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Case Number 608,2013

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.	)	No. 608, 2013
	)	
ROBERT ZIMMERMAN,	)	
	)	
Plaintiff Below/Appellee,	)	
	)	
- and -	)	
	)	
THE WILLIFORD FIRM, LLC and EVAN O. WILLIFORD,	)	
	)	
Intervenors Below/Appellees/Cross-Appellants.	)	

REPLY BRIEF OF INTERVENORS BELOW/CROSS-APPELLANTS THE WILLIFORD FIRM, LLC AND EVAN O. WILLIFORD

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Dated: March 6, 2014

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ARGUMENT

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

A. Defendants Cannot Ask The Court To Hear Appeals Of Unfavorable Rulings But Refuse Appeals Of Favorable Ones.

As set forth in the Answering Brief of Intervenors Below/Appellees, and Opening Brief of Cross-Appellants, The Williford Firm LLC and Evan O. Williford (the "Opening Brief"), defendants' associate William Graham bought all of plaintiff Robert Zimmerman's units in Adhezion after the Court's Post-Trial Opinion. Relatedly, The Williford firm LLC and Evan O. Williford ("TWF") withdrew from representing Zimmerman and intervened solely for the purposes of pursuing their fee petition.

Defendants attempt to appeal the adverse rulings contained in the Court of Chancery's Post-Trial Opinion. As set forth in the Opening Brief, they cannot, including because plaintiff has been deprived of standing to oppose any such appeal.

In the alternative, if defendants can somehow appeal allegedly adverse rulings in this now moot case, TWF respectfully asserts that it should be heard to appeal rulings adverse to its economic interests.

Notwithstanding defendants' argument that they can appeal rulings against them in this moot case, in their Joint Reply Brief on Appeal and Answering Brief

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on Cross-Appeal (the "Answering Brief"), defendants attempt to simultaneously argue that appeals from rulings in their favor should not be allowed. Defendants' contradictory position only further demonstrates the lack of merit of their appeal of the Court's substantive rulings below.

Defendants cite *Lindh v. Randolph*, 525 A.2d 1013 [TABLE] (Del. May 4, 1987), an unpublished order on appeal from a Family Court action. In *Lindh*, attorney Alfred Lindh represented Beatrice Atwood in a paternity/child support suit against Luke Randolph. The parties signed a stipulated order providing for determination of counsel fees to Lindh to be determined by the Court. The Supreme Court ruled that a later settlement between Atwood and Randolph did not deprive the Family Court of its obligation to determine due attorneys' fees. To the extent *Lindh* is relevant at all, it only shows why the Court of Chancery's determination of TWF's appropriate fee in this complex case should not be disturbed.

In that case, Lindh had requested a hearing on the settlement, opposing it on the grounds of undue influence and lack of financial disclosure. The Supreme Court ruled that he lacked standing to appeal the settlement. As to the comparison that defendants wish to make, *Lindh* and this case are quite a bit different. In that case, the former attorney was attacking a settlement of the action which benefitted his former client by providing her with child support. By contrast, Zimmerman did

not agree to settle the case, but only to sell his units in Adhezion to defendants' associate. The two arguments made on cross-appeal are ones Zimmerman himself chose to make below and do not affect him detrimentally. If defendants are permitted to appeal a merits ruling based upon the legal interest TWF has in its fee award, TWF should have the right to do the same.

B. Bryant Was Not Independent And The Operating Agreement Safe Harbor Did Not Apply.

In its Post-Trial Opinion, the Court held that Section 6.13 of the Adhezion Operating Agreement provided a safe harbor for the transactions at issue because directors Toni and Bryant were independent of Molinaro, whom the Court assumed to be interested. OB Ex. A at 45, 54. But, as set forth in the Opening Brief, Bryant was demonstrably ***not*** independent of Molinaro.

