EFiled: Jun 02 2017 12:13PM EDT
Filing ID 60673306
Case Number 43,2017

IN THE SUPREME COURT OF THE STATE OF DELAWARE

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| ISN SOFTWARE CORPORATION,<br><br>Respondent Below,<br>Appellant / Cross-Appellee,<br><br>v.<br><br>AD-VENTURE CAPITAL PARTNERS, L.P., POLARIS VENTURE PARTNERS FOUNDERS' FUND VI, L.P. and POLARIS VENTURE PARTNERS VI, L.P.,<br><br>Petitioners Below,<br>Appellees / Cross-Appellants. | ) | No. 43, 2017<br><br>On Appeal from:<br><br>The Court of Chancery of the State of Delaware, Consol. C.A. No. 8388-VCG<br><br>**PUBLIC VERSION EFILED**<br>JUNE 2, 2017 |

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**APPELLEE'S / CROSS-APPELLANT'S**
**<u>REPLY BRIEF ON CROSS APPEAL</u>**

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May 22, 2017

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# INTRODUCTION

ISN offers no credible defense for its expert's decision to adopt the controlling stockholder's (Bill Addy) counterfactual theories to artificially depress ISN's future cash flows and substantially discount his cash flow valuation.

ISN offers no response whatsoever to the facts that:

- the controlling stockholder changed ISN's accounting method ***after the merger*** in the mistaken belief that the switch would *create* a deferred revenue liability that would ***reduce the DCF value of ISN***; and
- the controlling stockholder's strategy for this appraisal case was based, in part, on the false premise that ISN's profitability would "*fade*," even though its EBITDA margin had increased every year prior to the merger and management forecasted that trend to continue.

ISN's only defense of its expert's work is that the court below found it "appropriate to start with [ISN's] DCF model as a framework." But the trial court did not, as ISN argues, simply accept ISN's DCF model. The court analyzed the evidence presented at trial and adjusted ISN's DCF model in a number of critical areas, including by adding back $34 million in excess cash sitting on ISN's balance sheet, removing the annual cash flow "adjustment" for phantom incremental working capital in ISN's model, and deciding to make no adjustment to working capital, as ISN historically operated with a negative working capital balance. Those adjustments amounted to a wholesale rejection of ISN's expert's treatment of excess cash, deferred revenue and working capital and artificially depressed his valuation conclusion.

And where the trial court failed to adjust ISN's DCF model to conform to the evidence—particularly by accepting ISN's depressed revenue and inflated expense projections, and by immediately "fading" ISN's EBITDA margin—ISN has no answer to the evidence that showed that its expert's revenue and expense projections and the controlling stockholder's margin fade theory were completely opposite of the unassailable evidence of the Company's actual and budgeted performance on the date of the merger. The evidence presented at trial exposed the flaws in ISN's expert's projections, which arose from his rote adoption of the controlling stockholder's litigation-driven valuation assumptions to artificially suppress ISN's future cash flows and dampen the DCF value of ISN. The court reversibly erred by adopting those projections and starting to "fade" ISN's margin without any evidence in the record to support the complete reversal of ISN's historical and budgeted performance at the time of the merger.

Similarly, ISN has no credible explanation for its insistence that the shares and options held by its employees should be included in the appraisal class, even though those employee shares were not entitled to statutory appraisal rights and ISN's management had set their value at the time of the merger. The employee shares were subject to highly-restrictive stockholder agreements that required ISN's employees to vote their shares "*in the same manner as the Founding Stockholder [Bill Addy]*." To the extent they wanted to cash out their shares when they were no longer employed, they could only get "*fair market value*" as determined solely by Bill Addy; not fair value, as ISN's brief states. Because the employee shares and options were entitled only to be valued by ISN's board of directors (*i.e.*, Bill Addy and Joe Eastin)—and were not eligible for statutory appraisal at the time of the merger—they should not have been included in the trial court's per share computation of fair value. The trial court's determination to include those shares should be reversed.

