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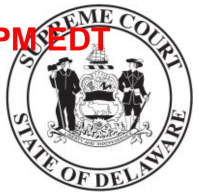

IN THE SUPREME COURT OF THE STATE OF DELAWARE

QUADRANT STRUCTURED PRODUCTS COMPANY, LTD., Individually and Derivatively on behalf of Athilon Capital Corp.,	No. 210, 2016
Plaintiff Below Appellant/Cross-Appellee,	Case Below:
v.	Court of Chancery of the State of Delaware C.A. No. 6990-VCL
VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALEZ, BRANDON JUNDT, J. ERIC WAGONER, ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENT ADVISORS LLC, MERCED CAPITAL, L.P., MERCED PARTNERS LIMITED PARTNERSHIP, MERCED PARTNERS II, L.P., MERCED PARTNERS III, L.P., and HARRINGTON PARTNERS, L.P.,	
Defendants Below Appellees/Cross-Appellants.	

APPELLANT'S REPLY BRIEF ON APPEAL AND
CROSS-APPELLEE'S ANSWERING BRIEF ON CROSS-APPEAL

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SUMMARY OF ARGUMENT ON CROSS-APPEAL[1]

Award of Attorneys' Fees: Denied. The trial court properly awarded Quadrant[2] a mootness fee for its successful recovery to Athilon on Quadrant's management fee and Junior Note interest claims. A1486. While the benefit conferred by Quadrant's litigation efforts could have supported a larger award, the trial court awarded attorneys' fees of $9.6 million—representing the actual fees and expenses incurred (and paid) by Quadrant. Defendants do not contend that the dollar figure was unreasonable in relation to the benefits conferred, nor do they contest that the litigation was the sole cause of a $40.7 million cash payment made to Athilon after trial. They argue that Quadrant should be denied any mootness fee award because its interests were "adverse" to Athilon in other respects. Quadrant's interests as a derivative plaintiff were entirely aligned with Athilon. Quadrant brought derivative claims in a representative capacity, which resulted in a recovery to Athilon of over $40 million. Quadrant's efforts conferred a significant corporate benefit on Athilon, and the Court should affirm the trial court's conservative exercise of its discretion in awarding a mootness fee award.

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[1] This Summary addresses only Defendants' arguments in support of their Cross-Appeal. Defendants' alternative grounds for affirmance are also denied. *See* Section IV.C and IV.D, *infra.*

[2] Capitalized terms are defined in Appellant's Amended Opening Brief ("Op. Br.").

ARGUMENT

I. NEITHER THE TEXT OF THE INDENTURE NOR THE LAW SUPPORTS THE TRIAL COURT'S CONSTRUCTION OF THE REDEMPTION RESTRICTIONS.

A. The Scope of Review Is *De Novo*.

Defendants concede that the Indenture is reviewed *de novo*, but suggest that this Court must defer to the trial court's "findings" concerning model forms. Appellees' Answering Brief on Appeal and Cross-Appellants' Opening Brief on Cross-Appeal ("Ans. Br.") 21. This is incorrect. This Court defers to findings as to the significance of the extrinsic *evidence* only where a contract is ambiguous. *AT&T Corp. v. Lillis*, 970 A.2d 166, 170 (Del. 2009). The trial court did not find the Indenture to be ambiguous, and the model forms are not evidence. This Court should not defer to the trial court's decision to give *legal* significance to model forms and commentaries when there is no evidence that parties discussed them in negotiations. *See Bank of N.Y. v. First Millenium, Inc.*, 598 F. Supp. 2d 550, 564-65 (S.D.N.Y. 2009), *aff'd*, 607 F.3d 905 (2d Cir. 2010) (model indenture provisions and related commentaries are not extrinsic parol evidence). *De novo* review applies.

B. The January Transaction Breached the Indenture's Redemption Restrictions.

As observed in Quadrant's Opening Brief, the Indenture does not define the word, "redemption." Quadrant maintains that a redemption is any reacquisition of

a security by the issuer when the security is then cancelled. *See* Op. Br. 21-24. As discussed below, this is the definition adopted by New York courts and that is supported by other text in the Indenture as well as the context extant when the Notes were issued.

Defendants would limit the term "redemption" to transactions in which a holder is *compelled* to tender its securities. Ans. Br. 22. Section 4.04 shows that compulsion cannot be part of the meaning. That section prohibits redemptions of Notes held by Affiliates of the Issuer. Given that the definition of Affiliate includes any party that controls, or is under common control with the Issuer, A726 the prohibition would be nonsensical if "redemption" required compulsion. If the Issuer is controlled by, or under common control with an Affiliate, then the Issuer can never compel its Affiliate to surrender securities. Thus, the drafters of the Indenture must have intended a broader meaning, unbound by any sense of compulsion, when they restricted redemptions from Affiliates. Under Defendants' definition of redemption, the facts contemplated by section 4.04 could never occur.

Defendants would define "redemption" to mean only transactions at par value. The Indenture defines "Redemption Price" to be par value and uses that term in connection with certain redemptions that are permitted. If the Defendants were correct about the meaning of redemption, then it would have been unnecessary to define the Redemption Price as par, because under that theory, all

redemptions would, by definition, be at par. New York law eschews this sort of superfluity. *First Millenium*, 598 F. Supp. 2d at 556-57; *Law Debenture Tr. Co. of N.Y. v. Maverick Tube Corp.*, 595 F.3d 458 (2d Cir. 2010). The definition of redemption as the reacquisition by the issuer of its security, followed by its retirement or cancellation, *see id.* 21-24, makes the "Redemption Price" definition not superfluous, because it is needed to define a limited subset of redemptions that are permissible, *i.e.*, those at par. If, as Quadrant contends, "redemption" means the reacquisition by the issuer of its security, followed by its retirement or cancellation, *see* Op. Br. 21-24, then defining the price at which such redemptions are permitted is not superfluous.[3]

Defendants' whole case on redemption is founded on this circular logic. Their question presented states, "Section 4.04 applies only to transactions in which Athilon exercises its contractual privilege to compel holders to sell Notes at the Redemption Price of 100% of par plus accrued interest." Ans. Br. 21. But if that were true, section 4.04 would have been drafted as a proviso or subsection limiting section 4.01, not a free-standing provision barring affiliated redemptions (and

[3] Defendants note that the Commentaries "explain that redemption provisions grant the issuer the contractual 'privilege to repay before maturity'" by compelling the noteholder to accept payment at a certain price. Ans. Br. 23. But the *Commentaries* do not limit redemption to that context. *See* American Bar Foundation, *Commentaries on Indentures*, 475-80 (1971). The *Commentaries* address other classes of redemption—for example, "sinking fund redemption" provisions by which the issuer is *required* to redeem a portion of its notes periodically throughout their term, *id*. at 479. The meaning of "redemption" is not confined to a single class of transactions in the Commentaries or the Indenture. *Id.; see also* A764 (section 4.05).

lacking any reference to section 4.01 or to "Redemption Price"). And defining "redemption" as Defendants suggest would lead to absurd results. Merced could circumvent the prohibition by paying itself $0.99—or, for that matter, $1.01.

The text and structure is much more straightforward than Defendants' gymnastics. "Redemption" means any reacquisition of a security by the issuer. *See* Op. Br. 22. Section 4.01 authorizes the issuer to impose one class of redemptions upon unwilling holders—if effected at par. Section 4.04 prohibits it from engaging in another—redemptions of Notes held by Affiliates. Defendants violated that prohibition, and the Court of Chancery erred by concluding otherwise.

