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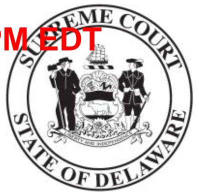

IN THE SUPREME COURT OF THE STATE OF DELAWARE

MORRIS FUCHS, *et al.*,	§	
	§	No. 281, 2015
Plaintiffs Below,	§	
Appellants, Cross-Appellees,	§	
	§	
v.	§	On Appeal from the
	§	Court of Chancery
WREN HOLDINGS, LLC, *et al.*,	§	of the State of Delaware,
	§	Consolidated C.A. No. 3940
Defendants Below,	§	
Appellees, Cross-Appellants.	§	

APPELLEES/CROSS-APPELLANTS' REPLY BRIEF ON CROSS-APPEAL

Of Counsel:
OTTERBOURG P.C.
Adam C. Silverstein
Stanley L. Lane, Jr.
230 Park Avenue
New York, New York 10169
(212) 661-9100

Co-Counsel for Defendants Below, Appellees, Cross-Appellants Wren Holdings, LLC, Javva Partners LLC, Dort A. Cameron, III, Howard Katz, Andrew Dwyer and Troy Snyder

ASHBY & GEDDES, PA
Richard D. Heins (#3000)
Andrew D. Cordo (#4534)
Stacy L. Newman (#5044)
Phillip R. Sumpter (#5811)
500 Delaware Ave., 8th Floor
P.O. Box 1150
Wilmington, DE 19899
(302) 654-1888

Counsel for the Defendants Below, Appellees, Cross-Appellants

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PRELIMINARY STATEMENT

On their cross-appeal, Defendants showed that the Trial Court erred in departing from *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), by finding that Plaintiffs had standing to pursue claims arising from the Recapitalization after SMC's merger out of existence, in the absence of (i) a controlling stockholder or its functional equivalent, (ii) an overpayment, and (iii) a corresponding extraction.[1] *See* AB 49-58. Defendants also showed that the court's granting of $2 million to Plaintiffs who actually incurred no fees or expenses, and who recovered *none* of the up to $130 million they sought at trial, was error. *See id.* at 59-64.

Plaintiffs' opposition to the cross-appeal completes the metamorphosis of their case from one for expropriation under *Gentile*—the case that Plaintiffs pleaded and tried, and on which the Trial Court based its finding that Plaintiffs had standing—into a case for usurping a purported "opportunity to invest" and/or breach of alleged "preemptive rights." *See*, *e.g.*, RB 32-33. With Defendants having proved at trial that there was *no* extraction in that the Recapitalization priced SMC's equity millions of dollars above the range of fairness, Plaintiffs now argue that the injury for which they seek a remedy was the expropriation of a contractual or other right to invest.

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[1] Capitalized terms are defined in the Appellees' Answering Brief on Appeal and Opening Brief on Cross-Appeal ("AB") and Appellants' Reply Brief on Appeal and Answering Brief on Cross-Appeal ("RB").

But Plaintiffs never pled—and against these Defendants cannot state—a claim for a violation of preemptive rights, nor did they have any other legally cognizable right to participate in the Recapitalization. Op. 129-30. And any claim for usurping a corporate opportunity would be a derivative claim that Plaintiffs lack standing to bring under the continuous ownership rule. Moreover, Plaintiffs' standing to recover disgorgement or rescissionary damages for an alleged usurpation of a corporate opportunity cannot rest on a claim of *Gentile*-type expropriation of stockholder equity that the Trial Court found did not occur.

In short, in the absence of any expropriation by a majority stockholder or its functional equivalent from minority stockholders in a corresponding amount, Plaintiffs lack standing, no matter how they now attempt to recast their claims.

Also unavailing is Plaintiffs' attempt to transform the Trial Court's grant of $2 million in fees as a form of compensation to Plaintiffs under the pre-litigation bad faith exception to the American Rule into a *quantum meruit* fee award to Plaintiffs' counsel for supposedly achieving an "unquantifiable" benefit in the litigation. *See* RB 39-42. In either case, the Trial Court erred in awarding *any* amount of fees or expenses; there was nothing to shift because Plaintiffs incurred no fees or expenses, and there was no benefit on which to premise a fee award. Accordingly, this Court should reverse the Judgment for lack of standing or, at the least, reverse the Fee Opinion.