## I. THE REVENUE AND EXPENSE PROJECTIONS ADOPTED BY THE TRIAL COURT ARE NOT SUPPORTED BY THE EVIDENCE.

The trial court abused its discretion by accepting revenue and expense forecasts refuted by the evidence. More specifically, the court erred by accepting the revenue and expense projections contained in ISN's expert's DCF model because those projections reversed the Company's consistent dramatic growth in the actual number of contractor subscriptions and cash collections, and arbitrarily assumed that ISN's trend of increasing profitability would reverse course and immediately begin to decline after the merger eliminated the minority stockholders.

In response to the overwhelming (and uncontroverted) evidence that reflected ISN's consistent growth on every measure, ISN offers little more than an excerpt from the Opinion where the trial court explains that it favored a "standard 5-year projection period," rather than Petitioners' longer forecasts.[1] But the trial court's decision on the length of the projection period does not erase the overwhelming evidence that proved that ISN's projections were artificially

[1] Contrary to ISN's argument, the length of the projection period does not have a significant impact on revenue projections because the further out the terminal year, the more the values are discounted. As Petitioners explained in their post-trial briefs, the purpose of extending projections beyond five years for this business was to allow ISN to reach a steady state, which Beaulne failed to do. *See* B0197-98 (citing SHANNON PRATT, VALUING A BUSINESS 219 (5th ed. 2008)); *accord* B0038-39. Furthermore, all three experts agreed that a price increase should be included in the sixth year of the projections, which required a projection period longer than the "standard" five years—even Beaulne projected growth in his terminal year, effectively transforming his model into a six-year model. *See* B0197-98.

depressed and could not be relied upon to determine fair value. ISN's lone argument that "*[its] expert report clearly showed that, as of the Valuation Date, contractor growth* ***rate*** *was in fact slowing*" is irrelevant. The evidence showed that, by any measure, ISN's customer base, revenues, and profits were growing every year prior to the merger, and that ISN's management expected that growth to continue at a similar rate. The trial court erred by adopting ISN's depressed revenue forecasts and arbitrary expense projections that inexplicably reversed that growth as the basis for its determination of fair value.

## A. ISN's Expert's Revenue Projections Contradict The Evidence Of ISN's Performance.

The unrebutted evidence presented at trial proved that the court should not have adopted the revenue forecast that ISN proffered in its five year revenue projection. ISN's expert reversed years of proven growth and projected that the number of net new contractors—the primary driver of ISN's cash collections—would drop precipitously in the two years following the merger, before flat-lining in 2015 at levels ***below*** the number of net new contractors that the Company added in 2008,[2] while still in its early growth stage.

[2] ISN's expert projected that ISN would add only 5,302 net new contractors in 2014—a level that ISN had not seen since before 2008 when it was operating in one industry vertical and one country. *See* B1666. At the time of the merger, ISN was operating in 19 industry verticals and more than 70 countries. A79; B1817-21; BR0020 (Client Development 1Q-2013 Deck).

ISN's expert blindly followed Bill Addy's litigation-driven efforts to depress ISN's fair value by reversing the Company's robust growth in net new contractors. But the controlling stockholder's false directives were directly contradicted by the contemporaneous evidence of how ISN was actually performing at the time of the merger, including by the testimony of ISN's other executives.

For example, as Ad-Venture detailed in its Opening Brief, ISN's artificially depressed revenue projections were completely contrary to the evidence of the Company's remarkable success,[3] including the incontrovertible evidence that:

- Since 2010, ISN had consistently added a substantial number of new contractors each year, and budgeted for contractor growth to continue in 2013, even after a 20% price increase in 2012;[4]
- ISN's cash collections had increased more than ten-fold during the years preceding the merger;[5]
- As ISN's expert admitted at trial, *Ad-Venture's revenue projections **(not his)** exactly tracked ISN's actual revenue data through 2014*.[6]

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3 ISN's rapid and consistent growth earned it a place on *Inc.* magazine's list of America's 5000 fastest-growing companies every year since 2006. BR0001.

4 B1665-66. ISN added 6,507 new contractors in 2010, 8,310 net new contractors in 2011, 7,223 in 2012, and was projecting to add between 6,377 and 8,700 net new contractors in 2013. B1666-67. To accommodate that growth, ISN had substantially increased its number of employees, B1633, office space, B1577-88; and global footprint, B1792; B2460.