Defendants argue that section 4.04's omissions of the words, "payment," "repurchase," or "purchase" allowed them to pursue the self-interested transaction. *See* Ans. Br. 24. But, as explained in the Opening Brief, these words refer to different types of transactions that are addressed elsewhere in the Indentures. Op. Br. 23-24, 27-28. The right to *repurchase*, addressed in Article 2, allows Athilon to acquire its own Notes on the secondary market and hold them for resale. Section 2.07(d) provides that any security "purchased" by Athilon or any Affiliate "may not be resold" by Athilon or the Affiliate unless certain conditions are met. A744. And section 2.09, as discussed in the Opening Brief, carves out repurchases of the broader class of "redemptions" if, but only if, the repurchased Notes are not delivered for cancellation. *See* Op. Br. 23-24, 27-28. Both of these

provisions would be superfluous if "repurchases" involved cancellation of the Notes. References in the Indenture to *"payment,"* discussed in sections 2.06(d) and 2.09, for example, refer to presentation by the holder of the security *at maturity*. A740, A746 The Indenture, read as a whole, shows that each term means a different thing. *Redemption* is reacquisition with cancellation. Op. Br. 21-24. *Repurchase* is reacquisition *without* cancellation. *Payment* is delivery of the amount due at maturity. Some redemptions are permitted, without consent, by section 4.01 on the basis of price, while others are barred, regardless of consent, by section 4.04 on the basis of being held by an affiliated party.

The textual conclusion is supported by the context of the Indentures, which involved *very* long-term, low-covenant, low-interest Notes, intended to be liquid investments, similar to treasury bills or bank deposits. A533. Given this context, section 4.04 is properly understood as a protection for unaffiliated creditors that bars insiders from providing an early return of capital to Affiliates and no one else. Defendants' definition turns section 4.04 on its head, rendering it both entirely unnecessary and in conflict with context, as a protection for Affiliates against a "compelled" redemption of their Notes. *See* Ans. Br. 27. Quadrant's reading is the only one that makes sense both of the text of section 4.04 and the logic and context of the Indenture as a whole. *See also* A762 §4.02(e) (requiring the Indenture Trustee to select shares for redemption in "fair and appropriate

manner"); A755 § 3.06(i) (prohibiting Issuer or Affiliates from submitting Buy or Sell Orders in Auction).

C. Case Law Supports Quadrant's Construction of Article IV.

Chesapeake Energy, the only case cited by the parties that explores the ordinary meaning of "redemption" under New York law, observed that in its noun form, the word means simply "[t]he reacquisition of a security by the issuer." *Chesapeake Energy Corp. v. Bank of N.Y. Mellon Tr. Co., N.A.*, 773 F.3d 110, 116 (2d Cir. 2014) (citation omitted). Defendants dismiss *Chesapeake Energy* in a footnote for not addressing "whether a voluntary purchase at a price not defined by an indenture constitutes a 'redemption' under New York law." Ans. Br. 26 n.1. But *Chesapeake Energy's* definition was not hedged in this way. The Second Circuit made no reference to voluntary or forced transactions, or to reacquisitions at, below, or above par. "Redemption" means, standing alone, "the reacquisition of a security by the issuer," whether voluntary, or forced and whether at, below, or above par.[4]

Neither case cited by Defendants speaks to the plain meaning of

[4] Two of the dictionaries cited in *Chesapeake Energy* include definitions of "redemption" as payment at par or a stipulated price. Ans. Br. 26 n.1. These are certainly *among* the several definitions. *Webster's* defines "redeem" not only as "to regain possession of by payment of a stipulated price," but also as "to repurchase." *Redeem*, WEBSTER'S NEW INTERNATIONAL DICTIONARY 2085 (2d ed. 1934). The alternative reference to a "stipulated price" transaction points to one common type of redemption, but not the entire class. The court in *Chesapeake Energy* had access to this alternative definition (having cited the dictionary), but did not make reference to it, defining the word correctly as any reacquisition by the issuer.

"redemption" under New York law. In *Katz v. Oak Industries, Inc.*, 508 A.2d 873 (Del. Ch. 1986), the issuer made an exchange offer to all unaffiliated bondholders within a class. 508 A.2d 873, 876-77. Plaintiff sought to enjoin the voluntary exchange offer, arguing that the deal structure left bondholders with no choice but to tender and thus that the transaction amounted to an impermissible forced redemption. *Id*. at 881. The court concluded that the structure of the exchange offer was not coercive and thus was "not the functional equivalent of a redemption which is, of course, an act that the issuer may take unilaterally." *Id*.

The court's decision denying a motion for preliminary injunction is not a final adjudication on the merits of any claim, and there was no significant discussion of the redemption issue. The plaintiff's equitable claim was that the transaction, because it coupled an otherwise arm's-length exchange offer with a consent solicitation to amend adversely the terms of the notes, was so coercive as to be the equivalent of a unilateral, forced redemption. There was no claim that any provision of the indenture expressly prohibited any other type of redemption, as section 4.04 does here. The only issue before the court in *Katz*, therefore, was whether the transaction was a forced redemption, not the meaning of the term, "redemption." It was true in *Katz* (as it is here) that "the issuer may" unilaterally redeem if the specified price is paid—not because the definition of the word is limited to unilateral acts, but because the contract authorized the issuer to redeem

at that price without noteholder consent. *Katz* simply did not consider a self-interested insider redemption under an indenture that barred redemptions of affiliate-owned debt. To the extent the court's remark about redemption is relevant at all, *Katz* supports Quadrant's view. The Chancellor did not (as he would have done were Defendants correct) simply hold that because the proposed transaction was not at par, it could not have been a redemption.

The Court of Chancery also did not specify what law it applied. The indentures in *Katz* were governed by California, Illinois, and New York law. *See Katz v. Oak Indus. Inc.*, C.A. No. 8401, at 29 (Del. Ch. Mar. 7 1986) (TRANSCRIPT). If the court purported to apply New York law, it did so without the benefit of the subsequent *Chesapeake Energy* ruling on the plain meaning of "redemption." In any event, the Chancellor did not discuss the redemption provisions in any detail other than to refer to "negotiated provisions dealing with redemption of [the issuer's] debt." *Katz*, 508 A.2d at 882. This pre-*Chesapeake Energy* decision, which interpreted indentures that are not in the record and are not before the Court, is of no value here.

Defendants also cite a dated, cryptic decision of the appellate division of New York's trial court. *Snyder v. Memco Eng'g & Mfg. Co.*, 23 A.D.2d 671 (N.Y. App. Div. 1965). The case involved a holder's suit to redeem his preferred stock in a close corporation after the corporation purchased holdings of others. The two-

paragraph decision does not disclose the terms of the security or suggest that it contained any analog of section 2.09. Nor does it address what "redemption" means under New York law. The dissent shows that the panel was influenced by the fact that, in contrast to Athilon, the stock was purchased out of surplus, rather than capital. "The fact that the price for the previously purchased stock was paid out of surplus rather than out of capital does not convert into a purchase what otherwise would be a redemption," wrote Justice Beldock in dissent. *Id*. at 671-72. Athilon made payments here out of capital, so it appears that the panel would have viewed this case differently. In half a century, *Snyder* has never been cited by the New York Court of Appeals or the appellate division itself. It was not cited by the Second Circuit in *Chesapeake Energy*. The case is of doubtful authority and sheds no light on New York's construction of the term "redemption."