ARGUMENT

I. THE TRIAL COURT ERRED BY NOT DISMISSING PLAINTIFFS' CLAIMS AS SOLELY DERIVATIVE.

A. The Trial Court Erred in Finding Plaintiffs' Claims Direct Under *Gentile*.

1. There Was No Control Group as a Matter of Law.

Plaintiffs incorrectly characterize Defendants' argument that the controlling stockholder requirement of *Gentile* was not satisfied as a challenge to the Trial Court's fact findings. *See* RB 34-36. Defendants do not challenge the court's finding that Wren and Javva agreed to give Catalyst an informal option to participate in the Preferred B-1 issuance, the sole fact on which the Trial Court based its conclusion that standing under *Gentile* existed. Op. 29, 64. Rather, Defendants' argument is that the Trial Court misapplied the legal standard by concluding that alone was sufficient to qualify Wren, Javva and Catalyst as a control group, and that the mere existence of a control group—absent an overpayment (which the Trial Court found did not occur) and a *corresponding* extraction (which the Trial Court, without explanation or analysis, found was unnecessary)—was sufficient to confer standing.

The parties agree that under the applicable standard, for separate stockholders to be deemed a control group, there must be a more substantial connection among them than concerted action or a common goal. *Compare* AB 53-54 *with* RB 35. That is, parallel self-interest does not convert separate

stockholders into the functional equivalent of a single controlling stockholder. If it did, any agreement to bring about corporate action would lead to such stockholders owing fiduciary duties. *See* AB 53-54. Plaintiffs argue that the Catalyst Memo, when coupled with the informal option, reflects the necessary "agreement, arrangement, and legally significant relationship" to establish a control group. *See* RB 35. But while finding that Catalyst's comments in the Catalyst Memo showed a "willingness" to work together with Wren and Javva toward a common goal, the Trial Court rejected Plaintiffs' contention that Wren, Javva and Catalyst had agreed in mid-2001 to seize control of SMC through a process culminating in the Recapitalization. Op. 63. Rather, the court based its determination that Wren, Javva and Catalyst (three unaffiliated entities with no prior or subsequent dealings) formed a control group—and, thus, that standing under *Gentile* existed—*solely* on the finding that Wren and Javva gave an informal 90-day option to Catalyst to induce it to vote in favor of the Recapitalization. *Id.* at 64. With a 90-day option in hand, Catalyst's vote for the Recapitalization advanced its own interests, not that of any monolithic control group to which Catalyst was beholden. Thus, for the reasons set out previously, AB 53-55, the option—which Catalyst never exercised—does not support the Trial Court's legal conclusion that a control group existed. Plaintiffs offer nothing to the contrary. Absent a controlling stockholder or its equivalent, standing does not exist under *Gentile*.

2. There Was No Issuance of "Excessive" Shares.

Plaintiffs dismiss as "wrong" the notion that the Trial Court's finding that there was no issuance of excessive shares or an overpayment in the Recapitalization—because the Recapitalization price was millions of dollars above the range of fairness—defeats standing under *Gentile*. RB 32-33. They contend that *Gentile* held a direct claim may be stated in the case of a "transaction that would benefit the fiduciary at the expense of the minority stockholders." *Id.* at 31.

Under that definition, however, any entire fairness dilution claim would fall within the ambit of *Gentile*. But the narrow category of simultaneously direct and derivative claims identified in *Gentile* requires more: the issuance of "'excessive' shares of [] stock in exchange for assets of [a] controlling stockholder that have a lesser value." 906 A.2d at 100. Such a claim is direct because it entails the "extraction or expropriation" of "s[tock]holder *value* and voting power embedded in the (pre-transaction) minority interest." *Id.* at 102 n.26 (emphasis added); *see also Feldman v. Cutaia*, 956 A.2d 644, 657 (Del. Ch. 2007) ("*Feldman I*") (interpreting *Gentile* as requiring the issuance of shares for "inadequate consideration"), *aff'd*, 951 A.2d 727 (Del. 2008) ("*Feldman II*"); *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 655 (Del. Ch. 2013) (describing the harm that *Gentile* seeks to remedy as the company receiving "too little" value in exchange for preferred shares). The Recapitalization, which was effected at a

"more than fair" price, did not result in the issuance of shares for inadequate consideration. Without an unfair exchange, *Gentile* is not satisfied, and thus Plaintiffs' claims should ultimately have been dismissed as derivative.