5 B1666.

6 A422; A710. Indeed, in his rebuttal report, ISN's expert inexplicably attempted to defend his declining projection by referencing that ISN ***actually*** added 7,059 and 6,979 net new contractors in 2013 and 2014—indicating growth well above ISN's expert's projections of 6,300 and 5,300. A710; B1666.

By adopting ISN's expert's model "as a framework" and failing to adjust the counterfactual revenue projections in that model to conform to the evidence of ISN's actual and budgeted performance, the trial court mistakenly understated the fair value of ISN. Thus, the trial court's adoption of ISN's assumption regarding revenue growth because it found it to be "more likely than the bolder growth assumed by the Petitioners' experts" is directly contrary to the evidence, and an abuse of discretion that must be reversed.

Although ISN's expert claimed that his depressed revenue projections were supported by Bill Addy's statements that ISN would be faced with increasing competitive pressure and may have reached a point of market "saturation," there was no evidence in the record to support those statements. To the contrary, Bill Addy testified at trial that, at the time of the merger, ISN continued to occupy a "*truly dominant position in oil and gas in the U.S. and Canada*" and was growing "*rapidly*."[7] In fact, as Bill Addy was forced to concede at trial, ISN had experienced a ***45% growth rate*** in the twelve months preceding the merger.[8]

Furthermore, when asked at trial to identify any threats faced by ISN, Bill Addy did not mention competition or market saturation—instead he referenced cyber-security, a government mandate that might overtake their business, and the

[7] A287.

[8] A289; *accord* B1612-13.

possibility of a lawsuit stemming from a "*major accident*."[9] Bill Addy's testimony as to those "competitive threats" was not supported by any evidence from the ordinary course of ISN's business. In fact, the evidence showed that no one—neither ISN's management nor its expert—had ***ever*** analyzed competition or market saturation.[10] There is no evidence in the record to support ISN's controlling stockholder's self-serving and baseless pessimism.

To the contrary, the ***only*** evidence of possible competitive threats or market saturation that is supported by the record is the unrebutted testimony from the only industry expert who presented his analysis in expert reports and at trial, which established that, based on analysis of ISN's existing and potential clients at the time of the merger, there was no evidence of market saturation.[11] ISN offered no rebuttal to that testimony at trial and simply ignores it on appeal.

Of course, there is no mystery as to why ISN's expert assumed that ISN's trend of consistent revenue growth would precipitously drop immediately after the merger—Bill Addy pre-ordained that result as part of the litigation strategy he developed in the weeks following Ad-Venture's unexpected appraisal demand.

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[9] A287-88. There was no evidence that any of those threats was imminent. *Id.*

[10] A321 ("*I would love to know how each segment can be saturated, but I don't believe we've ever created that analysis*.") (Addy); *see also* A330 (Eastin); A357, 366 (Callahan); A424, 440-41 (Beaulne); B3097 (Yemenu).

[11] A149, A158; B1805; B1829.

The documentary evidence on that point is remarkable and unequivocal. In an email to Joe Eastin within weeks of Ad-Venture's demand for appraisal, Bill Addy directed that, "*[w]hen it comes time to value ISN in the appraisal action, we might make the following points . . .*"

> *a.* *Industry growth is* ***5% or so – certainly our long term growth must be capped at that level and could be less – adding 5,000 net new contractors each year*** *gets us to about 5% growth in a few years.*[12]

Viewed in that context, ISN's reactionary arguments on appeal are exposed for what they are—a last-gasp attempt to defend Bill Addy's ill-conceived efforts to eliminate the minority holders at a price far below fair value by artificially depressing the DCF valuation conclusion that ISN presented in this action.

1. <u>ISN's Contractor Growth Rate Does Not Indicate Declining Revenue.</u>

ISN's time-worn argument that the *rate* of new contractor growth indicated that ISN's growth was slowing during the years leading up to the merger—and its most recent extension that "*[i]t is axiomatic that slowing growth rates lead mathematically to slowing growth*"—is nothing short of misleading. As the trial court noted,[13] the reason that the growth *rate* was slowing was that, as the total

[12] B1772.

