EFiled: Jan 22 2016 01:28PM EST
Filing ID 58467001
Case Number 523,2015D

IN THE SUPREME COURT OF THE STATE OF DELAWARE

OPTIMISCORP, a Delaware corporation, ALAN MORELLI, and ANALOG VENTURES, LLC, Plaintiffs Below-Appellants, v. JOHN WAITE, WILLIAM ATKINS, GREGORY SMITH, and WILLIAM HORNE, Defendants Below-Appellees,	)	No. 523,2015 On Appeal from the Court of Chancery, C.A. No. 8773-VCP

CROSS-APPELLANTS JOHN WAITE, WILLIAM ATKINS, AND GREGORY SMITH'S REPLY BRIEF ON CROSS-APPEAL

Dated: January 22, 2016

BAYARD, P.A.

Stephen B. Brauerman (No. 4952)
Vanessa R. Tiradentes (No. 5398)
Sara E. Bussiere (No. 5725)
222 Delaware Avenue, Suite 900
Wilmington, DE 19801
(302) 655-5000

Attorneys for Defendants-Below/Cross-Appellants John Waite, William Atkins, and Gregory Smith

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

I. INTRODUCTION[1]

The trial court erred in finding that the Director Defendants breached their duty of loyalty because the Director Defendants' one week delay in disclosing the Company's flawed corporate structure did not implicate their duty of candor.[2] Even if this brief delay implicated the duty of loyalty,[3] the Director Defendants did not breach their duty of loyalty because their delay was justified, they actually disclosed the structural defect to the Board, and they received no personal benefit from the delay. This Court should reverse and find that the Director Defendants did not breach their duty of loyalty.

---

[1] Capitalized terms not defined herein shall have the meanings attributed to them in Appellees John Waite, William Atkins, and Gregory Smith's Answering Brief on Appeal and Cross-Appellants' Opening Brief on Cross-Appeal, cited herein as "Op. Br. at []." (D.I. 19.) Appellants' Reply Brief on Appeal and Cross-Appellees' Answering Brief on Cross-Appeal is cited as "Ans. Br. at []." (D.I. 23)

[2] This Court has cautioned against the imprecise invocation of the duty of candor. *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992) ("[T]he term "duty of candor" has no well accepted meaning in the disclosure context. Its use is both confusing and imprecise given the well-established principles and duties of disclosure that otherwise exist. Thus, it is more appropriate for our courts to speak of a duty of disclosure based on a materiality standard rather than the unhelpful terminology that has crept into Delaware court decisions as a 'duty of candor.'"). The Court of Chancery's efforts to craft a fiduciary violation out of the duty of candor under the unique facts of this case reflect precisely the dangers about which this Court warned.

[3] The duty of candor is not a stand-alone fiduciary duty; rather it "implicate[s] either the duty of care or the duty of loyalty depending on the factual situation." (Op. at 186 n.578 (citing *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 357-363 (Del. Ch. 2008)).) Here, the Court of Chancery found the Director Defendants' disclosure violation implicated the duty of loyalty. (*Id.*)

II. ARGUMENT

A. THE DIRECTOR DEFENDANTS DID NOT BREACH THEIR DUTY OF DISCLOSURE BY WAITING ONE WEEK TO ADVISE THE BOARD OF THE COMPANY'S FLAWED CORPORATE STRUCTURE.

The Court of Chancery, relying on *Mills Acq. Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989) and *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 357-363 (Del. Ch. 2008),[4] found:

> The Director Defendants had a duty to deal candidly with their fellow directors. Having become aware of the problem with the Rancho-Optimis structure, I conclude that the Director Defendants breached their duty of candor by not alerting the Board to the issue. Because they acted intentionally for their own benefit, I further find the Director Defendants breached their duty of loyalty in this regard.