Plaintiffs alternatively contend that the Recapitalization did result in an expropriation—not of excessive shares, but of the opportunity to invest or of preemptive rights. *See* RB 33 n.11. This latest argument fails for several reasons. To start, this case was not pleaded, litigated or tried as a breach of preemptive rights or usurpation of corporate opportunity case; it was brought and litigated through trial as a case for expropriation "under *Gentile*." *See*, *e.g.*, A363. To the extent that the claim now is that Defendants expropriated Plaintiffs' preemptive rights, no such claim can lie. Any preemptive rights that any Plaintiffs held (and, according to Plaintiffs, only about half of them held such rights, RB 15) would have been a matter of contract between Plaintiffs and SMC.[2] Plaintiffs never pled any claim either for breach of contract or tortious interference with contract. Indeed, Plaintiffs' complaints make no reference at all to preemptive rights. *See*

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[2] The preemptive rights that Plaintiffs allege they held arose out of stock purchase agreements that some of them signed and which contained "most favored nation" rights, which in turn "most likely" gave them certain preemptive rights. Op. 29 n.100, 82; *see* OB 7; RB 32. The Trial Court's footnoted observation that some Plaintiffs "most likely" had preemptive rights pertained to the time period when Catalyst received its right to invest months before the Recapitalization closed. Op. 29 n.100. The Trial Court did not find that any Plaintiffs had unexpired, enforceable preemptive rights at the time that the preferred shares were issued when the Recapitalization was consummated. Nor did it hold that those rights were triggered (or breached) by the Recapitalization. *See* B174-76 (Defendants' pretrial brief discussing issues surrounding the availability of preemptive rights).

A93-130; A271-329. Nor could they have stated such claims against these Defendants—SMC stockholders, directors and affiliated persons—as opposed to SMC itself. *See Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 817 A.2d 160, 172 (Del. 2002) ("It is a general principle of contract law that only a party to a contract may be sued for breach of that contract."); *Goldman v. Pogo.com, Inc.*, 2002 WL 1358760, at *8 (Del. Ch. June 14, 2002) ("officers or directors may be held personally liable for tortious interference with a contract of the corporation if and only if they exceed the scope of their agency. . ." (brackets omitted)).

Furthermore, Plaintiffs' contractual preemptive rights "do not implicate any fiduciary duty." *Gildor v. Optical Solutions, Inc.*, 2006 WL 4782348, at *10 (Del. Ch. June 5, 2006) (rejecting an attempt to characterize a breach of preemptive rights as a breach of fiduciary duty). Because "preemptive rights were provided to [certain] stockholders owning shares of certain series of stock, and those rights arose expressly out of the Stockholder Agreement, not as a matter of equity," SMC "was bound contractually, not by common law fiduciary duties, to" honor any preemptive rights belonging to Plaintiffs. *See id.* Just as Plaintiffs cannot premise a claim for breach of fiduciary duty on a breach of preemptive rights (much less an *unpled* breach of preemptive rights), *see id.*, they cannot base direct standing under *Gentile* on an alleged breach of preemptive rights.

More to the point, a direct claim under *Gentile* must be premised on the

extraction of economic value embedded in stockholders' *equity*. *See Gentile*, 906 A.2d at 102 & n.26; *Caspian Select Credit Master Fund Ltd. v. Gohl*, 2015 WL 5718592, at *5 (Del. Ch. Sept. 28, 2015) ("*Gentile* cannot stand for the proposition that . . . a direct claim arises whenever a controlling stockholder extracts and expropriates economic value from a company to its benefit and the minority stockholder's detriment," as "[s]uch an exception would largely swallow the rule that claims of corporate overpayment are derivative"). Whatever preemptive rights some Plaintiffs may have had at some point in time were solely contractual in nature, not attached to their shares. Thus, even if there had been an impairment of preemptive rights, there was not an extraction of equity.