[13] A232 (THE COURT: "I understand … if you're adding one contractor a year and you start with one, the first year it's 50 percent growth. The second year it's a third growth. The next year, it's a quarter….").

number of ISN's customers grew, the percentage of new customers would arithmetically be lower than the prior year. That did not mean, however, that ISN's actual ***growth***[14] (*i.e.*, increases in the number of new contractors and the corresponding increased revenue) was slowing in the years leading up to the merger.

Moreover, the evidence of ISN's actual performance showed that, by every relevant metric, ISN's robust growth had continued. As the tables below indicate, ISN was continuing to add increasingly larger numbers of net new contractors each year, which, coupled with regular price increases in excess of 20% and no material or identifiable increase to expenses incurred to acquire or service those new accounts (because the software was scalable and subscription renewals were always above 90+%), produced dramatic and consistent growth during the years prior to the merger, including a record $36.8 million increase in cash collections in 2012—an increase of 41% over the prior year.[15]

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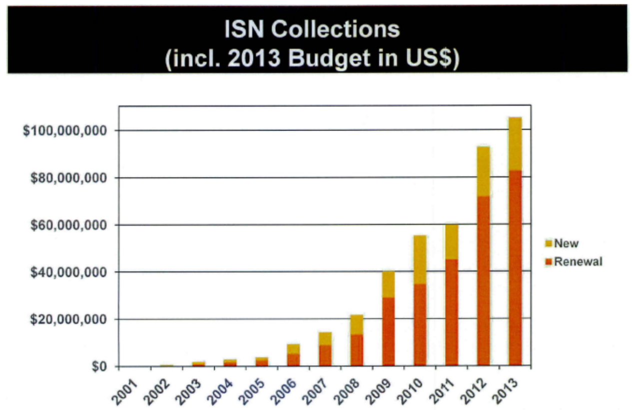
[14] All of the experts' projections implied a declining growth ***rate***, but unlike ISN, Petitioners' experts reached valuation conclusions that comported with the contemporaneously-prepared evidence, in part because they did not assume that ISN's established trend of adding, on average, 7,000 net new contractors each year, would immediately reverse after the merger. *See* A710 (comparing experts' contractor projections).

[15] B1665-67 (ISN's Budget Presentation Deck).

**ISN Collections Basics for 2013**

| Year | # of Contractors BoY | # of Contractors EoY | Contractor Growth Rate (%) |
|---|---|---|---|
| 2006 | 4,000 | 6,000 | 50% |
| 2007 | 6,000 | 11,000 | 83% |
| 2008 | 11,000 | 16,500 | 50% |
| 2009 | 16,500 | 22,872 | 33% |
| 2010 | 22,872 | 29,379 | 28% |
| 2011 | 29,379 | 37,689 | 28% |
| 2012 | 37,689 | 44,912 | 19% |
| 2013 | 44,912 | 51,289 | 14% (Budgeted) |




2. <u>ISN Did Not Plan To Cut Its Future Price Increases In Half.</u>

ISN also cannot defend its expert's decision to grossly underestimate the effect of planned future price increases on ISN's revenue projections.

- ISN raised its prices by 50% in 2006, 32% in 2009, and 20% in 2012, yet still substantially increased the number of new customers it added every year prior to the merger.

- ISN's expert agreed that the Company would continue to raise prices on a three-year cycle, but assumed that the price increase in 2015 would drop to 9.9%—half of the prior cycle price increase and just 3.3% annually.

Although ISN tries to mask the effect of its expert's arbitrary decision to slash the planned price increase in half by arguing that its estimate was "*in line with ISN's historical price adjustment trend*," the testimony from ISN's President was that ISN had planned to continue its triennial price increases based on "*what the market would bear*," and "*in line with the past price increase*."[16] He did not testify that future price increases would be cut in half—nor would that make any

[16] A323; A329.

sense since ISN had regularly pushed through 20%+ price increases with virtually no customer attrition and continuing record-setting growth in cash collections.[17]

3. <u>The Polaris Memo Does Not Support ISN's Depressed Revenue Projections.</u>

Faced with no evidence to support its decision to reverse ISN's growth trend, ISN's argues that cherry-picked statements from an internal Polaris memo indicate that ISN's business should have been forecasted to decline. ISN can only make that argument by conveniently omitting all of the reasons listed in the memo that detail why ISN's robust growth and business model was very attractive, including:

- [redacted]
- [redacted]
- [redacted]
- ISN is a [redacted]
- ISN has a [redacted]
- The price at which Polaris purchased its ISN shares was [redacted] and

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[17] As Bill Addy testified, ISN's history of price increases had driven its enormous growth between 2005 and the merger. A282 ("*So you can see in 2006 we increased the number of contractors 50 percent, we increased the average collection per contractor 50 percent.* ***So that was a nice price adjustment***.").