D. The Record Does Not Support the Trial Court's Decision.

Evidence upon which Defendants rely, but the trial court did not, does not help them here. Primus, another CPDC with a similar indenture, bought back notes held by Quadrant at a discount. There is no record evidence of whether Primus delivered the notes it repurchased to the trustee for cancellation or held them for potential resale. *See* B298-99 (Tr. 879-888). Nor did the record show whether the Primus offer was made to *all* holders of the issue (instead of being limited to insiders), or whether all holders and the issuer consented to the

transaction (thereby curing any breach). What Quadrant's witnesses thought "redemption" means outside the context of any particular indenture, or what the term means under the Indenture here is irrelevant under the plain meaning rule. *Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 559-60 (N.Y. 2014). Nevertheless, it bears emphasizing that Quadrant's CEO did not testify that the Primus transaction was not a redemption *because* it occurred at less than par. He merely testified that, in his view, Primus's buyback of notes at a discount to par was not a redemption. B299 (Tr. 887). The record on Primus is not instructive.

Nor is the Indenture Trustee's decision not to pursue remedies for breach of the Indenture instructive. The Indenture Trustee *participated* in the transaction by accepting the certificates for cancellation. At trial there was no evidence that, as of the time of acceptance, the Trustee reviewed the Indenture at all, and certainly none that the Trustee concluded that the Affiliate transaction was permissible under section 4.04. Having participated in the January Transaction, it was hardly in a position to bring suit to challenge it. And even if the Trustee declined because it believed the transaction was not a redemption, its subjective interpretation has no legal significance here. *See Quadrant*, 23 N.Y.3d at 559-60.

II. THE IMPLIED COVENANT PROHIBITED THE DEBT TRANSACTIONS.

If the Indenture did not expressly require compliance with the redemption provision for repurchases initiated by the seller, the implied covenant of good faith and fair dealing nonetheless barred Athilon from engaging in a self-interested, above-market repurchase of Notes only from insiders under the circumstances present here. Quadrant agrees that no duty should be implied that "would be inconsistent with other terms of the contractual relationship." *In re HSBC Bank, USA, N.A., Debit Card Overdraft Fee Litig.*, 1 F. Supp. 3d 34, 51 (E.D.N.Y. 2014) (citation omitted). The implied covenant is breached, however, when "a party has complied with the literal terms of the contract, but has done so in a way that undermines the purpose of the contract and deprives the other party of the benefit of the bargain." *Id.* (citation omitted). An implied covenant preventing insiders from liquidating corporate assets to prepay Affiliate-owned Notes, in transactions unavailable to outside creditors, is consistent with the express terms of the Indenture. *See* A755 § 3.06(i) (prohibiting the issuer and its affiliates from submitting orders in any auction); A751 § 3.05(ii) (auctions must be conducted "competitive[ly]" and "in a commercially reasonable manner"); A764 § 4.04 (prohibiting "either (a) the Issuer or (b) an Affiliate of the Issuer" from participation in redemptions); A762 § 4.02 (vesting the trustee with power to allocate partial redemptions).

Defendants rely on the lack of an express covenant against self-interested repurchase transactions, but this misses the point. *Every* implied covenant claim asks the Court to imply a covenant that is not written in the agreement. If lack of an express covenant were a sufficient defense, the implied covenant would cease to exist. Here an implied covenant precluding insiders from partially liquidating Athilon to prepay only Affiliate-owned Notes is necessary to protect the creditors' enjoyment of the express rights and covenants set forth in the Indenture.[5] The express covenants in the Indenture, *see* A751, A755, A762, A764, give rise to the implied covenant.

Quadrant's express and implied covenant claims are claims in the alternative, not claims impermissibly duplicative, as Defendants now (belatedly) argue. Quadrant asserts that the January Transaction was a redemption that violates the express terms of section 4.04. In the alternative, and only if the first argument is rejected, Quadrant contends that the Debt Transactions breached an implied covenant. The rule barring duplicative claims is not a substantive rule that precludes alternative claims for breach of express and implied covenants. Rather, it is a rule of pleading, recognizing that the implied covenant claim is an alternative

[5] As set forth in Op. Br. 30-34, the trial court did not meaningfully address Quadrant's assertion that if the January Transaction was not a redemption barred by the Indenture, the implied covenant nevertheless prohibited Athilon from returning capital only to insiders. Defendants contend that the trial court in fact addressed Quadrant's argument, but they misleadingly quote from the trial court's opinion at 31. There, the trial court merely quoted Quadrant's explanation from its post-trial brief, but never meaningfully addressed Quadrant's argument that the implied covenant prohibited preferential prepayments to insiders.

theory for relief for breach of the contract, and does not require a second "count" to be pled. *See Thompson v. Advanced Armament Corp.*, 614 F. App'x 523, 525 (2d Cir. 2015) (citing *Harris v. Provident Life & Acc. Ins. Co.*, 310 F.3d 73, 80 (2d Cir. 2002)) ("breach of the implied covenant is not a separate claim from breach of contract, it is an alternative means by which a contract may be breached"); *Hosp. Auth. of Rockdale Cty. v. GS Capital P'rs V Fund, L.P.*, 2011 WL 182066, at *4 (S.D.N.Y. Jan. 20, 2011). That rule has no application where, as here, the claims have already been tried to judgment.[6]

The argument was waived in any event. Before their Answering Brief, Defendants never argued that Quadrant could not allege that the January Transaction breached the express terms (as a redemption) and, alternatively, implied terms (as a self-interested partial liquidation). Ans. Br. 31. Defendants cannot raise this argument for the first time on appeal. *See* Supr. Ct. R. 8; *Mammarella v. Evantash*, 93 A.3d 629, 636 (Del. 2014) ("Because this argument was not raised below or in the briefs, it is waived."); *see also* Ct. Ch. R. 15(b) (failure to amend pleadings to conform to issues tried by express or implied consent "does not affect the result of the trial of these issues").

[6] Neither case cited by Defendants is a post-trial decision. *See Harris v. Provident Life & Acc. Ins. Co.*, 310 F.3d 73, 75 (2d Cir. 2002) (motion for summary judgment); *L-7 Designs, Inc. v. Old Navy, LLC*, 647 F.3d 419, 421 (2d Cir. 2011) (motion for judgment on the pleadings).

Defendants argue that the implied covenant would add a substantive provision that was not bargained for. *See* Ans. Br. 31-32. But protection against liquidation of Athilon's assets solely for the benefit of inside debtholders was bargained for: it was a fundamental premise of the Indenture, as reflected in the express terms. The drafters surely did not anticipate the possibility that (i) the CDPC market would fail completely; (ii) the auction procedures set forth in the Indenture would also fail; (iii) secondary purchasers (after acquiring Notes and equity control of an insolvent entity) would cease any efforts to maintain or restore Athilon's AAA ratings or carry out the CDPC business, as Athilon promised to do, but instead used their equity power to unilaterally transform Athilon's assets into a private piggy-bank, unrestricted by the ratings agencies; and (iv) those insiders, when called to account for that conduct in court, would seek to manipulate Athilon's balance sheet through debt cancellations and other transactions to avoid judicial scrutiny of their self-dealing; all for the purpose of granting their affiliated noteholders a preferential, early return of capital at prices well above the market value of the debt. That the specific congruence of adverse events and self-dealing was unforeseen does not mean that the Indenture permits Defendants' conduct. Where the parties did not address an unpredictable turn of events, the implied covenant fills the gap, and requires the court to determine whether the parties who negotiated the Indenture would have permitted the conduct at issue had they

foreseen its possibility. *See Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del. 2005). The court asks whether a reasonable person, reading the Indenture as a whole, would conclude that the challenged actions are consistent with the parties' express rights. *Id.*

Any reasonable party would have understood, from the express provisions of the Indenture, that in order to protect *pari-passu* noteholders from self-dealing or manipulation by insiders in both the pricing and liquidity of the Notes, the conduct engaged in here would not be permitted. *See* Op. Br. 31-32 (citing A533, A751, A755, A764). The evidence showed that the Notes were to be liquid securities, protected by an auction mechanism to ensure liquidity for unaffiliated investors on unbiased terms, and a prohibition on insider participation in the auctions or redemptions. *Id.* These express terms plainly reflect an intent to protect and provide liquidity to outside creditors *before* insiders, not the reverse. Permitting preferential insider repurchases, where the failed auction mechanism has deprived noteholders of an effective market for the Notes, deprives the unaffiliated noteholder of its bargained-for protections. Op. 5; A533. Had the parties foreseen the collapse of the CDPC market and the other events that led to Defendants' self-dealing here, it is absurd to believe that they would have agreed that such conduct would be permitted—and even more absurd to suggest that the Notes ever could have been marketed to investors under that supposition. A533.