If Plaintiffs now claim that Defendants expropriated some *non*-contract-based right to invest, that claim cannot lie either. Plaintiffs do not identify any basis outside of alleged contractual preemptive rights for any of them to have had a right to participate in the Recapitalization. To the contrary, as the Trial Court found, Defendants had "no duty to allow the Plaintiffs to participate" in the Recapitalization. Op. 129-30. Accordingly, any attempt to base standing on an expropriation of a non-contract right to invest is misplaced.

In addition, even if Plaintiffs had pled valid claims for usurpation of a corporate opportunity (which they did not), such claims would be purely derivative. *See*, *e.g.*, *In re Digex, Inc. S'holders Litig.*, 789 A.2d 1176, 1189 (Del. Ch. 2000)

("A claim that a director or officer improperly usurped a corporate opportunity belonging to the corporation is a derivative claim"). Any such usurpation would have affected all stockholders proportionately. Indeed, the disgorgement damages sought by Plaintiffs reflect that: Plaintiffs, a portion of all former stockholders in SMC at the time of the Recapitalization, seek disgorgement of *all* supposedly ill-gotten profits received by Defendants (four years later in the Akamai Merger) at the purported expense of *all* other stockholders in the Recapitalization. OB 2. Any claim for such a remedy is purely derivative.

In short, in the absence of any expropriation of equity (which the Trial Court found did not take place) from these stockholders (or anyone else for that matter), Plaintiffs lack standing under *Gentile* as a matter of law.

3. There Was No Corresponding Dilution.

Plaintiffs argue that their claims are direct under *Gentile* even though the Recapitalization resulted in the issuance of a "small portion" of SMC's equity to entities other than Defendants. RB 29. Plaintiffs' argument is at odds with the plain language of *Gentile*, which requires a benefit to the controlling stockholder "corresponding" to, or "to the same extent" as, the dilution of the minority stockholders. *See* AB 50-51. The only decision of this Court to revisit *Gentile* in depth, *Gatz v. Ponsoldt*, which Plaintiffs cite, uses the same language. *See* 925 A.2d 1265, 1279 (Del. 2007) (holding *Gentile* invoked by the first part of a two-

step transaction in which the controlling stockholder obtained majority control through the issuance of underpriced shares "to the corresponding detriment of the [company's] public s[tock]holders.").

None of the other cases that Plaintiffs cite interprets *Gentile* differently. *See* RB 31-32. Only one case, *Carsanaro*, has held that a direct claim was stated under *Gentile* when some of the equity was issued to non-defendants. That decision, however, did not mention, and apparently did not consider, the issuance of equity to non-defendants as part of its analysis. *See* 65 A.3d at 659-60. *Carsanaro*, therefore, does not support Plaintiffs' argument. The other cases that Plaintiffs cite, *Tri-Star* and *Feldman I*, both recited and applied the "corresponding" extraction criterion for a direct claim literally. *See In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 330 (Del. 1993) (finding plaintiffs' claims to be direct, in part, because "the practical effect of cash-value dilution is to increase the value of the controlling stockholder's interest at the *sole expense* of the minority" (emphasis added)); *Feldman I*, 956 A.2d at 657 ("Because neither the Dilutive Transactions nor the ESOP grants conferred an exclusive benefit on any controlling stockholder of [the company], [plaintiff] cannot bring Count V as a direct claim.").

Plaintiffs reject the correspondence element of a direct claim under *Gentile* as "overly formalistic." RB 30. But the requirement is more than form over substance: it goes to the heart of what distinguishes a dual direct-derivative

dilution claim from any other dilution claim, which is exclusively derivative. When the transaction at issue results in dilution to all of a corporation's stockholders to some extent, then the harm is exclusively derivative and not direct. *See Tri-Star*, 634 A.2d at 330 (describing a derivative waste claim); *see also In re Paxson Commc'n Corp. S'holder Litig.*, 2001 WL 812028, at *5 (Del. Ch. July 12, 2001) (citing *Tri-Star* for the proposition that "dilution claims are individual in nature where a significant stockholder's interest is increased 'at the sole expense of the minority'" and dismissing a purportedly direct dilution claim because shares were issued to a third party). That is because what distinguishes a *Gentile*-type dual direct-derivative claim from an ordinary derivative dilution claim is the controlling stockholder taking economic and voting rights directly away from the minority stockholders solely for its own benefit. In the words of *Tooley*, such a claim is direct because the minority stockholders can prove a harm unique to them "independent of any alleged injury to the corporation." *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004); *see Feldman II*, 951 A.2d at 733; *Gentile*, 906 A.2d at 99, 102-03. The Trial Court's and Plaintiffs' interpretation of *Gentile* as recognizing a direct claim even if a portion of the equity is issued to third parties (or other Plaintiffs) contradicts the underpinnings of *Gentile* as well as its plain language.