[18] AR1.

- The [redacted]

ISN cannot point to a single contemporaneous document of its own to support its depressed growth story. To the contrary, ISN's documents and the only industry expert testimony at trial[20] established that ISN had considerable growth opportunities, including in the oil and gas markets.

In sum, neither arguments about "slowing growth *rates*" nor selective clips from a Polaris investment memo can justify ISN's artificially-depressed revenue projections when all of the contemporaneous evidence was to the contrary. The court below abused its discretion by accepting ISN's projections.

### B. ISN's Expert Adopted The Controlling Stockholder's Theories By "Backing Into" Expense Projections And Arbitrarily "Fading" ISN's Profit Margin.

There is also no support in the record for the trial court's decision to adopt ISN's expert's artificially-inflated expense projections or counterfactual "margin fade."

Not surprisingly, ISN's expense projections were not supported by evidence of ISN's actual expense history—ISN's expert testified that he simply "*backed into*" his expense estimate *after* selecting an arbitrary EBITDA margin from ***other***

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[19] AR5; A448 (ISN's expert dissembling and failure to rebut the evidence that Polaris valued ISN at significantly more than the purchase price).

[20] *See supra* note 11 & accompanying text.

public company data, none of which were recognized by the Court as comparable. He then compounded his error by "fading" ISN's EBITDA margin, even though he could not identify a single expense that would increase at a rate faster than revenue, and the Company's margin had increased every year prior to the merger.

As Ad-Venture detailed in its Opening Brief, the evidence showed that:

- ISN's expert admitted he "backed into" ISN's expenses, ignoring ISN's historical experience and 2013 budget;
- In the four years leading to the merger, ISN's EBITDA margin had steadily increased from 3.9% in 2009, to 16.0% in 2010, to 17.8% in 2011, and to 20.1% in 2012;
- In the 2013 budget, management budgeted for ISN's EBITDA margin to continue its upward growth trend and expand to 24.3%;
- ISN's expert testified that he was aware of, but ignored, the evidence that ISN's margins expanded year-over-year leading to the merger and that management had budgeted for that trend to continue post-merger;
- The sole basis for abandoning ISN's historical trend and 2013 budget was Bill Addy's theory that margins would "*revert to the average of the overall industry of comparable companies* …"; and
- At trial, ***Bill Addy conceded that***, despite predicting since 2008 that ISN's margins would fade, ***ISN's margin had never faded***, it had ***increased*** each year prior to the merger.

ISN has no answer to those facts, and offers no argument or citation to any evidence to rebut the fact that its expert ignored ISN's history and arbitrarily inflated its expenses by adopting the controlling stockholder's baseless theory that ISN's profitability would suddenly "fade" immediately following the merger.

1. ISN's Expert Ignored ISN's Actual Expenses To Attempt To Defend The Controlling Stockholder's Efforts To Depress The Valuation.

Rather than simply admitting that its expert performed no analysis of the Company's actual expenses,[21] ISN attempts to obfuscate its result-oriented approach to valuation by arguing that:

> *Mr. Beaulne forecasted ISN's projected operating expenses by considering the Company's historical EBITDA margins and observing the EBITDA margins of comparable companies in the industry*.[22]

That argument ignores the trial testimony from ISN's expert (Mr. Beaulne), in which he admitted he did nothing close to what ISN now suggests:

> Q: So what you really did—let's put it in plain English for the Court. ***What you really did was you picked the EBITDA margin, and you backed into the expenses. Right?***
>
> A: *Yes.*[23]

That testimony alone shows that it was error for the trial court to adopt ISN's expert's expense projections, because they admittedly were not based on evidence of ISN's actual expenses.