[4] The Court of Chancery cites *In re Transkaryotic Therapies, Inc.* as "discussing the evolution of the law on this issue." (Op. at 186 n. 578.) Each of the disclosure cases analyzed by the Court of Chancery in *Transkaryotic* involved board or stockholder action, where the inadequate disclosure implicated the effectiveness of the vote taken. *See generally Transkaryotic*, 954 A.2d at 356-360 (alleging breach of fiduciary duties for failure to disclose material facts to stockholders before stockholder vote on merger); *see also Smith v. VanGorkom*, 488 A.2d 858 (Del. 1985) (alleging breach of fiduciary duties for "failure to disclose all material information such as a reasonable stockholder would consider important in deciding whether to approve the Pritzker offer"); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983) (finding "Material information, necessary to acquaint those shareholders with the bargaining positions of Signal and UOP, was withheld under circumstances amounting to a breach of fiduciary duty"); *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977) (alleging disclosure breach when controlling stockholder failed to disclose material information when making tender offer). In contrast, the Director Defendants' supposed disclosure violation did not implicate any stockholder vote and cannot constitute a breach of fiduciary duty as a matter of law.

(Op. at 187.) This holding is factually unsupported and legally incorrect and the Court should reverse the Court of Chancery's finding that the Director Defendants breached their duty of candor.

Plaintiffs echo the Court of Chancery's holding – claiming (without any support[5]) that "the Director Defendants knew of a material problem with the corporate structure, failed to disclose it to the board, and then attempted to 'exploit that very flaw.'" (Ans. Br. at 39.) Because the duty of disclosure did not apply, or in the alternative, because the Director Defendants were either excused from or complied with any disclosure duties they might have had, the Director Defendants did not breach their duty of loyalty.

---

[5] Plaintiffs rely on page 186 of the Opinion to support this argument. The cited portion of the Opinion does not refer to *any* record evidence. (Op. at 186.) This Court need not defer to the Court of Chancery's *unsupported* factual findings. *Nixon v. Blackwell*, 626 A.2d 1366, 1378 (Del. 1993) ("This Court respects and gives deference to findings of fact by trial courts when supported by the record, and when they are the product of an orderly and logical deductive reasoning process, especially when those findings are based in part on testimony of live witnesses whose demeanor and credibility the trial judge has had the opportunity to evaluate . . . . the crucial findings in the Vice Chancellor's opinion are somewhat vague and the opinion does not crisply and clearly set forth findings of fact in a form which we believe is entitled to such deference. Thus, we hold that these findings are not the product of an orderly and logical deductive reasoning process."). The record indicates that the Director Defendants learned of the flawed corporate structure on June 18, 2013. (See *infra* notes 6-7.) They disclosed the flawed corporate structure to the Optimis Board on June 25, 2013. (B1528-37.) Neither the Court of Chancery nor Plaintiffs cite any case that holds that a seven day delay in disclosing a fact about which all parties had equal knowledge is enough to breach a disclosure obligation – especially in the absence of any transactional trigger event.

1. The Director Defendants' Knowledge Of The Structural Defect Did Not Implicate The Duty Of Disclosure

The Director Defendants were not obligated to inform the Board of Rancho's flawed corporate structure because the duty of disclosure is not implicated by the facts of this case. The Court of Chancery has explained:

> The duty of disclosure arises because of 'the application in a specific context of the board's fiduciary duties'.... Its scope and requirements depend on context; the duty 'does not exist in a vacuum' [and therefore] [w]hen confronting a disclosure claim, a court therefore must engage in a contextual specific analysis to determine the source of the duty, its requirements, and any remedies for breach.

In re Wayport, Inc. Litig., 76 A.3d 296, 314 (Del. Ch. 2013) (internal citations omitted). The unique facts of this case show that the Director Defendants were not obligated to disclose the structural defect to the Board.

The record evidence, which neither the Court of Chancery nor Plaintiffs cited, shows that the Director Defendants learned[6] of the structural defect on June

[6] The Director Defendants learned of the structural defect after consulting with legal counsel retained to advise them ***personally*** regarding their disputes with Morelli and Optimis. (BR5-6, Atkins Dep. 17:5-18:10 (explaining that he sought advice of counsel after discussion regarding his employment agreement with Rancho), 416:23-423:13 (stating that he learned about the illegal structure from counsel and explaining reasons for non-disclosure); B2714, Waite Dep. 519:10-520:19 (testifying that he learned about flawed structure from a June 18, 2013 legal opinion); AR60, Smith Dep. 370:16-17 ("We did find out that the agreement was null and void from an opinion letter that we received.")).