Defendants make a contorted argument that the implied covenant would be commercially unreasonable because Athilon and its creditors would prefer for Athilon to cancel Notes it acquires rather than hold them. Ans. Br. 32-33. Quadrant contends that cancellation determines whether a transaction is a redemption prohibited by the Indenture's express covenants. The implied covenant claim arises only if that claim is rejected, and does not turn on whether the transaction is defined as a redemption, but on whether the implied covenant of good faith and fair dealing permits insiders to partially liquidate the corporate assets for a partial liquidation undertaken to prepay only debt held by Affiliates, at prices above fair market value.

Defendants' comparison is artificial in any event. Athilon and its creditors would be better off still if insiders did not return capital to insiders in a self-interested transaction, or returned capital to all creditors pro-rata; hence the prohibition of insider transactions of this sort. Had the Merced purchase *not* been accompanied by cancellation, it likely would not have occurred at all. Without the cancellation, it would have shifted a third of the company's assets to Merced *without* reducing the company's balance sheet debt. Athilon would have held Notes, but the Notes' value would have been gravely diluted by the inflated value paid for the Notes and the loss of corporate assets to pay them.

The express terms of the Indenture evidence an intent to bar insiders and their affiliates from obtaining liquidity at the expense of other noteholders. The implied covenant of good faith and fair dealing requires that if Athilon chooses to partially liquidate its assets for the benefit of creditors, it must provide the same liquidity opportunity to all creditors, not only its affiliates. If this Court denies that the January Transactions breached the express covenant, it should reverse the trial court and hold that the implied covenant of good faith and fair dealing in the Indenture was breached by Athilon's self-interested partial liquidation.

III. THE TRIAL COURT ERRED BY CONCLUDING THAT DEFENDANTS DID NOT INTEND TO HINDER, DELAY OR DEFRAUD ATHILON'S CREDITORS.

The standard of review is not deferential, as Defendants argue. Ans. Br. 34-35. The trial court's errors were not based not on witness credibility, but on failure to consider significant badges of fraud. That failure arose from a flawed legal premise that "[u]nless a creditor bargains for an applicable contract right, the creditor does not have the ability to interfere with the operations of a solvent firm." Defendants do not dispute that the premise is wrong as a matter of law. It negates 6 *Del. C.* § 1304(a), which depends on neither solvency nor contract. The trial court misapplied the law, and *de novo* review is warranted. *See, e.g.*, *Leibowitz v. Imsorn*, 2003 WL 21785620, at *2 (N.D. Ill. Aug. 1, 2003) ("Because nothing in the record indicates whether the Court considered if the second and third badges of fraud … were present, I will review each badge *de novo*"). Even if reviewed as an issue of fact, the trial court's decision was not the product of an orderly and logical reasoning process.

The burden lay on the insiders to overcome a presumption of fraud where they caused Athilon to buy only Affiliate-held debt at above-market prices in a concealed transaction after litigation was commenced. Op. Br. 35-40. The trial court recognized that the burden of proof rested with Defendants, Op. 41-42, but did not hold Defendants to their burden or explain how Defendants overcame it.

The trial court inadequately considered or ignored two key badges of fraud—concealment and lack of reasonably equivalent value.

The trial court sanctioned Defendants for shielding the January Transaction from discovery, A196, but it failed to consider concealment as a badge of fraud, reasoning that the discovery sanctions had already remedied the wrong. This was wrong as a matter of law. Discovery sanctions do not erase the concealment's evidentiary weight as proof of the transferor's *intent*. Defendants believed that the transaction was questionable enough to justify hiding it, and that concealment is strong evidence of fraudulent intent. The trial court inappropriately disregarded a material badge of fraud. *See Homestore, Inc. v. Tafeen*, 886 A.2d 502, 506 (Del. 2005) (trial court abuses its discretion "when a relevant factor that should have been given significant weight is not considered"). Defendants do not address this point of error and therefore concede it.

The trial court also passed over the absence of reasonably equivalent value, a "central" badge of fraud. *See In re Arbaney*, 345 B.R. 293, 302 (Bankr. D. Colo. 2006) ("[a]dequacy of consideration is central to any discussion of a transfer of assets in derogation of the rights of a transferor's creditors"). Defendants argue that the trial court adequately considered value, Ans. Br. 35, referring to the trial court's citation of 6 *Del. C.* § 1304(b). Citing the checklist does not amount to considering a specific badge. Defendants also locate consideration of the badge in

the trial court's statement that the January Transaction "did not render Athilon insolvent, it strengthened Athilon's balance sheet." Ans. Br. 35; Op. 40. The quotation is devoid of context. Solvency is not the issue. The reasonably equivalent value badge asks whether the transferor received roughly the value of what it gave. *In re Charys Hldg. Co.*, 443 B.R. 628, 637 (Bankr. D. Del. 2010) (applying federal and Delaware law). Whenever a company sells debt for below face value, its balance sheet improves. That does not mean the company received a fair exchange. If a company's debt trades at one cent on the dollar, a redemption by insiders of insider debt for 99 cents on the dollar strengthens the company's balance sheet, by removing $1 face of debt, but the company surely has not received reasonably equivalent value—it overpaid by 98 cents. The relevant question is whether Athilon received equivalent value when it paid 92 cents on the dollar (or even 78 cents in Defendants' view (Ans. Br. 36-37)) for Notes it could buy in the market for 52 cents on the dollar. Op. Br. 37.

The trial court never addressed this question. Nor did it consider the other factors relevant to the reasonably equivalent value issue: "the good faith of the parties, the difference between the amount paid and the market value, and whether the transaction was at arm's length." *Peltz v. Hatten*, 279 B.R. 710, 736-37 (D. Del. 2002) (citing *Mellon Bank, N.A. v. Official Comm. of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.)*, 92 F.3d 139, 148–49 (3d Cir. 1996)) *aff'd*, 60 F.

App'x 401 (3d Cir. 2003). It considered neither the "difference between the amount paid and the market value," *id.*, nor the facts demonstrating the absence of good faith or arm's-length bargaining in setting the 92 cent price. Op. Br. 17, 37. The price was set by Vertin, a conflicted insider, and Athilon hired no advisors, conducted no diligence, and negotiated no terms, because doing so "wasn't worth the brain damage." *Id.* On the record below, even had the trial court found that the 92 cent price amounted to reasonably equivalent value, the finding would be clearly erroneous.

The trial court's failure to consider these material badges of fraud applicable to the January Transaction was reversible error. *See Gen. Trading Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1500 (11th Cir. 1997) (vacating opinion because court failed to consider significant badge and erred in its analysis of another: "In addition to the magistrate judge's failure to consider the 'close relationship' badge of fraud, we find error with the court's application of . . . whether [the] 'transfer was of substantially all of the debtor's assets.'"). Had the trial court properly applied the law and properly considered the badges of fraud, Defendants could not have overcome the presumption of fraud. The Court should reverse the trial court's decision and remand for the entry of an appropriate remedy.