ISN tries to have this Court ignore that evidence by arguing that ISN's expenses would outpace the Company's revenue growth in the future due to the

[21] A423-25.

[22] Ans. Br. at 25.

[23] A423 (emphasis added).

Company's expansion into new markets. That is an odd response in view of ISN's persistent refusal in this proceeding to acknowledge ISN's potential for continued robust growth, and ignores the fact that ISN's expert admitted that he had conducted no analysis of ISN's expenses, no studies on market saturation or competition, and had no data on expansion.[24]

In addition, ISN ignores the fact that its expert conceded at trial that his margin fade assumption was necessarily based on the premise that "*ISN was going to have to see a substantial increase in expenses if it was going to have a margin fade*." Yet he could not identify ***any*** expenses, even at a general level, that would increase faster than revenues and cause ISN's margin to fade. Indeed, he admitted at trial that he had not made any attempt to conduct such an analysis.[25] Quite the contrary, the evidence showed that, since 2009, ISN was realizing the merits of scalability—*i.e.*, increasing profitability because revenue growth always outpaced expenses.

2. ISN's "Margin Fade" Theory Is Not Supported By The Evidence Of The Company's Performance.

At trial, ISN failed to adduce any evidence supporting its expert's arbitrary, yet deliberate, decision to "fade" ISN's EBITDA margins every year beginning in 2013, when the evidence showed that ISN's management had projected the

[24] A424-25.

[25] A425.

Company's margin to increase. Indeed, although ISN's expert characterized his decision to freeze the growth in 2012 by holding the EBITDA margin "*constant*" in 2013,[26] his decision to use an EBITDA margin that was more than four percentage points lower than the margin that ISN's management had budgeted for 2013 was a decision to begin to immediately reverse the Company's growth trend after the merger. ISN offers ***nothing*** in support of its expert's decision to undercut management's projected EBITDA margin and begin the controller's counterfactual fade—other than its expert's naked conclusion that it was appropriate to arbitrarily cut the project margin "***to be fair***…."[27] Fair to whom?[28] Certainly not to ISN's minority stockholders.

ISN's expert then compounded the effects of his unsupportable decision to arbitrarily cut the margin that ISN had budgeted for 2013 by deciding to continue

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[26] A424.

[27] Ans. Br. at 25-26.

[28] The error of utilizing ISN's expert's projections is easily seen in the evidence of ISN's actual performance. ISN's expert projected that the Company's cash flow would *drop* from $17.9 million in 2012 to $11.3 million 2013, *even though he was simultaneously projecting an increase in revenue* of nearly $20 million and no material increase in expenses. *Compare* A663 (2013 net cash flow of $11.3M), *with* B1638 (2012 net cash flow of $17.9M). As ISN's (now former) CFO testified, **it would be "*crazy to see*" *any kind* of decrease in cash flow in 2013**—let alone one of the magnitude that ISN's expert was forecasting for purposes of this litigation. A391.

to “fade” ISN’s margin throughout the projection period, just as the controlling stockholder had ordered,[29] even though he admitted at trial that:

- ISN’s margins had increased ***every year*** in the four years prior to the merger;
- ISN had budgeted for a higher EBITDA margin in 2013;[30] and
- ***ISN’s margins had not begun to fade prior to the merger***.[31]

ISN’s latest argument—that its expert’s decision to “fade” the Company’s EBITDA margin down to 15% was supported by ISN’s historic average of 14.5%—is nothing more than a *post-hoc* rationalization of its expert’s decision to adopt the controlling stockholder’s baseless “margin fade” theory. The fault with ISN’s four-year average is that it allows ISN to paper over the fact that, during that same period, ISN’s EBITDA margin grew at a compound annual growth rate of ***142%***—and was budgeted to continue to expand in 2013. Thus, using any other benchmark would have shown that ISN’s expert’s selection of 15% was inappropriate. For example, ISN’s trailing three-year average EBITDA margin was 18%, in 2012 it grew to 20.1%, and its budgeted EBITDA margin for 2013

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29 *See* B1772 (laying out strategy for depressing the “*Terminal Value Calculation*” “*[w]hen it comes time to value ISN in the appraisal action*” by applying “*The Fade*” to reduce ISN’s margins to 13%).