18, 2013.[7] (B2714, Waite Dep. 519:10-520:9.) One week later, on June 25, 2013, the Director Defendants resigned their Optimis directorships and disclosed the structural defect. (B1528-37.) One day after resigning, the Director Defendants filed suit to void their transaction with Optimis based on the structural defect. (B1547-58.) On these facts, the disclosure obligations implicated by the duty of loyalty do not apply.

None of the hallmarks of a disclosure violation exist here. *In re Wayport, Inc. Litig.*, 76 A.3d 296, 314 (Del. Ch. 2013) (noting that the duty of disclosure generally applies to (1) common law ratification; (2) board requests for stockholder action; (3) statements made by a corporate fiduciary; and (4) the purchase or sale of shares directly from or to an outside stockholder). The Director Defendants did not withhold information about the structural defect from any vote by Optimis stockholders. *Malone v. Brincat*, 722 A.2d 5, 11 (Del. 1998) ("In the absence of a ***request for stockholder action***, the Delaware General Corporation Law does not require directors to provide shareholders with information concerning the finances

[7] At trial, Waite testified that the Director Defendants learned about the structural flaw in June 2013 prior to their June 25, 2013 resignation. (A484, 1137:20-1138:3 (Waite).) The Director Defendants' deposition testimony was consistent: Smith testified he learned about the illegal structure in "May or June of 2013;" Waite and Atkins had more specific recollections about when they learned about the illegal structure. (AR 60, Smith Dep. 370:13-372:1; B2714, Waite Dep. 519:10-520:19 (testifying learned about flawed structure from a June 18, 2013 legal opinion); BR144-46, Atkins Dep. 416:23-423:13 (stating learned about the illegal structure from counsel "literally days" before the June 25, 2013 special board meeting).) No record evidence is to the contrary.

or affairs of the corporation.") (emphasis added); *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992) (explaining that the duty of candor "represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control ***when it seeks shareholder action***") (emphasis added). The Director Defendants did not use their superior knowledge about the structural defect to mislead any Optimis director or otherwise impair the exercise of the Board's fiduciary duties. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1283 (Del. 1989) (finding disclosure violation where, during a bidding war, management (itself interested in the transaction) disclosed confidential corporate information to one bidder but not another). The Director Defendants did not make a voluntary, but incomplete disclosure about the structural defect. *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996) ("[D]irectors are under a fiduciary obligation to avoid misleading partial disclosures. The law of partial disclosure is likewise clear: '[O]nce defendants travel[ ] down the road of partial disclosure . . . they . . . [have] an obligation to provide the stockholders with an accurate, full, and fair characterization of those historic events.'") (internal citations omitted). The Director Defendants did not become aware of or perpetrate a fraud on Optimis involving the structural defect.[8] *Hoover Indus., Inc. v. Chase*, 1988 WL 73758, at

[8] Throughout this litigation, Plaintiffs unsuccessfully attempt to malign Mr. Waite

*2 (Del. Ch.) ("The intentional failure or refusal of a director to disclose to the board a defalcation or scheme to defraud the corporation of which he has learned, itself constitutes a wrong, unless a recognized privilege against disclosure pertains."). The Director Defendants did not personally engage in any transactions relating to the structural defect.[9] *Big Lots Stores, Inc. v. Bain Capital Fund VII,*