IV. THE TRIAL COURT ERRED BY CONCLUDING THAT QUADRANT LACKED DERIVATIVE STANDING.

This is a case about a preferential partial liquidation benefitting insider *creditors*. Before trial, the Court of Chancery held that the question of whether to operate or liquidate an insolvent company is a question of business judgment. The question that remained after discovery was whether that company's board might use equity control not to operate the company, nor to liquidate it, but to liquidate only *enough* of the company to prepay debt held by their affiliates, on terms offered to no one else. The Court of Chancery erred when it avoided reaching the merits of that question by holding, after trial, that Quadrant lacked derivative standing to assert this claim.

On appeal, Defendants advocate a derivative standing rule for creditors which operates like a light-switch based on fluctuating balance-sheet solvency, and ask the Court to ignore the inequity of a standing rule that would give the insiders the power to "flick off" judicial review of their self-dealing. Derivative standing, an "invention of equity," *see Koster v. (Am.) Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522 (1947), is neither a light-switch nor a flimsy device so easily manipulated by insiders. It is a flexible tool of equity that must remain available to a creditor where, as here, the facts show that the creditors truly are the only residual stakeholders with both the interest and incentive to protect the corporation against self-interested fiduciaries. *See Schoon v. Smith*, 953 A.2d 196, 201-02 (Del. 2008).

The trial court's error—viewing creditor standing as a reflexive tool, impotent to meet the equitable needs of the situation here—infects each of Defendants' arguments on derivative standing. They argue (i) that the fiduciary challenge to the January Transaction does not relate back, and thus solvency had to be assessed anew, and (ii) equity does not support standing here. They then advance two alternative grounds that were correctly rejected below: arguing for a "continuous solvency" rule for creditor derivative standing, and a definition of insolvency that imports receivership standards to limit derivative standing. None of these arguments has merit.

A. Quadrant's Fiduciary Duty Claim Relates Back.

Defendants argue first that the fiduciary duty claim as pled in the SAC does not relate back, relying on *Central Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings LLC*, 2012 WL 3201139 (Del. Ch. Aug. 7, 2012), which held that an amendment alleging additional claims for breach of loan-specific representations in certain contracts would not relate back to a prior complaint challenging different misrepresentations in different contracts. The court held that each sale contract "constitute[d] a separate transaction or occurrence." *Id*. at *18.

The derivative claims alleged by Quadrant involve neither distinct contracts nor separate fiduciary wrongs. The wrongdoing challenged in this action was pled and proven to be part of a unified, inequitable scheme by which insiders in control

of a defunct, non-operating, and insolvent business used their control over the corporation to funnel corporate assets to their affiliates in various ways. From the start, Quadrant argued that liquidation was the sensible solution for Athilon and that the decision not to do so was motivated by the self-interested payments, including but not limited to management fees and interest on out-of-the-money Junior Notes, flowing to Defendants' affiliates. After discovery revealed that Defendants' scheme included the plan (ultimately effectuated) to partially liquidate Athilon, in order to prepay only debt held by insiders, and no one else, Quadrant amended its complaint to include allegations challenging this self-interested partial liquidation plan. The core claim—that the insiders were improperly using their control to funnel non-*pro rata* benefits to affiliates—was always the same.

To be sure, the original Complaint challenged that Defendants were preferring their own interests as stockholders over the interests of Athilon and its creditors. A142; A147-48; A152-53. Discovery revealed that the self-dealing was more audacious. The insiders did not seek to benefit their affiliates as holders of equity (as Quadrant and the trial court had inferred), but as creditors. Otherwise, the scheme was the same as initially pled—to use control of Athilon to benefit insiders at the expense of Athilon and its other stakeholders. *Compare* A152 with A258. The SAC thus merely "expand[ed and] amplifie[d]," Quadrant's original claim that the decision not to liquidate was a self-interested one, by clarifying the

nature of Defendants' self-interest and including additional allegations as to the damages caused by their wrongful scheme. *See Cent. Mortg.*, 2012 WL 3201139, at *17.

The facts proved were therefore unlike *Central Mortgage*, but quite like *Acierno v. New Castle County*, 2000 WL 718346 (D. Del. May 23, 2000), where a developer alleged that a county violated his rights by voiding a development plan and later rezoning the property to a more restrictive classification. 2000 WL 718346, at *2. The developer sued in 1992, then filed an amended complaint in 1993, adding equitable claims relating to the voiding of the development plan and the rezoning decision. *Id.* at *7-8. The rezoning claims would have been time barred as of the 1993 filing date, but the court held that they related back because they arose from the same pattern of conduct as the voiding of the development plan. *Id.* at *9. As in *Acierno*, the pattern of wrongdoing here did not cease upon the filing of the initial complaint. Conduct to advance the prepayment strategy matured after the filing of the Complaint, and discovery revealed additional details about Defendants' self-interested plan. A256-57.

Central Mortgage confirms that the determinative factor in the relation-back analysis is "whether a defendant should have had notice from the original pleadings that the plaintiff's new claim might be asserted against him." 2012 WL 3201139, at *17. In holding that "fair notice" of a claim for breach of contract

required contract-specific notice, the court in *Central Mortgage* expressly acknowledged that allegations of a pattern of conduct can provide defendants with "fair notice" of unpled claims challenging related conduct in other contexts, including for fiduciary duty claims like those at issue here. *Id.* at *18 n. 155; *see, e.g.*, *FDIC v. Connor*, 20 F.3d 1376, 1378 (5th Cir. 1994). Defendants in fact always knew that Quadrant's challenge to their self-interested decision to "risk on" for the benefit of insiders would include claims to remedy any other self-dealing transactions that were identified in discovery, including the plan to prepay insider debt. That knowledge is evident from their efforts to conceal their partial liquidation plan with "silly" discovery objections until the plan was a *fait accompli*. *See* Op. Br. 46-47. The trial court itself had warned that additional claims could be asserted to challenge future self-dealing. *See* A185 ("To the extent these fellows have *or plan to enter* into other self-interested transaction or transactions where they receive a non-ratable benefit, . . . those could be conceivably challenged.") (emphasis added). Because the record reflects that Defendants had ample notice that their self-interested partial liquidation strategy (including any related transactions that transferred value to Merced) would be challenged, relation-back principles apply.

B. Equitable Standing Is Appropriate Here.

Quadrant argued that general principles of derivative standing cut against

Defendants' "light-switch" test for insolvency. Defendants disagree, arguing that "Athilon was solvent" in January 2015, and thus that no self-dealing occurred. *See* Ans. Br. 42. Athilon, of course, "was solvent" only after years of careful engineering in which insiders shifted Merced debt into Merced debt-like equity positions, in order to leapfrog other creditors in debt repayments, and improve balance sheet solvency; transferred illiquid assets from Merced to Athilon, while reserving enough liquid assets to fund prepayment of insider debt; then engineered a self-interested redemption of affiliated debt, including additional exchanges of debt for debt-like equity positions. *See* Op. Br. 13-17. If this scheme can avoid review based on light-switch insolvency, then the equity holder of an insolvent company can always advance inside creditor interests by shifting some of its debt to equity securities and then liquidating assets to itself in the form of dividends, or by prepaying insider debt interests.[7]

Defendants' real argument is on the merits. They attempt to show that the challenged conduct benefited Athilon. Ans. Br. 42-44. But because it denied Quadrant's standing, the trial court never reached the merits. Defendants' arguments are appropriately addressed to the Court of Chancery on remand. In this case, where one party controls all of the equity and the majority of the debt, and

[7] Regardless of whether the debt prepayment here was contractually permissible, it violated the fiduciary duty of loyalty owed to Athilon, by depriving Athilon of valuable below-market capital.

uses board control to prepay its debt holdings at the expense of the corporation, then regardless of solvency, another creditor is the only party available to protect the corporate enterprise from the self-dealing of its fiduciaries. There is literally no one with an incentive to protect Athilon except its non-insider creditors. The equitable purpose of derivative standing requires that creditor standing survive such manipulations.[8]

C. Insolvency, for Purposes of Derivative Standing, Is Properly Examined at the Time the Action Commenced, Not Continuously.