One issue that accentuates Bryant's lack of independence and the lack of applicability of this provision is that no vote was ever held solely by the allegedly disinterested/independent directors. Rather, the only votes on the transactions were ones in which all five directors participated, three of whom (a majority) the Court assumed to be interested or nonindependent. Thus only the whole majority-interested Board, not just the argued-to-be-disinterested directors, voted in favor of the transactions. *See* OB Ex. A at 53 (citing this Court's discussion in *Gatz Props., LLC v. Auriga Cap. Corp.*, 59 A.3d 1206, 2012 WL 5425227, at *6 (Del. 2012) of

a transaction conditioned on approval of an informed majority of nonaffiliated members).

As set forth in the Answering Brief, Molinaro and Bryant had a shared working history that is so close as to be rare to unique. These were not men who had simply golfed together, or happened to attend some of the same dinner parties, or moved in the same circles. Rather, the two worked together ***for more than two-thirds of Bryant's working career***, as Bryant himself agreed. B30. In the course of founding and running a business together, Intraoptics, they worked alongside one another for a number of years during which, as Bryant characterized it, there was just not a lot of time outside of business. B18-21, B26-27.

This Court has recognized 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 . . . ." *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004). If the relationship between Molinaro and Bryant did not qualify as a "particularly close . . . business affinity" under *Beam*, there is no such thing.

Defendants claim in passing that TWF has "exaggerated" the facts, but do not say how. AB at 19. Rather, defendants mischaracterize the working relationship between Bryant and Molinaro as them as having "worked together for the same employers for portions of their careers". *Id.* That is simply not an

accurate description of the facts. Bryant and Molinaro worked together for two-thirds of Bryant's professional life (aside from having gone to the same college), a number of years of which they established and ran a start-up together.

Defendants attempts to distinguish *Beam* as a motion to dismiss case in which "all inferences had to be drawn in the plaintiff's favor". RB at 19. That is not the case. *Beam* was decided under Court of Chancery Rule 23.1 and the well-known *Aronson* test, which require that "a plaintiff has alleged particularized facts creating a reasonable doubt of a director's independence to rebut the presumption at the pleading stage." *Id.* at 1049. *Beam* was discussing the particularized facts necessary to create a reasonable doubt of independence, not only those that could create a mere plausible inference.

Defendants attempt to distinguish *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 947 (Del. Ch. 2003), as a case regarding the "unique loyalty found among faculty and donors on prestigious academic campuses". AB at 22. Nothing in the Oracle opinion suggests it is limited to that specific factual setting, or that the setting somehow created an exception to how the independence rules operate. Rather, the Court of chancery came to a conclusion regarding independence based upon a number of facts that tended to challenge it, facts that are similar in degree to the facts at issue here.

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Defendants point out that *Oracle* involved an accusation of a benefactor of a violation of criminal law. Here, however, Bryant would have been in the position of rejecting multiple funding transactions by VC Investors who actively controlled Adhezion and/or had the power to hire and fire his long-time business partner Molinaro. To hold him responsible as a matter of law for ensuring that the transactions were financially fair to Adhezion and its minority stretches the concept of independence to the breaking point.

Defendants cite *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150 (Del. Ch. 2005) (Parsons, V.C.), which concerned two directors that had a longstanding personal friendship. *Id.* at 178-79. The substantial working relationship between Bryant and Molinaro, however, distinguishes this case from *Benihana*.

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

A. Defendants Cannot Ask The Court To Hear Appeals Of Unfavorable Rulings But Refuse Appeals Of Favorable Ones.

Defendants argue that the Court cannot hear this second argument on cross-appeal for the same reasons it argued as applicable to first. As set forth above, however, should the Court determine it may hear defendants' appeal of the merits ruling on the interpretation of the Adhezion Operating Agreement, it should hear these issues on cross-appeal as well. *Supra* at 1-3.

B. The VC Investors Control Adhezion.

In the Answering Brief, TWF summarized the mountain of evidence that caused the Court of Chancery to conclude on summary judgment that there was a reasonable inference that the VC Investors "acted in concert" and "had a pervasive influence in directing the Company's capital-raising activity". OB Ex. C at 26-29. In doing so, the Court asked whether they had "actual control" such that that they were "no differently situated than if they had majority voting control." *Id.* (quoting *Kahn v. Lynch Commc'ns Sys., Inc.*, 638 A.2d 1110, 1113 (Del. 1994)).