30 It is worth noting that only half of the effect of the 2012 price increase was reflected in ISN’s post-merger GAAP financial statements, which deferred the other 50% of increased collections resulting from that price increase in 2013.

31 A423.

was 24.3%.[32] Based on that record of ISN's actual performance, even Bill Addy admitted at trial that there was no evidence—none—indicating that ISN's margin had plateaued or begun to fade.[33]

Moreover, due to ISN's rapid growth, ISN's GAAP financial statements—which pushed recognition of a substantial portion of its cash collection into each following year—understate ISN's actual profitability leading up to the merger. In fact, Bill Addy testified that he had always targeted a cash-basis margin of 25%, and that ISN had "*delivered that 25 [percent] every year up through 2013*."[34] Indeed, in the three years leading up to the merger (2010 to 2012), ISN had averaged a cash basis operating margin of 29%.[35] Consistent with that history Petitioners' experts projected that ISN would maintain its profit margins consistent with its pre-merger margins.[36]

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[32] Indeed, when projecting other inputs, such as working capital, ISN's expert did not use a four-year average—which would have shown working capital based on ISN's post-merger, litigation-driven GAAP balance sheet to be just 2.5%—but instead looked only to ISN's experience in 2012—the only year which could possibly support his now-discredited estimate of 12%. A403; A431.

[33] A304-06.

[34] B3125.

[35] B3015 (ratio analysis showing net income as a percentage of total cash collections); *see also* B2066, 74-75, B2244-46 (Polaris' expert's reports).

[36] *See* A706 (summarizing experts' projected EBITDA margins and illustrating that Petitioners' experts are within the range of the pre-merger cash margin of 29%, while ISN's experts trends downward from 20% to 15%).

In view of the uncontroverted evidence that, during the entire four-year period leading up to the merger, ISN's EBITDA margin had steadily increased, and ISN's utter failure to point to evidence to support its expert's arbitrary decision to accept Bill Addy's directive and "fade" the margin, the trial court abused its discretion by adopting ISN's margin fade. When faced with ISN's consistent growth in its EBITDA margin at trial, even ISN's controlling stockholder abandoned his baseless "margin fade" theory. The trial court should have rejected that assumption as well.

## II. THE TRIAL COURT OVERSTATED THE NUMBER OF SHARES ENTITLED TO APPRAISAL.

All shares of ISN stock held by its employees were subject to stockholder agreements that prevented the holders from dissenting from any merger approved by Bill Addy. Thus, those shares could not seek appraisal under Section 262, and, as a matter of Delaware law, should not be counted in the calculation of the per-share merger price in this appraisal proceeding.[37] ISN does not refute that legal principle, but rather argues that the employee stock was not so restricted. ISN's argument simply ignores or misstates the key facts in the trial record, and should be rejected.

First, ISN's claim that the shares and options held by ISN employees were not subject to restrictions that deprived them of the right to dissent from the merger and seek appraisal under Section 262 is flatly contradicted by the plain language of the employee stockholder agreements. Each of the highly-restrictive agreements contained a voting agreement by which the employee stockholder agreed to vote all stock "*in the same manner as the Founding Stockholder [Bill Addy]*" and granted Bill Addy an irrevocable proxy for "*any matter for which a stockholder*

[37] *See* Appellants' Br. at 64-66; *In re Appraisal of Ford Hldgs, Inc. Pref'd Stock*, 698 A.2d 973, 974 (Del. Ch. 1997). Contrary to ISN's unfounded assertion, Ad-Venture cited *Ford Hldgs* in its post-trial briefs. *See* B0072; B0226.

*vote is required or sought….*"[38] Thus, the employee shares could *never* meet the requirement of Section 262 that the shares not be voted in favor of a merger that Bill Addy had approved by written consent, and thus could not seek statutory appraisal.

ISN cannot eliminate those contractual restrictions by relying on the mailing of a Notice of Stockholder Action Taken by Written Consent and Notice of Appraisal Rights to one of its employees.[39] That mailing does not amend the restrictions or wipe out the irrevocable proxy in the employee stockholder agreement. Instead, the mailing that ISN belatedly relies upon is nothing more than a reflection of ISN's confusion over which of its stockholders had appraisal rights in the merger.[40] The Notice could not and does not grant a statutory appraisal right that did not exist prior to the merger.