Asserting alternative grounds for affirmance, Defendants argue that the Court of Chancery erred by not adopting a "continuous insolvency" rule, under which busy courts would be required to reassess a company's solvency during the course of the litigation. On summary judgment, the Court of Chancery correctly held that the insolvency test is applied "at the time suit was filed." A315. Defendants have tried to conflate solvency with the continuous ownership requirement, which serves to ensure that plaintiff's economic interest aligns with

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[8] Defendants assert a separate argument that the trial court should have dismissed Quadrant's claims against the independent directors at the pleadings stage under *In re Cornerstone Therapeutics, Inc. S'holder Litig.*, 115 A.3d 1173 (Del. 2015). The SAC sufficiently alleged, and the evidence at trial, confirmed that the independent directors acted in bad faith. Quadrant alleged, for example, that in July, 2014 the Athilon board recognized that the company would have to form a special committee of the independent directors to assess any proposal by Merced to redeem debt held by insiders. A225, 244-45. But when Merced made the proposal, independent directors met hastily, and voted to approve the transaction, without any negotiation or counter-proposal, without consulting independent counsel or financial advisors, and without even considering why the independent process previously contemplated did not occur. A246. These allegations, supported by the evidence at trial, *see* Op. Br. 17, were sufficient to infer bad faith by the independent directors.

the corporation's interest. *See Parfi Hldg. AB v. Mirror Image Internet, Inc.*, 954 A.2d 911, 935 (Del. Ch. 2008); *Ala. By-Prods. Corp. v. Cede & Co.*, 657 A.2d 254, 265-66 (Del. 1995). As the trial court held, the correct creditor analog to continuous ownership is continuous creditor status, which is not in dispute here.

"Continuous insolvency" is not an analog. Insolvency does not "mark a transformational point when creditors suddenly gain and stockholders concomitantly lose an interest in the financial condition of the firm. Creditors always have some interest in improving the financial condition of the firm." A323-24. Whenever a creditor has shown a reasonable inference of insolvency at the outset, the economic reality is that its interests will align with the corporation's interests, because any recovery in the derivative action will improve the likelihood that corporate debt is paid.[9] The trial court correctly noted that, under a continuous insolvency regime, "[i]f the corporation's financial condition fluctuated significantly, misconduct would evade review." A325. This concern was borne out in the present litigation: Defendants engaged in self-interested transactions to manipulate Athilon's balance sheet solvency for the express purpose of evading judicial review of their self-dealing conduct. *See* Op. Br. 15-17.

The practical difficulties of a continuous insolvency rule cannot so blithely

[9] Defendants' argument that Quadrant suffered no redressable injury, Ans. Br. 47, 49, fundamentally misconstrues the nature of a derivative action: where the relevant injury to be redressed is to the *corporation*, not the representative plaintiff.

be dismissed as Defendants would suggest. Repeated review of solvency would turn courts into auditors. Discovery of operational, financial and valuation information throughout litigation, continual motion practice, and renewed motions to dismiss would waste judicial and party resources. The cost and distraction can hardly be justified as necessary to protect against conflicts of interest. A creditor derivative plaintiff by definition pursues a remedy for the corporation, and is not conflicted merely by creditor status. If conflicting interests arise, the Court of Chancery has the inherent authority to remedy them. *See, e.g.*, *MCG Capital Corp. v. Maginn*, 2010 WL 1782271, at *21-23 (Del. Ch. May 5, 2010). Defendants' real argument seems to be that derivative litigation is an evil to be eradicated, rather than an important equitable tool necessary to police the fidelity of corporate directors. But that is contrary to the law. *See Agostino v. Hicks*, 845 A.2d 1110, 1116-17 (Del. Ch. 2004).

D. The "No Reasonable Prospect" Qualifier Is Not Part of a Solvency Test.

Defendants argue last that Athilon was never insolvent in the first place. Delaware law recognizes two tests for measuring insolvency: the balance sheet and cash flow tests. *U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C.*, 864 A.2d 930, 947 (Del. Ch. 2004) *vacated on other grounds*, 875 A.2d 632 (Del. 2005). The first asks whether a company's liabilities exceed the fair value of its assets. *See Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P.*, 906 A.2d 168, 195

n.74 (Del. Ch. 2006) (company is insolvent if it "has liabilities in excess of a reasonable market value of assets held"); *see also* AR55-56. This is the test codified in Delaware's fraudulent transfer act, *see* 6 *Del. C.* § 1302(a) ("[a] debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets, at a fair valuation."), in federal bankruptcy law, *see* 11 U.S.C. § 101(32) ("[t]he term 'insolvent' means . . . financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation"), and in Delaware's commercial code, *see* 6 *Del. C.* § 1-201(b)(23) (incorporating bankruptcy definition of insolvency).

Defendants jettison Delaware's traditional balance sheet test in favor of a novel standard that would not treat a company as insolvent until the company is on its deathbed. They contend that in addition to having liabilities in excess of assets, a company also must have "no reasonable prospect that the business can be successfully continued in the face thereof." Ans. Br. 55. The trial court correctly rejected this argument. Its thorough treatment demonstrates that the "no reasonable prospect" language is not a measure of solvency at all. A333 (examining cases and concluding that "[a] close examination of precedent thus demonstrates that the irretrievable insolvency test only applies in receivership cases for reasons unique to that remedy"). The "no reasonable prospect" language arises from receivership law and addresses a concern specific to receivership:

whether a court should exercise an extraordinary judicial power by supplanting the board. The receivership statute obliges a plaintiff to make two showings. The first prong, insolvency, gives rise to the court's jurisdiction under 8 *Del. C.* § 291. A332-333. The second prong, whether the company has a reasonable prospect of success under current management, is a separate inquiry intended to avoid displacing disinterested managers striving to solve the company's problems with a receiver. A333 ("This additional showing was necessary because the appointing of a receiver was a 'drastic' act that displaced the corporation's board of directors."). The two inquiries (insolvency and cause to appoint a receiver) were separate, but over time receivership cases began merging the two inquiries into a single shorthand. The "no reasonable prospect" language therefore is not part of the balance sheet test of solvency; it is an additional test applicable only in receivership cases.

It would be inequitable to import this test to creditor standing. Creditor standing arises where creditors become "the principal constituency injured by any fiduciary breaches that diminish the firm's value." *N. Am. Catholic Educ. Programming Found., Inc. Gheewalla,* 930 A.2d 92, 102 (Del. 2007) (citing *Prod. Res*., *Grp., L.L.C. v. NCT Grp., Inc.* 863 A.2d 772, 794 n.67 (Del. Ch. 2004)). When equity value falls below zero, all corporate harm is their harm. But the prospect that things might improve in the future is in the first instance their benefit:

they are the most incentivized constituency in either case. More practically, what the future holds will undoubtedly be disputed. To rest a threshold procedural rule—standing (as opposed to a draconian remedy—receivership) on predictions about the future would effectively bar judicial review. That is why the traditional balance sheet test is a more reliable rule of thumb for the standing inquiry. *See* A334 ("[in *Production Resources*], when discussing the point at which creditors gained standing to sue, the Chief Justice drew the line at traditional balance sheet insolvency . . . ."). By contrast, the "no reasonable prospect" test would find insolvency only well after creditors have become the principal constituency injured by any fiduciary breaches. The test therefore does not capture—and in fact frustrates—the "equitable considerations" that this Court recognized allows creditors of insolvent corporations to assert derivative claims. *Gheewalla*, 930 A.2d at 102.