In addition to advancing no basis in the language or rationale of *Gentile* for

permitting a direct claim when the corresponding dilution criterion is not satisfied, Plaintiffs do not advocate a workable standard. If the test is not "corresponding" dilution "to the same extent" that the controlling stockholder is benefitted, as *Gentile* says, then what is it? Is the cut-off for distinguishing a dual direct-derivative dilution claim from a purely derivative dilution claim when 95% or 90% or 75% of the excess equity is transferred to the controlling stockholder? There is no principled basis under *Gentile* for allowing direct claims to proceed if less than some arbitrary threshold of equity is issued to non-defendants.

Beyond that, Plaintiffs' description of the Recapitalization as involving the issuance of a "small portion" of equity to non-Defendants, RB 29, does not accurately describe the substance of the transaction. While the majority of the equity issued went to Wren and Javva in the form of Preferred B-1 shares, approximately 3% of SMC's total equity was issued to third party e-Media (in the form of Preferred B-2 shares), and 23% to the holders of SMC secured debt (in the form of Preferred A shares), which included Wren, Javva, Catalyst and several Plaintiffs. Op. 41. Thus, Wren, Javva and Catalyst were not the sole participants in the transaction, and their equity interest was not increased in direct proportion to the amount by which Plaintiffs' equity was diluted.

This reality is demonstrated by the effect of the Recapitalization on Catalyst, which exchanged its secured notes for Preferred A shares, but received no

Preferred B-1 shares. Thus, there was no net transfer of economic or voting rights to Catalyst. Its equity interest in SMC was diluted by more than half—the same extent as that of several Plaintiffs who likewise owned common stock and secured notes before the transaction. *See* AB 52. That the Trial Court found that Catalyst had an option to participate in the Preferred B-1 issuance—which it never exercised—does not change the result, since *Gentile* applies only to claims of equity expropriation, not unexercised contractual rights. In sum, none of the criteria for standing to assert a direct claim under *Gentile* was satisfied.

4. The Unjust Enrichment and Disclosure-Based Claims Are Derivative.

Plaintiffs also assert that their claims for unjust enrichment and disclosure violations are direct in nature because the conduct at issue "harmed Plaintiffs individually, and damages would go to them." RB 33. The assertion is mere *ipse dixit*. As the Trial Court found, and Plaintiffs do not seriously dispute, Plaintiffs' unjust enrichment claims seek redress for the same harm as their breach of fiduciary duty claims. *See* Op. 126; SJ Op. 21; AB 55. That harm, according to Plaintiffs, necessitates disgorgement of *all* profits Defendants made in the Akamai Merger as a result of the increase in their share percentage in the Recapitalization. Thus, these Plaintiffs seek for themselves the profits that Defendants made at the supposed expense of *all* SMC stockholders—the epitome of a derivative claim.

Therefore, the standing analysis for unjust enrichment is the same as for breach of fiduciary duty; the claims are solely derivative under *Tooley* and *Gentile*. AB 55.

Plaintiffs also argue that their claims for non-disclosure are direct because "Defendants' disclosure violation . . . prevent[ed Plaintiffs] from participating in the Recapitalization pro rata—despite their having preemptive rights." RB 33. Their logic is flawed. To begin with, while the Trial Court found that the post-transaction disclosure was "materially misleading" for "fail[ing] to disclose who participated in the Recapitalization or on what terms," it also found that the disclosure nevertheless "described the Recapitalization in general terms," including the issuance of "'several new series of convertible preferred stock.'" Op. 44-45, 93-94. Hence, assuming *arguendo* that Plaintiffs had extant preemptive rights at the time the Recapitalization closed, the Update was sufficient to put Plaintiffs on notice that their preemptive rights may have been triggered. Accordingly, the incomplete disclosure did not prevent Plaintiffs from exercising whatever preemptive rights they now claim to have had.

