are also the two largest investors in the Company, collectively having invested more than [redacted] since 2008. Moreover, as early-stage venture capital investors, Liberty and Originate likely have similar economic interests vis-a-vis their investments in the Company.

OB Ex. C at 27.

The Court held that plaintiff had "identified multiple communications among Defendants that would support a reasonable inference that the VC Investors exercised actual control over Adhezion's capital raising efforts":

> For example, in a September 2009 email regarding preparation for an investor conference, Molinaro stated that the amount of money he would be looking to raise from other investors was a "sensitive issue as Liberty & Originate both would like to see [the investment as] a smaller number." In addition, certain contemporaneous Board meeting minutes reflect that Liberty and Originate had advised that they "would continue to temporarily satisfy Adhezion's cash

> requirements" until the Company concluded various ongoing negotiations with other potential partners. Bryant similarly testified that Gausling had communicated to Molinaro that the VC Investors did not "want [Molinaro] to continue trying to raise venture capital funding or funding outside of the Company because [the VC Investors] want[ed] [Molinaro] to focus on running the business and that [the VC] investors and so forth would continue to fund the business." These communications support not only Zimmerman's allegations that the VC Investors had a pervasive influence in directing the Company's capital-raising activities, but also his averment that the VC Investors acted in concert.

Id. at 27-28.

Notwithstanding all of the facts recognized in its summary judgment ruling, the Court inexplicably failed in the Post-Trial Opinion to recognize the fiduciary duty applying to the VC Investors stemming from their control.

First, the Court misstated the law governing control by two or more unitholders. It held that such power exists "where "various director-stockholders . . . were involved in a blood pact to act together" or where they were "bound together by voting agreements or other material, economic bonds" they should be treated as a group. Ex. A at 40 (quoting *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del Ch. Aug. 18, 2006)). At its conclusion, it held again that the evidence did not support the argument that "Liberty and Originate were acting in concert, through a blood pact or voting agreement, and exercising 'actual control'" over the Board. Ex. A at 43.

The Delaware courts' flexible and fact-specific law on more than one unitholder together exercising control does not depend upon unitholders swearing a blood pact in front of a campfire at midnight.

Rather, the proper test is whether a controlling part of the "voting power in the corporation join hands in imposing its policy upon all" or where a controlling group of unitholders "speak for and determine the policy of the corporation". *Weinberger*, 409 A.2d at 1265.

The Court's ruling, contrary to controlling precedent, imposing a standard so narrow that it will rarely if ever be met. A group of unitholders with parallel interests will be free to control a Delaware corporation as they please without fiduciary duties to control their exercise of self-interest so long as they do not have a formal agreement or participate in "a blood pact".

The Court reasoned that because the "directors designated by Liberty and Originate, are sophisticated and competent businesspeople," they did not "act[] as one unit or that one exerted control over the other." *Id.* at 41. This conclusion is illogical, as sophisticated and competent businesspeople may seek to have others' agreement to and in their goals so that they may be better assured jointly of reaching them.

Aside from the facts the Court noted in its own summary judgment opinion, numerous others compel the conclusion that the VC Investors controlled Adhezion:

- The VC Investors were on both sides and the principal beneficiaries of each of the Challenged Transactions, the only equity funding transactions Adhezion was allowed to engage in from 2009 to the present.

- Adhezion's only counsel was Pepper Hamilton, a law firm with a conflict of interest vis-à-vis the VC Investors as it did hundreds of thousands of dollars in business with them. B.12-13 (since 2006/2005 Originate and/or affiliates have paid [redacted], and Liberty and its affiliates [redacted] to Pepper for legal services).

- Molinaro deferred to and ran significant matters first, and sometimes only, by VC Investor designees Crothall and Gausling. B.05-06 (email to Crothall and Gausling reporting that Kensey Nash inquiry on potential sale "in case it gets back to you"); B.10; B.11 (including Morse); B.09 (discussing potential counteroffer to Kensey Nash because "They have a board meeting tomorrow and [want] to present something to their board."); B.07 (soliciting Liberty's view on Kensey Nash so Molinaro could respond to Kensey Nash management).