Relying on *Francotyp-Postalia AG & Co. v. On Target Technology, Inc.*, 1998 WL 928382 (Del. Ch. Dec. 24, 1998), Defendants argue that a "mere book imbalance" could establish insolvency and open the floodgates. Ans. Br. 58. The Court of Chancery considered and properly rejected this point. *See* A338-40.

V. THE TRIAL COURT PROPERLY AWARDED ATTORNEYS' FEES.

A. Question Presented.

Whether the trial court abused its discretion by awarding Quadrant $9.6 million in attorneys' fees for claims that Defendants mooted after trial, where Quadrant's litigation was the sole cause of a $40.7 million cash payment made to Athilon expressly because it would moot those fiduciary duty and fraudulent transfer claims that the trial court found "had meaningful prospects for success at trial," *see* A1487. Preserved at AR80, AR118.

B. Scope of Review.

This Court reviews the decision to grant or deny an award of attorneys' fees for abuse of discretion. *Chrysler Corp. v. Dann*, 223 A.2d 384, 389 (Del. 1966). The trial court's decision involved no formulation of legal principles requiring *de novo* review.

C. Merits of the Argument.

During the litigation, and in order to challenge Quadrant's standing to pursue its derivative claims by improving Athilon's solvency, A1381-83, Defendants cancelled insider-held Junior Notes, improving Athilon's balance sheet by $50 million. The "recapitalization" initiated by the Junior Note cancellation, Defendants noted internally, "could dramatically weaken litigation plaintiff's case." A1381-83. After trial, recognizing that Quadrant would likely prevail on some of its claims, Defendants paid $40,748,742 to Athilon, and then moved to

dismiss as moot Quadrant's fiduciary duty and fraudulent transfer claims seeking damages for the payment of exorbitant management fees by an insolvent Athilon to Athilon's servicing affiliate, and its payments of interest on the Junior Notes. AR72, B1779-80. The total benefit to Athilon of the litigation thus exceeded $90 million. *See* AR99. Because its litigation was the direct and admitted cause of these corporate benefits, Quadrant applied for a mootness fee award of $22.5 million in attorneys' fees, representing slightly less than 25% of these benefits. AR102. On March 9, 2016, the trial court granted a fee award of $9.6 million—the amount of attorneys' fees and expenses actually incurred (and paid) by Quadrant, which had not proceeded under a contingency fee arrangement. A1489.

Defendants mount an all-or-nothing challenge. They do not claim that $9.6 million was an unreasonable sum under a *Sugarland* analysis, nor do they seriously contend[10] that the trial court incorrectly applied the *Allied Artists* corporate benefit test. *See Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 149 (Del. 1980); *Allied Artists Pictures Corp. v. Baron*, 413 A.2d 876, 878 (Del. 1980). They focus on a single argument—that this Court should reverse the trial court's decision because, they say, Quadrant's interests were "adverse" to the corporation.

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[10] They devote less than a sentence to the discussion of *Allied Artists*. Ans. Br. 64.

1. The Trial Court Properly Exercised Its Discretion to Award Attorney's Fees to Quadrant.

Defendants' challenge to the fee award rests on three cases where the Court of Chancery exercised its discretion to deny fee applications on facts that are categorically different from this case. In the first, *In re Dunkin' Donuts Shareholders Litigation*, 1990 WL 189120 (Del. Ch. Nov. 27, 1990), the Court of Chancery denied a fee award sought by the bidder in a hostile corporate takeover. The bidder had not sought a "free and open auction" of the company to the highest bidder, and thus had not sought to benefit all of Dunkin' Donuts' stakeholders. *Id*. at *2. As a bidder for the company, its interests were diametrically opposed to the corporation's interest: the lower the price, the better its result. *See also Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 789 A.2d 1216, 1227 (Del. Ch. 2001) ("[B]idders have economic interests that are inherently and structurally in conflict with the target company's stockholders' interest in receiving maximum available value") *aff'd*, 818 A.2d 959 (Del. 2003)).

In *In re Orchard Enterprises, Inc. Stockholder Litigation*, 2014 WL 4181912 (Del. Ch. Aug. 22, 2014), the court denied a fee application by appraisal plaintiffs who brought their claims in an individual capacity *and who never sought to represent the other stakeholders*, even after discovering fiduciary wrongdoing. *Id*. at *13. Because the appraisal plaintiffs "chose not to attempt to extend the benefits of their efforts to other stockholders" and "were content with what they

obtained for themselves," their fee application was denied. *Id.* Fees *were* awarded, however, to class plaintiffs who pursued the fiduciary duty claims. *Id.*

Defendants point out that these cases demonstrate that the Court of Chancery is not obligated to award fees in every case where litigation confers a benefit on the corporation. That is undoubtedly true, as the power to award fees for a corporate benefit "is a flexible one, based on the historic power of the Court of Chancery to do equity . . . ." *Id.* at *3. But the cited cases do not provide any basis to reverse the Court of Chancery's exercise of its discretion to award fees in *this case*. Quadrant was not a hostile bidder in a position adverse to Athilon, or its stakeholders and it was—and remains today—a substantial stakeholder with interests aligned with Athilon. From the beginning, Quadrant pursued derivative fiduciary duty claims, seeking an award of damages to be paid *to Athilon* for the pro-rata benefit of all of Athilon's stakeholders. As to the mooted claims,[11] there was never even "the potential for [Quadrant's] interest to diverge from those of the class," let alone any actual conflict, as the trial court concluded months before trial. A329 ("at present there is no conflict between [the mooted claims] and the interests of Athilon."). The trial court's conclusion that Quadrant's interests with respect to the Mooted Claims were not adverse to Athilon and that Quadrant therefore should be awarded its fees was a proper exercise of its discretion.

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[11] The Mooted Claims included both derivative and direct claims seeking to unwind the transfers. A257-267, A278-79.

Defendants are judicially estopped to contend otherwise. Defendants mooted Quadrant's breach of fiduciary duty claims (pursued on behalf of Athilon and for which Quadrant sought a payment to the company) by making a payment to Athilon. Quadrant's fraudulent transfer claims were direct, and thus could have supported an individual award to Quadrant, but Defendants argued that they, too, could be mooted by the payment to Athilon. The trial court accepted this argument, and dismissed both Quadrant's direct claims and the derivative claims as moot based on the $40 million paid to Athilon. A1486. By mooting the claims as they did, *Defendants* elected to remedy their wrongdoing by conferring a benefit on Athilon, AR72, and in arguing that even the direct claims were mooted by a payment to Athilon, they *necessarily* conceded that those claims also benefitted Athilon. Defendants cannot reverse field now and deny that Quadrant benefitted the company. *MidAtlantic Farm Credit, ACA v. Morgan*, 2015 WL 1035423, at *4 (Del. Ch. Mar. 4, 2015) (judicial estoppel prevented litigant advancing position contrary to that previously taken and accepted by the court); *Hermelin v. K-V Pharm. Co.*, 2011 WL 6225377, at *1 (Del. Ch. Dec. 13, 2011) (same).