In all events, Plaintiffs' disclosure claim amounts to no more than contending that they should get damages because they were prevented from challenging the Recapitalization earlier. Any harm from being prevented from challenging the Recapitalization, however, can be no different than the harm from the Recapitalization itself. Thus, as the Trial Court correctly found, Plaintiffs

identify no damages for the lack of disclosure distinct from Plaintiffs' underlying claims for breach of fiduciary duty. *Id.* at 93 n.325. As such, their disclosure claim, like their breach of fiduciary duty claim, is derivative. *See* AB 55.

Plaintiffs argue that their disclosure claim nevertheless is direct for "the separate reason that it is akin to a disclosure violation when seeking a shareholder vote." RB 33. Plaintiffs cite no authority for this novel proposition, which is, in any event, incorrect. The Update was sent to disclose stockholder action by written consent under Section 228 of the DGCL. *See* Op. 93. The purpose of Section 228 is to authorize stockholder action without a stockholder vote. *Prime Computer v. Allen*, 1988 WL 5277, at *1 (Del. Ch. Jan. 25, 1988), *aff'd*, 540 A.2d 417 (Del. 1988). Disclosing corporate action taken by written consent is, therefore, an act of independent legal significance that is not "akin" to seeking stockholder action. In short, all of Plaintiffs' claims are derivative.

B. This Court Should Reject the Novel Theory of Direct Claims Created By *Carsanaro*.

Defendants previously showed that *Carsanaro* contradicts *Tooley* and *Gentile*, and undermines the continuous ownership rule by eliminating the controlling stockholder and exclusive benefit requirements, thereby making any claim attacking dilution approved by a conflicted board into a direct claim. *See* AB 56-58. In response, Plaintiffs contend that *Carsanaro* is not so broad. According to Plaintiffs, the court in *Carsanaro* "carefully cabined its reasoning"

by noting that "[s]tanding will not exist if there is no reason to infer disloyal expropriation," such as when stock is issued to an unaffiliated third party or when a majority of disinterested and independent directors approves the terms. RB 37-38. But the "careful cabin[ing]" to which Plaintiffs cite merely represents the flip-side of the same coin: according to *Carsanaro*, where a majority of interested directors stand on both sides of a transaction, the claim is both direct and derivative; when that is not the case, the claim is solely derivative. That is exactly the problem: under *Carsanaro*, *any* dilution claim involving a disloyal board would be direct, leaving as exclusively derivative only those rare cases attacking dilution approved by independent and disinterested directors. In contrast, *Gentile* reaffirms that claims of corporate dilution are generally exclusively derivative. *See* AB 56-58.

Carsanaro's elimination of all three elements of direct standing under *Gentile*—a controlling stockholder, an overpayment and a corresponding extraction—should be rejected.

II. THE TRIAL COURT ERRED IN GRANTING PLAINTIFFS ATTORNEYS' FEES AND EXPENSES.

On their cross-appeal, Defendants showed that the Trial Court erred in: (i) granting attorneys' fees under *Saliba* where Plaintiffs did not incur any fees; and (ii) formulating its quasi-*Sugarland* analysis. AB 59-64. Plaintiffs agree that the quasi-*Sugarland* analysis constituted legal error. RB 39. They argue that they were entitled to be granted fees despite not incurring any, either as fee shifting or on a *quantum meruit* basis. *Id.* at 39-42. Their argument is meritless.

A. Plaintiffs Are Not Entitled to Fee Shifting Because They Incurred No Fees or Expenses.

Defendants previously demonstrated that *Saliba v. William Penn Partnership*, 2010 WL 1641139 (Del. Ch. Apr. 12, 2010), *aff'd*, 13 A.3d 749 (Del. 2011), the sole authority invoked by the Trial Court in inviting a fee application, *see* Op. at 131 & n.432, necessitates the conclusion that no fees should have been granted in this case. AB 60-63. *Saliba* awarded attorneys' fees *actually incurred* by plaintiffs in successfully challenging defendants' bad faith pre-litigation conduct for which the court determined not to award any damages. The court reasoned that it "would be unfair and inequitable to require plaintiffs to shoulder the costs incurred in demonstrating . . . unfairness." 2010 WL 1641139, at *1. Here, Plaintiffs shouldered no costs in demonstrating the overall unfairness of the Recapitalization because they (wisely) eliminated that possibility through contract

with their complete contingency counsel. Thus, *Saliba* compels the conclusion that Plaintiffs are not entitled to any fees.