---

with a perceived "misrepresentation" allegedly made in the Section 225 Action. (Ans. Br. at 3 n.2.) No misrepresentation occurred and the trial court appropriately ignored Plaintiffs' repeated attempts to exploit their misreading of an argument advanced by Mr. Waite's counsel. (*Id.*) Mr. Waite's counsel wrote: "This case does not, however, involve competing factions with differences of opinion about the optimal strategic direction of the Company. Nor is this the coup that Plaintiffs claim it to be. Instead, the actions at issue were necessary after it received a report detailing a claim of sexual harassment alleged against Mr. Morelli by an employee under his supervision." (A1985 at ¶¶ 2-3.) These statements were and remain true. As the Court of Chancery found, the Board did not remove Mr. Morelli at the October 20 Meeting because they disagreed with his vision for the Company; rather they removed Mr. Morelli in good faith, upon the advice of well-qualified legal counsel, to protect the Company from liability after Mr. Morelli repeatedly engaged in egregious acts of sexual misconduct against a subordinate. (Op. at 177 ("[T]he evidence supports the finding that this was a good faith, independent investigation by outside counsel that concluded Optimis' CEO apparently had engaged in sexual harassment."); 178-79 ("The October 20 Meeting . . . does not provide a basis for any breach of the duty of loyalty. Viewing the October 20 Meeting in light of my findings . . . the meeting looks like nothing more than a board attempting in good faith to follow the advice provided by several separate legal advisors.").) Despite his protestations to the contrary, this case is and always was about Mr. Morelli's misconduct and not about any conspiracy.

[9] Filing a "not meritless" lawsuit is not a transaction. Even if it were, the filing of the Rescission Action occurred ***after*** the Director Defendants resigned as fiduciaries and cannot implicate the duty of loyalty. (Op. at 185 (finding that "[b]ecause of the bright-line rule as to the temporal scope of directors' fiduciary duties, filing the lawsuit itself could not have breached a duty they no longer owed.").)

LLC, 922 A.2d 1169, 1184 (Del. Ch. 2006) (The "duty to disclose is not a general duty to disclose everything the director knows about transactions in which the corporation is involved. Rather, the director disclosure cases decided in Delaware courts have implicated circumstances in which the ***director is personally engaged in transactions harmful to the corporation, but beneficial to the director***.") (emphasis added). The *only* thing the Director Defendants did here was wait one week (in the midst of an on-going conflict with a depraved, legally sophisticated, and well-funded adversary who controlled the Company) to disclose the structural defect they learned from their ***personal*** legal counsel – a fact the Board equally could have discovered by reviewing its own records and which it already knew. Delaware law does not impose disclosure obligations under these circumstances and Plaintiffs have not cited any case law to the contrary.

The Court of Chancery (and subsequently Plaintiffs) relied upon three cases, none of which is applicable, to find that the Director Defendants owed and breached disclosure obligations by waiting one week to disclose the structural defect to the Board. *Mills Acquisitions Co. v. Macmillan, Inc.* involved the improper disclosure, by self-interested fiduciaries, of confidential information to one of two participants in a competitive biding process to favor their preferred bidder. 559 A.2d 1261, 1279-80 (Del. 1989). Making matters worse, management never informed the board of the improper disclosure at the meeting where the

board considered and ultimately approved the transaction. *Id.* at 1282-83 ("Given the materiality of these tips, and the silence of Evans, Reilly and Wasserstein in the face of their rigorous affirmative duty of disclosure at the September 27 board meeting, there can be no dispute that such silence was misleading and deceptive. In short, it was a fraud upon the board.").[10] No such fraud occurred here.

Unlike *Macmillan*, the Director Defendants did not selectively disclose confidential information they were duty-bound to protect to further their own self interest and then lie about it. Instead, the Director Defendants engaged legal counsel to advise them about escalating disputes with Morelli, during which they learned of the flawed Rancho-Optimis structure. (BR5-6, Atkins Dep. 17:17-18:5 (Q: When did you become interested in learning about the legal effect of the ownership structure of Rancho? . . . A. It was after the very last board meeting I

[10] The other two cases on which the Court of Chancery relies, *Int'l Equity Capital Growth Fund, L.P. v. Clegg* and *Hoover Indus., Inc. v. Chase*, are similarly inapposite. *Clegg* deals with a pleading stage challenge to the acquisition of a production facility from a company controlled by a director, where that director allegedly concealed "design and structural" defects in the production facility. 1997 WL 208955, at *7 (Del. Ch.). *Clegg* straightforwardly holds that the failure to disclose the defects in the manufacturing facility, if proven, could constitute a breach of the duty of loyalty. *Id.* It does not inform the disclosure obligations owed by directors who independently learn of a problem with a long-consummated transaction where those fiduciaries were the Company's contractual counterparties in the original transaction. *See id.* *Hoover* similarly holds that a director breaches "his duty of loyalty if he knows that the company has been defrauded and does not report what he knows to the board or to an appropriate committee of the board, at the very least when he is involved in the fraud and keeps silent in order to escape detection." 1988 WL 73758, at *2 (Del. Ch.). These facts do not exist here.