In its Post-Trial Opinion the Court ruled otherwise, now requiring plaintiff to show that the VC Investors "were involved in a blood pact to act together" or were "bound together by voting agreements or other material, economic bonds to justify treating them as a unified group." OB Ex. A at 40 (quoting *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006)). This standard departs from the flexible one set forth by this Court in *Kahn*, and implements one in which a controlling stockholder group may avoid fiduciary duties, no matter how much they may as a practical matter control the organization, as long as there is not a contract or contract-like "economic bond" between the members of that group.

As set forth in the Opening Brief, the Court of Chancery ignored evidence that it itself had cited in its Summary Judgment Opinion and misread

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communications it had correctly read earlier. Moreover, it erred as a matter of law in failing to correctly read the Adhezion Operating Agreement, which allowed the VC Investors together to at will fire any other director on the Board, a specific contractual right of control.

This Court is urged to simply review for itself the numerous communications included in TWF's Appendix that show how Adhezion was in fact run. These communications clearly show that Originate and Liberty – and Gausling and Crothall/Morse on their behalf – called the shots, with Molinaro deferring to them and running significant matters by them first, and sometimes only. The trial evidence is fundamentally inconsistent with defendants' argument that Liberty and Originate did not together exercise control over their investment.

Defendants do not even attempt to defend the Court's ruling as to the Adhezion Operating Agreement and thus concede that it is legal error. Defendants make a different argument that the Adhezion Operating Agreement was in fact structured to "*prevent* Originate or Liberty from exercising actual control" because each could designate only one board member and did not have two-thirds of the preferred units". AB at 33 (emphasis in original). The fact that neither Originate nor Liberty ***by themselves*** could control Adhezion misses the point. Delaware law establishes that when shareholders combine to exercise control over a corporation fiduciary duties are imposed upon that exercise of control.

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At a September 29, 2009 Board Meeting, Molinaro informed the Board of his ongoing and planned fund-raising efforts, only to be instructed by Gausling and non-director Morse (who was apparently "substituting" for director Crothall on behalf of Liberty, which substitution itself evidences the effective power structure) to "cease all capital raising activities at this time". B02-4. Months before a financing transaction in which the VC Investors cut almost in two the price per unit they were offering to pay, this exertion of control hamstrung efforts by Adhezion to raise outside money.

Defendants do not even attempt to explain away much of the documentary evidence cited by TWF in the Answering Brief. They, however, include quotations at trial from their witnesses who gamely tried to explain away this particular obvious exercise of control. Morse testified that the instruction was because "the company had no chance of raising outside money" and this comment was "giving the company runway enough in cash" to try to find distribution partners." AB at 29. As to the former, this was a self-fulfilling prophecy because future steps Molinaro had planned to raise money were cancelled. After all, if Adhezion had no chance or raising money, why did Liberty and Originate themselves put in more? Surely they did so out of a reasonable expectation of potential profit, which outside investors could have shared as well. As to the latter, any "runway" came at the cost of cutting the sale price of Adhezion units in two. Molinaro does not deny

that he was being told to "cease all capital raising activities at this time" expressly including "discussions with other VC firms and attendance at investment conferences", only stating the truism that the order was not necessarily "permanent." AR4.

Defendants note that Molinaro later approached [redacted] about investing in Adhezion. AB at 30. But the communications regarding [redacted] ***clearly and especially*** shows the control Liberty and Originate had over Adhezion. For instance, when [redacted] instead wanted to buy Adhezion outright (giving the lie to Morse's assertion that to outsiders it was worthless) Molinaro consulted with VC Investor designees Crothall and Gausling, not the other board members Toni and Bryant, before conveying a counteroffer to [redacted] B9. In other words, when it came time to set terms to negotiate the sale of the Company, Crothall and Gausling were necessary to consult because their firms together controlled Adhezion.

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