Plaintiffs' response that *Saliba* "turned not on who paid the fees, but rather on who 'breach[ed] [their] fiduciary duties,'" RB 39 (alteration in original), casts fee shifting as a form of punishment to defendants, not compensation to plaintiffs. That is *not* the purpose of fee shifting under the pre-litigation bad faith exception. Indeed, the Court of Chancery is not authorized to award punitive damages. *Beals v. Wash. Int'l, Inc.*, 386 A.2d 1156, 1160 (Del. Ch. 1978); *see Cantor Fitzgerald, L.P. v. Cantor*, 2001 WL 536911, at *3 (Del. Ch. May 11, 2001) (limiting fee shifting as damages to fees actually spent, concluding that to award any greater damages would be "tantamount to awarding punitive damages").

Plaintiffs' contention that their reading of *Saliba* "comports with the myriad Delaware cases that award fees where counsel took the case on contingency and the plaintiffs had not paid out of pocket," RB 40, confuses fee *shifting* cases like *Saliba* with fee *award* cases. In fee award cases, where plaintiffs' counsel has provided a valuable benefit (monetary or otherwise) to others, such as in class or derivative actions, counsel (regardless of their fee arrangement) may be awarded a fee. *See Goodrich v. E.F. Hutton Group, Inc.*, 681 A.2d 1039, 1044-45 (Del. 1996); *Seinfeld v. Coker*, 847 A.2d 330, 333-34 (Del. Ch. 2000). But in fee shifting cases, the court does not make an award to counsel. Rather, it shifts fees

as a form of damages to compensate the plaintiff for actually incurring such fees. *See Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 687 (Del. 2013), *on remand*, 2013 WL 5152295 (Del. Ch. Sept. 16, 2013). On remand in *Scion*, the Court of Chancery held that this Court's reasoning that fees arising from pre-litigation conduct could not be awarded pursuant to a contractual fee-shifting provision where counsel had not charged for its work also applied to equitable fee shifting. 2013 WL 5152295, at *8.[3]

Plaintiffs argue that Defendants' logic is "backwards" and that Defendants are seeking a windfall at the expense of Plaintiffs' counsel as a result of counsel's contingent fee arrangement. RB 40. On the contrary, Defendants' logic is consistent with both case law and principles of equity: when plaintiffs have not incurred attorneys' fees to redress pre-litigation conduct that resulted in no damage, they are not entitled to fee shifting because such plaintiffs are already whole—they have suffered no damages and have incurred no expenses. Indeed, it is Plaintiffs' counsel who is seeking a windfall by attempting to be paid under a contingency fee arrangement after failing to achieve any recovery for their clients.

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[3] In *Scion*, the Court of Chancery distinguished between pre-litigation conduct such as that at issue here, and conduct during the litigation. The Court held that a fee award based on pre-litigation conduct is compensatory and is based on fees actually incurred. *Id*. at **8, 10. Misconduct during litigation, however, "go[es] beyond monetary harm to the opposing party," and "affects the court" and therefore the public. *Id*. at *10. Thus, fee awards resulting from bad faith litigation conduct may be issued "to deter abusive litigation in the future, thereby avoiding harassment and protecting the integrity of the judicial process." *Id*. (internal quotation marks omitted). Such a sanction, however, is not appropriate in connection with pre-litigation conduct. *Id*. at **8, 10. There was no bad faith in the conduct of this litigation. Fee Op. 6 n.21.

According to Plaintiffs, "[c]ountenancing Defendants' theory risks disincentivizing attorneys from accepting breach of fiduciary duty cases on contingency, thus reducing meritorious suits." *Id.* In reality, the only cases that might be discouraged if Plaintiffs are denied fees in this case, are those contingency cases where the challenged transaction is priced fairly and the plaintiffs have not suffered any harm. But there is no reason to incentivize attorneys to devote time with a lodestar value (here, over $11 million) that substantially exceeds not only what the litigation achieved (zero) but also any objective estimate of what the litigation might have achieved ($3-4 million). Fee Op. 8. The Trial Court's grant of fees and expenses should be reversed.