Second, the fact that "*ISN had no right to purchase [employee] shares … until the employee was no longer employed*" does not change the fact that the Company had valued employee shares at $23,000 per share at the time of the merger. The repurchase policy was never merely a "hypothetical" exercise—ISN's

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[38] *E.g.*, B2971-72 at ¶¶ 4(i). 4(j); B2986-87 at ¶¶ 4(i), 4(j).

[39] ISN does not claim to have mailed notices to any of its option holders.

[40] *See* A318-19 (testifying that ISN believed that the "*merger structure was set up so that Ad-Venture would not be able to seek appraisal" and that it "came as a big surprise*" when Bill Addy learned that Ad-Venture had appraisal rights.).

financial statements noted and Bill Addy corroborated at trial that, at the time of the merger, "***[t]he company ha[d] established a practice** of acquiring vested options from former employees when former employees request to exercise their vested options….*"[41]

Critically, the value assigned to each of those shares and the price paid to the ISN former employee was never—as ISN's now argues—the "fair value" of such shares. To the contrary, each of the employee stockholder agreements provided that the price to be paid was based on "***the fair market value** … as determined by the [Company's] Board of Directors*" (*i.e.* Bill Addy and Joe Eastin)[42]—a value that may be cut in half if the employee is terminated for cause[43]—or the value determined under the appraisal scheme set forth in the stockholders agreement,[44] which specified that the appraiser's determination of "***fair market value***" ***must*** include "*the application of any and all appropriate discounts relating to*" the employee shares, after deducting half of the costs of the private appraisal process.[45]

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[41] B1641 (emphasis added); *accord* A287 (Addy).

[42] B2972 at ¶5(a)(i); B2987-88 at ¶ 5(a)(i).

[43] B2972 at ¶5(a)(ii); B2987-88 at ¶ 5(a)(ii).

[44] B2972 at ¶5(a)(iii); B2987-88 at ¶ 5(a)(iii).

[45] B2966 ("Appraised Value"); B2981-82 ("Appraised Value").

The fact that the Company believed that the employee shares would never be entitled to statutory appraisal is further evidenced by the fact that ISN's financial statements booked a liability for the vested option shares at the time that any employment was terminated.[46] At the time of the merger, the Company had fixed the redemption value of the Restricted Shares at $23,000 per share and had calculated that, if all outstanding vested options were exercised, the Company would receive $4.4 million in proceeds (representing the aggregate exercise price for the options).[47] ISN cannot now disavow that number—the practice was confirmed in its financial statements produced in August of 2015, and the redemption value remained fixed when employees attempted to exercise options both before ***and after*** the merger.[48]

Accordingly, the Restricted Shares would *never* be entitled to fair value in a statutory appraisal proceeding and it was legal error to include those 714 shares of stock in the determination of the appraisal award. This Court should reverse as a matter of law the trial court's decision to include those shares in its calculation.

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[46] The absence of any holder of those shares in this appraisal proceeding is telling.

[47] B1647 (cost to exercise); *accord* A249 (Clarke); *see also* B1964-66; B2201-01.

[48] A287 (Addy); A388-89 (FitzPatrick); *see also* BR0003; BR0025-28; BR0022. The financial statements reflect a liability of $729,666 related to 49.34 vested options, which is based on the fixed per share value of $23,000 less the exercise price.

## CONCLUSION

For the foregoing reasons, as well as those set forth in Petitioners' other briefs on appeal, Ad-Venture respectfully requests that this Court: (1) **reverse** the trial court's determination to rely upon ISN's revenue and expense projections, margin fade, and number of shares entitled to appraisal; and (2) **remand** this matter to the trial court for a determination of the fair value of ISN's shares after correcting the errors with respect to the revenue and expense projections and eliminating the margin fade.

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May 22, 2017
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CERTIFICATE OF SERVICE

I hereby certify that on June 2, 2017, the foregoing was caused to be served upon the following counsel of record via File & Serve*Xpress*:

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