Defendants' actions post-trial -- VC Investor member William Graham buying out plaintiff's stock at a premium to attempt to "flout" the Court's ruling describing rights of the common unitholders – was even more evidence of concerted behavior of and control by the VC Investors. OB Ex. A at 24 n.57.

Of the "multiple communications among Defendants" that ***the Court of Chancery itself held*** in its summary judgment opinion "would support a reasonable inference that the VC Investors exercised actual control over Adhezion's capital raising efforts", OB Ex. C at 27, the Post-Trial Opinion discusses only one.

The passage in full (only part is quoted in the Post-Trial Opinion) from a September 29, 2009 meeting of the Board of Directors is as follows:

> ***Fundraising Update & Next Steps.*** Molinaro provided a summary of the venture capital firms that he had contacted and the status of these discussions. He also indicated that he had planned to present Adhezion as a possible solicitation of investment at several start-up and medical device investment conferences including the MAC Conference. The board recommended that Molinaro cease all capital raising activities at this time, including discussions with other VC firms and attendance at investment conferences. Mike Gausling and Tom Morse advised Moloinaro [sic] that their respective firms would continue to temporarily satisfy Adhezion's operating cash requirements until we saw where the Medline or Braun discussions finalized, at which time we would make a decision about next capital raising steps.

B02-4 (emphasis in original).

The passage clearly shows that after informing the Board of ***ongoing*** fund raising efforts, Molinaro was shut down by the Board. That action ensured that the VC Investors would have no significant competition (the VC firms were demonstrably worried about large investments that could threaten their control) for their next financing, the February 2010 Issuance in which they almost halved the price per unit they demanded of and received from Adhezion. Because director Toni was absent from that meeting, the majority of the "Board" other than Molinaro were the representatives of the two VC Investors. Defendant Tom Morse, not even a director, was substituting for Board member Crothall on behalf of Liberty. The "temporar[y] satisfy[action]" of Adhezion's operating cash

requirements soon turned into a large increase in the benefits flowing to the VC Investors for that satisfaction.

The reasoning of the Court of Chancery in rejecting this as evidence of the VC Investors' control of Adhezion is illogical. There is no evidence Molinaro disobeyed it, or that he went to the investor conference he previously had planned. Indeed, he himself admitted he was "***told to***" focus on the business, not fund-raising, which directly undercuts the Court's supposition that this was "not an instruction". The Court's reference to Molinaro being given enough cash by Liberty and Originate misses the point, because the instruction caused Molinaro to alter pre-existing fund-raising activities, and ultimately the terms for those cash were raised, something that may not have happened had Adhezion had alternatives.

The Court references a potential patent issue regarding litigation that was never in fact brought – in any event this does not lessen one example of the VC Investors' exercise of control over Adhezion. The Court also references that a month later "Gausling himself attempted to secure outside funding of [redacted]" though he did not in fact secure it and no reference is made to what terms he may have demanded, such as terms that did not threaten his control with Liberty of the investment.

Moreover, the Court erred as a matter of law in failing to recognize that the VC Investors could at will fire any other director on the Board, pursuant to

Operating Agreement provisions 6.2(a)(iv), 6.5, and 7.1. A178-79, A183. Adhezion had six directorships – two appointed by the VC Investors; the current CEO; two "industry" directors; and a director for the common unitholders. Adhezion in fact had five directors – there being a dispute at trial as to whether Toni (who owned no common stock and no common unitholder voted for him as their representative) was a common director or an industry director, not necessary for resolution as to this issue.

The Industry Directors were by specific contract provision elected by the majority of the Common director and the Series A directors. Since the (two) Series A directors would always outvote the (one) Common director, those two could elect the two industry directors at will. Even assuming *arguendo* Toni was the common director, the two Series A preferred directors and the two industry directors they could unilaterally choose could at will control the Board as well as replace the CEO director by appointing a new CEO.

The Court's Post-Trial Opinion states without reasoning that it is "not clear" that the Series A directors can fire the CEO. To the contrary, that is absolutely clear – the Series A directors together with the two Industry directors they could appoint can "designate" a person to "serve as officers of the Company" including the "Chief Executive Officer", who would ipso facto become the CEO director as the "then-current Chief Executive Officer of the Company".

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