attempted – attended with Optimis, and . . . I was concerned after that meeting about my employment, and so I talked to my attorney.") At a time when their disagreements with Morelli and the Morelli-controlled Board was well known, the Director Defendants exercised their right to consult with counsel and prepare to take action to protect their legal rights. *Cf. Intrieri v. Avatex Corp.*, 1998 WL 326608, at *2 (Del. Ch.) ("The Board had every right to consult with counsel and to obtain legal advice . . ."); *SBC Interactive, Inc. v. Corp. Media Partners*, 1997 WL 770715, at *4 (Del. Ch.) (discussing scope of attorney-client privilege and roles and responsibilities of counsel after partner withdrew and its interests became adverse to the interests of the partnership and the remaining partners).

To find a disclosure violation under these unique facts would place an undue burden on corporate fiduciaries and is contrary to existing Delaware precedent. Taken to its logical conclusion, the Court of Chancery's holding would prevent any fiduciary from taking any action inimical to the Company – even if that fiduciary did not use corporate assets, information, offices, or authority to take the subject action and where his contrary interest was obvious. *Cf. Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 364 (Del. 1993) ("[W]e reject Cinerama's contention that 'any' found director self-interest, standing alone and without evidence of disloyalty, is sufficient to rebut the presumption of loyalty of our business judgment rule."). Delaware law does not require corporate fiduciaries to

check their independent legal, contractual, and equitable rights at the door; rather it prevents them from benefitting personally at the expense of their principals absent adequate disclosures and independent approvals. 8 *Del. C.* § 144; *Valeant Pharm. Int'l v. Jerney*, 921 A.2d 732, 745 (Del. Ch. 2007) ("Before the 1967 enactment of 8 Del. C. § 144, a corporation's stockholders had the right to nullify an interested transaction. To ameliorate this potentially harsh result, section 144 as presently enacted provides three safe harbors to prevent nullification of potentially beneficial transactions simply because of director self-interest."); *Gentile v. Rossette*, 906 A.2d 91, 103 (Del. 2006) (explaining fiduciary duty owed by controlling shareholder "not to cause the corporation to effect a transaction that would benefit the fiduciary at the expense of the minority stockholders."). *Macmillan* does not support such an expansive interpretation of the duty of candor and this Court should reverse.

2. Director Defendants Did Not Breach the Duty of Disclosure

To the extent the Court finds that the Director Defendants had a duty to disclose the Optimis-Rancho structural flaw, the Director Defendants did not breach their fiduciary duty of loyalty because (1) the attorney-client privilege protected the information they learned; and (2) they actually informed the Board of the structural defect. (*See* Op. Br. at 67-68.) To the extent the Director Defendants had any duty to disclose this information to the Optimis Board, they could not do

so without waiving the attorney-client privilege. *Chase* recognizes that certain privileges absolve corporate fiduciaries of their disclosure obligations. 1988 WL 73758, at *2 (Del. Ch.) ("The intentional failure or refusal of a director to disclose to the board . . . itself constitutes a wrong, ***unless*** a recognized privilege against disclosure pertains.") (emphasis added). Therefore, their delay in disclosing the structural defect cannot constitute a breach.

Plaintiffs argue that the Director Defendants waived any claim of privilege because they eventually disclosed the structural flaw to the Optimis Board.[11] (Ans.