B. Plaintiffs' Counsel Is Not Entitled to a *Quantum Meruit* Fee Award Because They Provided No Common Benefit.

Plaintiffs assert that they are entitled to fees on a *quantum meruit* basis. RB 41-42. Fees are only awarded on a *quantum meruit* basis, however, when counsel's efforts have created a valuable benefit (monetary or non-monetary) on behalf of a discernible group, such as a stockholder class. *See In re First Interstate Bancorp Consol. S'holder Litig.*, 756 A.2d 353, 356-57 (Del. Ch. 1999), *aff'd sub nom. First Interstate Bancorp v. Williamson*, 755 A.2d 388 (Del. 2000). No such benefit was obtained here. While Plaintiffs seek to portray the benefit conferred here (on whom, it is unclear) as "unquantifiable" and, thus, deserving of *quantum meruit* compensation, the "benefit" achieved in this litigation, in fact, is readily

quantifiable: $0. Plaintiffs' counsel brought this action on a contingency basis seeking up to $130 million in damages, and recovered nothing. The only "benefit" they achieved—the vindication of their clients' rights by establishing liability—would be present whenever a plaintiff wins a judgment. If that were the standard, then a fee award would be justified every time a plaintiff prevails.[4]

Plaintiffs' contention that they earned the same benefit as that purportedly secured by the plaintiff in *Saliba*, RB 42, also misses the mark. *Saliba* was a fee shifting case, not a fee award case. The court did not award fees to counsel under the common benefit exception; rather, it shifted fees to the plaintiff to reimburse them for costs they "shouldered" in suing. *See supra* at 18; AB 62.

Plaintiffs' further assertion that they "do not lose their right to fees for failing to achieve benefits [such as corrective disclosures, governance changes or modifications to a transaction] that Defendants' misconduct long ago rendered unattainable" is equally misplaced. RB 42. Plaintiffs fail to identify any otherwise available remedy that was rendered unattainable as a result of the misleading disclosure of the Recapitalization. Rather, just as the Trial Court declined to grant a remedy (other than fees) in 2014 because the Recapitalization was effected at a "more than fair" price, the result would have been the same in 2002. In any event,

[4] Plaintiffs' contention that Defendants conceded in briefing in the Trial Court that a benefit had been conferred, RB 42, misstates the record. To the contrary, Defendants stated that "the litigation did not produce a benefit in the sense required to invoke [the common benefit] exception to the American Rule." B356. That statement was (and is) accurate.

Plaintiffs cite no authority for the proposition that a court may award fees when no common benefit has been achieved but might have been achieved but for a disclosure violation. Such a rule would make litigation an end in and of itself, and transform fee awards into penalties to those who violate disclosure obligations. Accordingly, Plaintiffs are not entitled to fees on a *quantum meruit* basis.

CONCLUSION

For the foregoing reasons and those discussed in the AB, Defendants respectfully request that this Court: (i) reverse the Judgment on the grounds that Plaintiffs lacked standing because their claims were exclusively derivative and therefore should be dismissed with prejudice; or (ii) in the alternative, affirm the Opinion in all respects and reverse the Trial Court's grant of attorney's fees and expenses to Plaintiffs' counsel in the Fee Opinion.

Dated: October 13, 2015

ASHBY & GEDDES, PA

/s/Andrew D. Cordo

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Richard D. Heins (#3000)
Andrew D. Cordo (#4534)
Stacy L. Newman (#5044)
Phillip R. Sumpter (#5811)
500 Delaware Ave., 8th Floor
P.O. Box 1150
Wilmington, DE 19899
(302) 654-1888

Counsel for the Defendants Below, Appellees, Cross-Appellants

Of Counsel:
OTTERBOURG P.C.
Adam C. Silverstein
Stanley L. Lane, Jr.
230 Park Avenue
New York, New York 10169
(212) 661-9100

Co-Counsel for Defendants Below, Appellees, Cross-Appellants Wren Holdings, LLC, Javva Partners LLC, Dort A. Cameron, III, Howard Katz, Andrew Dwyer and Troy Snyder