Where defendant's actions moot a claim before judgment, a plaintiff is entitled to a fee award if "the suit was meritorious when filed; action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and the resulting corporate benefit was causally related to the

lawsuit." *Allied Artists*, 413 A.2d at 878. The trial court's step-by-step consideration of the corporate benefit test was not "mechanical," *see* Ans. Br. 65, but carefully reasoned and correct.

As to the first prong of the test, as the trial court observed, a claim has merit "if it can withstand a motion to dismiss on the pleadings if, at the same time, the plaintiff possesses knowledge of provable facts which hold out some reasonable likelihood of ultimate success." *Chrysler Corp. v. Dann*, 223 A.2d 384, 387 (Del. 1966); A1487. Not only *could* the claims challenging the management fees and the non-deferral of interest on the Junior Notes have survived a motion to dismiss on the pleadings, they *did* in fact survive *multiple* pre-trial motions. A297; A1487. Defendants illogically argue that Quadrant's claims were nonetheless not meritorious because the trial court ultimately denied Quadrant standing to pursue its other derivative claims, which Defendants did not moot. Ans. Br. 64. The trial court's post-trial decision that Quadrant lacked standing to assert new claims first asserted in the SAC in April, 2015 because Athilon was *then* solvent, Ans. Br. 64, has no bearing on whether Quadrant's assertion of the mooted claims was meritorious. The mooted claims were filed in 2011, when Athilon was "deeply insolvent." *See* Op. 11.

Under the second and third prongs of the test, benefit and causal connection, the benefit to Athilon included, at a minimum, the cash payment of $40,748,742,

and Defendants expressly acknowledged, in their mootness motion, that the payment was made solely to eliminate the risk of an adverse judgment after trial. AR75; B1779-81. The trial court thus correctly concluded that Quadrant was entitled to a fee award under *Allied Artists*, and there is no basis to reverse its exercise of its equitable discretion to award fees to Quadrant.

2. The Trial Court Did Not Abuse Its Discretion in Granting the $9.6 Million Fee Award for the Mooting Payment.

Having failed to contest the reasonableness of the $9.6 million award in relation to the benefit achieved for Athilon, Defendants have waived any right to do so. "The merits of any argument that is not raised in the body of the opening brief shall be deemed waived and will not be considered by the Court on appeal." Supr. Ct. R. 14(b)(vi)(A)(3); *Bank of N.Y. Mellon v. Commerzbank Capital Funding Tr. II*, 65 A.3d 539, 547 n.20 (Del. 2013) (claim procedurally barred due to failure to raise it in opening brief); *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1264 (Del. 2012) (same). For this reason, Defendants can only challenge the *fact* that the fees were awarded at all, and not the amount. As discussed above, there is no basis to reverse the trial court's decision to award fees to Quadrant, therefore, this Court should affirm the fee award in all respects.

In any event, the record shows that the Court of Chancery properly exercised its discretion as to the amount of the fee in accordance with the five-factor test set forth in *Sugarland*. *Sugarland*, 420 A.2d at 149. The trial court exercised its

discretion in a highly conservative way, awarding Quadrant only $9.6 million of the $22.5 million Quadrant sought. This award was well within the bounds of the trial court's discretion. *See In re Abercrombie & Fitch Co. S'holders Deriv. Litig.*, 886 A.2d 1271, 1275 (Del. 2005) (finding no abuse of discretion in fee award based on Court of Chancery analysis consistent with the factors set forth in *Sugarland*).

The Court of Chancery recognized its obligation to consider *Sugarland*, and, while it observed that it had contemplated all of its factors, A1489 (referring to the impact of the "other *Sugarland* factors" on the court's analysis), its concentration on the absence of a contingency fee weighed heavily in the calculation of the award. The trial court began with a percentage of the quantifiable benefit approach (the first *Sugarland* factor), used here as a metric against which to assess a fee award to Quadrant based upon fees actually incurred. A1488-89. This factor is typically the most important factor in determining an award, and "the 'common yardstick by which a plaintiff's counsel is compensated in a successful derivative action.'" *Ams. Mining Corp.*, 51 A.3d at 1257-58. The trial court used the $40.7 million cash mootness payment as the amount of the benefit.

This was a conservative decision. The trial court could have applied the higher figure advocated by Quadrant—$90,748,842—the amount of the post-trial cash payment plus $50 million, in value contributed to Athilon in the 2013 Junior

Note cancellation. AR99. The record showed that the mooted claims were at least a substantial factor in Defendants' decision to cancel the Junior Notes. *See* AR137-39; A1381 ("[p]roperly executed recapitalization could dramatically weaken litigation plaintiff's case," with handwritten comment noting, "solvency clear").

There can be no dispute, however, that the cash mootness payment was a dollar-for-dollar benefit to Athilon. The trial court selected 25% of the benefit as a "reasonable and conservative" yardstick against which to consider the reasonableness of fees and expenses actually incurred. A1489 (noting that 25% of the benefit would support an award of $10,187,185). This percentage is well within the range of awards historically granted in the Court of Chancery. *Ams. Mining Corp.*, 51 A.3d at 1259-60 (noting fee awards for benefits achieved after trial in the Court of Chancery support awards from 25-33% of the monetary benefits conferred with the "[h]igher percentages . . . warranted when cases progress to a post-trial adjudication"); *Forsythe v. ESC Fund Mgmt. Co. (U.S.)*, 2013 WL 458373, at *3 (Del. Ch. Feb. 6, 2013) ("33⅓% [is] a reasonable estimate in the event of post-trial success")*; In re Jefferies Grp., Inc. S'holders Litig.*, 2015 WL 3540662, at *3 (Del. Ch. June 5, 2015) (the "significant additional risk and investment of resources involved in going to trial and the further exposure of appellate review" justifies a higher award for post-trial recoveries).

Turning to the fourth of the *Sugarland* factors, the trial court decided to cap the fee award at the actual time charges and expenses incurred and paid, because the case was not pursued on a contingent basis. A1489. Since, "[i]n this case, counsel did not take on any contingency risk," the trial court concluded that Quadrant was "entitled to the fees and expenses that they bargained for, but no more." A1489. *Sugarland* does not *require* a contingency fee arrangement in order for an award based on a percentage of the benefit: the presence of any such arrangement is but one *Sugarland* factor. *Sugarland*, 420 A.2d at 149, 151; *see also Julian v. E. States Constr. Serv., Inc.*, 2009 WL 154432, at *2 (Del. Ch. Jan. 14, 2009) (*Sugarland* is "a flexible, multi-factor approach").

In sum, although the Court of Chancery might well have awarded a higher fee, the conservative fee award it granted can hardly be challenged *by the defense* as an abuse of the trial court's discretion under *Sugarland*. *United Vanguard Fund, Inc. v. TakeCare, Inc.*, 727 A.2d 844, 857 (Del. Ch. 1998) (where benefit conferred not easily quantifiable, fee actually incurred was "the best . . . measure of the value of the services rendered"); *In re Nine Sys. Corp. S'holders Litig.*, 2015 WL 2265669, at *3 n.22 (Del. Ch. May 7, 2015) ("A number of cases have limited awards to amounts 'actually incurred' by plaintiffs."). Because Defendants have identified no basis for this Court to supplant the trial court's exercise of discretion, the order awarding fees should be affirmed.

CONCLUSION

For the foregoing reasons, Quadrant respectfully requests that the Court reverse the Court of Chancery's judgment as set forth in Quadrant's Opening Brief, and affirm the Court of Chancery's Order and Final Judgment, insofar as it awarded attorneys' fees and expenses to Quadrant.

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