[11] Plaintiffs also argue that this argument was not presented to the court below and therefore may not be raised on appeal. (Ans. Br. at 41.) Supreme Court Rule 8 provides that "[o]nly questions fairly presented to the trial court may be presented for review; provided, however, that when the interests of justice so require, the Court may consider and determine any question not so presented." SUP. CT. R. 8. This Court "may consider the issue only if the interests of justice require us to do so" and "[o]ne factor in this analysis is whether an issue is outcome-determinative with significant implications for future cases." *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 679 (Del. 2013) (internal quotations omitted); *see also Sandt v. Delaware Solid Waste Auth.*, 640 A.2d 1030, 1034 (Del. 1994) ("We need not decide whether this argument was fairly raised below, because we believe the interests of justice require that we decide the issue for two reasons: (1) the issue is outcome-determinative and may have significant implications for future cases; and (2) our consideration of the issue will promote judicial economy because it will avoid the necessity of reconsidering the applicability of sovereign immunity in the event that Wetterau or Raytheon are found liable and seek contribution from the DSWA."); *Blinder, Robinson & Co. v. Bruton*, 552 A.2d 466, 474 (Del. 1989) ("The Commissioner concedes, however, that the question of whether there should be a remand for redetermination of the penalty was discussed at oral argument before the Chancellor. In any event, given the importance of this issue and the somewhat convoluted manner in which the Commissioner's action was ultimately affirmed, we believe 'the interests of justice' require consideration of this issue by this Court under Supreme Court Rule

Br. at 41.) While true, that argument is irrelevant and proves that no fiduciary violation occurred because, as Plaintiffs recognize, the Director Defendants *disclosed* the structural flaw. (*Id.*) Rather, the invocation of the then-applicable attorney-client privilege – which the Director Defendants did not waive until they made the disclosure – justifies and excuses any *delay* in disclosing the structural problem and compels the Court to reverse the trial court's duty of candor finding as a matter of law. Because the Director Defendants were justified in delaying until they determined to waive the attorney-client privilege and ultimately disclosed the structural defects with Rancho-Optimis, they could not have breached their duties of loyalty as a matter of law and this Court should reverse the Court of Chancery's contrary finding.

Even if the Court finds that the privilege does not excuse the one week delay in disclosing the structural defect, the Director Defendants disclosed the flawed structure to the Board before they filed the Rescission Action and cannot, therefore, have breached the duty of disclosure. (B1527-37.) Plaintiffs argue that the Director Defendants breached their fiduciary duties because they "never

---

8."). While the Director Defendants did not rely on the attorney-client privilege to justify their one-week delay in disclosing the structural defect, this is a product of Plaintiffs' ever shifting claims and the fact that "[b]riefing on this issue by both Plaintiffs and the Director Defendants was sparse and largely unhelpful." (Op. at 185; *see also* Op. at 144-145, 198 (recognizing "Plaintiffs' generally shifting litigation strategy").) Now that Plaintiffs have crystalized the issue and settled on a legal theory, the interests of justice permit the Director Defendants to raise all legitimate explanations for their conduct.

disclosed the concerns expressed in their declarations in support of the rescission action to the Optimis board, never approached the Optimis board with a solution that would benefit the Optimis stockholders, and never considered the impact their decision to seek rescission might have on Optimis stockholders." (Ans. Br. at 38.) The Director Defendants' resignation itself belies Plaintiffs' assertion, as it provided a detailed account of the Director Defendants' concerns regarding the structural flaw. (B1528 ("[W]e have reached the conclusion that any ownership structure for Rancho Physical Therapy, Inc. ("Rancho") in which anyone other than licensed physical therapists own shares (and particularly corporate ownership of shares) is illegal under California law. Today's events – in which the Optimis board made the decision to put both Rancho and the care of its patients at risk (and thus Optimis' shareholders) without anything approaching adequate consideration or information – make clear to us that we can no longer watch as the board continues, in our opinion, to abdicate its fiduciary responsibilities."); *see also* B15655 (expanding upon concerns of structural flaw and Morelli's leadership).) That they did not "approach the Optimis board with a solution" is of no moment – they had no obligation to find a solution, did not believe the Board would consider their suggestions,[12] and in any event resigned their positions as fiduciaries. This

[12] As the Director Defendants' resignation letter and the Opinion make clear, by 2013, the Morelli-dominated Optimis Board committed systematic breaches of its fiduciary duties by placing Morelli's interests ahead of those of Optimis. (*See, e.g.*

Court should reverse the Court of Chancery's finding that the Director Defendants breached their duty of loyalty because they actually disclosed the structural defect and were justified, in reliance on the attorney-client privilege, in taking one week to make that disclosure.

3. The Director Defendants Did Not Personally Gain From Knowledge of Optimis-Rancho Structural Flaw

Even if the Court finds that the Director Defendants owed a duty of candor under the unique facts of this case and overlooks that the Director Defendants actually disclosed the Rancho-Optimis structural defect, the Director Defendants did not breach their duty of loyalty because they did not personally benefit from the one week delay in disclosing the flaw in the Optimis-Rancho corporate structure. *Matter of Seidman*, 37 F.3d 911, 936 (3d Cir. 1994) ("The duty of candor requires corporate fiduciaries to disclose all material information relevant to corporate decisions from which they may derive a personal benefit.") (internal citations and quotations omitted). As discussed above, the disclosure had no impact on any decisions facing the Board. Neither the Court of Chancery nor

---

B1527-37; Op. at 4 n. 3; 32 n. 68; 68 n. 202; 136 n 466; 162 ("There is no evidence that the Board, before October 20, 2012, operated as any substantial check on Morelli in any area or served any useful purpose other than rubber-stamping his proposals. When a Board member did something Morelli disliked, such as disagree with him, he reacted negatively."); 164 n. 532.) Those breaches are the subject of pending litigation in the Court of Chancery, captioned *Atkins, et al. v. Morelli, et al.*, C.A. No. 11581-VCMR.

Plaintiffs identified any benefit the Director Defendants derived from delaying their disclosure of the structural flaw. (Op. at 187; Ans. Br. at 38-39.)

The only purported "benefit" the Director Defendants could have received from the delayed disclosure was a one-week head start in preparing a complaint in the Rescission Action that the Court of Chancery found they were legally permitted to file. (Op. at 185.) The exercise of pre-existing contractual and equitable rights flowing out of the original Rancho sale transaction where the Director Defendants were contractual counterparties to Optimis and Morelli cannot constitute the personal benefit necessary to justify a fiduciary breach. *Robotti & Co., LLC v. Liddell*, 2010 WL 157474, at *10 (Del. Ch. Jan. 14, 2010) ("Robotti is unable, from its well-pled factual allegations, to support the inference that the Defendants received a personal benefit from the Offering. ***The Defendants had pre-existing contractual rights to a percentage of Gulfport's equity at a predetermined price***.") (emphasis added). Nor is there any record evidence that the one week provided any substantive, procedural or strategic advantage. Thus, the Director Defendants did not gain anything by waiting one week to disclose the flawed entity structure to the Board and could not have breached their fiduciary duties as a result.

B. THE COURT OF CHANCERY ERRED IN FAILING TO AWARD THE DIRECTOR DEFENDANTS THEIR ATTORNEYS' FEES AND EXPENSES.

For the reasons set forth in Horne's Appellate Brief and Cross-Appellant William Horne's Reply Brief on Cross-Appeal, which the Director Defendants incorporate by reference here, the Court should sanction Plaintiffs and their counsel for their litigation misconduct, and require Morelli and his counsel to pay the Director Defendants' fees and costs incurred in defending this action.

III. CONCLUSION

The Director Defendants respectfully request that the Court (i) reverse the Court of Chancery's holding that the Director Defendants breached their duty of candor and loyalty; and (ii) award the Director Defendants their attorneys' fees and expenses incurred in defending this action.

Dated: January 22, 2016

BAYARD, P.A.

/s/ Stephen B. Brauerman
Stephen B. Brauerman (No. 4952)
Vanessa R. Tiradentes (No. 5398)
Sara E. Bussiere (No. 5725)
222 Delaware Avenue, Suite 900
Wilmington, DE 19801
(302) 655-5000

Attorneys for Defendants-Below/Cross-Appellants John Waite, William Atkins, and Gregory Smith