



IN THE SUPREME COURT OF THE STATE OF DELAWARE

SAMUEL ZALMANOFF,)	
)	
Plaintiff-Below/)	
Appellant,)	No. 609, 2018
)	
v.)	COURT BELOW:
)	Court of Chancery
JOHN A. HARDY, KENNETH I.)	of the State of Delaware
DENOS, FRASER ATKINSON,)	
ALESSANDRO BENEDETTI,)	C.A. No. 12912-VCS
RICHARD F. BERGNER, HENRY W.)	
HANKINSON, ROBERT L. KNAUSS,)	
BERTRAND DES PALLIERES and)	
EQUUS TOTAL RETURN, INC.,)	
)	
Defendants-Below/)	
Appellees.)	

APPELLANT SAMUEL ZALMANOFF'S
REPLY BRIEF

OF COUNSEL:

Jeffrey S. Abraham
ABRAHAM, FRUCHTER &
TWERSKY, LLP
One Penn Plaza
Suite 2805
New York, New York 10119
(212) 279-5050

PRICKETT, JONES & ELLIOTT, P.A.
Ronald A. Brown, Jr. (#2849)
J. Clayton Athey (#4378)
Samuel L. Closic (#5468)
1310 King Street
Wilmington, Delaware 19801
(302) 888-6500

Attorneys for Plaintiff-Below/Appellant

Dated: March 14, 2019

TABLE OF CONTENTS

	<u>Page No.</u>
TABLE OF AUTHORITIES	ii
SUMMARY OF ARGUMENT	1
ARGUMENT	3
I. THE TRIAL COURT APPLIED THE REASONABLE STOCKHOLDER STANDARD INCORRECTLY	3
II. THE DISCLOSURES IN THE 2015 10-K, EVEN IF DEEMED TO BE INCORPORATED BY REFERENCE, FAILED TO INFORM A REASONABLE STOCKHOLDER OF ALL MATERIAL FACTS	12
CONCLUSION	18

TABLE OF AUTHORITIES

	<u>Page No.</u>
CASES	
<i>Appel v. Berkman</i> , 180 A.3d 1055 (Del. 2018)	12
<i>Brinckerhoff v. Texas Eastern Products Pipeline Co., LLC</i> , 2008 WL 4991281 (Del. Ch. Nov. 25, 2008)	7, 16
<i>Gilliland v. Motorola, Inc.</i> , 859 A.2d 80 (Del. Ch. 2004)	4, 14
<i>In re Micromet, Inc. S'holders Litig.</i> , 2012 WL 681785 (Del. Ch. Feb. 29, 2012)	10
<i>Morrison v. Berry</i> , 191 A.3d 268 (Del. 2018)	13
<i>ODS Techs., L.P. v. Marshall</i> , 832 A.2d 1254 (Del. Ch. 2003)	5, 11, 14
<i>Rabkin v. Philip A. Hunt Chem. Corp.</i> , 498 A.2d 1099 (Del. 1985)	16
<i>Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.</i> , 532 A.2d 1324 (Del. Ch. 1987)	10
<i>The Williams Cos. v. Energy Transfer Equity, L.P.</i> , 2016 WL 3576682 (Del. Ch. June 24, 2016)	13, 14
<i>In re Trans World Airlines, Inc. Shareholders Litigation</i> , 1988 WL 111271 (Del. Ch. Oct. 21, 1988)	6, 10, 14
<i>Wolf v. Assaf</i> , 1998 WL 326662 (Del. Ch. June 16, 1998)	8, 9
<i>Zirn v. VLI Corp.</i> , 681 A.2d 1050 (Del. 1996)	4, 7
RULES	
Chancery Court Rule 8(a)(1)	16

SUMMARY OF ARGUMENT

The importance of providing stockholders with a full and fair disclosure of the company's conduct of operations when seeking their approval of director compensation cannot be overstated. It is undisputed that the 2016 Proxy¹ soliciting stockholder approval of the EIP failed to include any information respecting the Plan of Reorganization or the Company's investment activity. Instead, that information was supposedly set forth in other SEC filings that Defendants purportedly sought to incorporate by means of a boilerplate incorporation provision. The 2016 Proxy's boilerplate incorporation provision, however, failed to inform reasonable stockholders where the omitted material information respecting their vote on the EIP could be found.

The trial court nevertheless held Defendants were able to cure the 2016 Proxy's material deficiencies with prior disclosures because they were mailed together with the 2016 Proxy. This was error because the trial court failed to give due weight to the facts and circumstances respecting the omitted facts, the nature of the requested stockholder action, or the potential for deception and misinformation. Moreover, the trial court's application of Delaware's reasonable stockholder

¹ Unless otherwise noted, capitalized terms shall have the meaning ascribed to them in Appellant Samuel Zalmanoff's Corrected Opening Brief [Filing ID 62932772].

standard imposes an unreasonable burden on stockholders and creates substantial opportunities for mischief.

Even assuming, *arguendo*, that the 2015 10-K was fairly incorporated into the 2016 Proxy, the Company's stockholders were still without all material facts when voting on the EIP. Equus's lack of investment activity was important for stockholders to consider because it is inconsistent with the Company's purpose as a BDC and the Company's prior disclosures respecting the Plan of Reorganization. Nevertheless, the 2015 10-K made no mention of the fact that Equus's contractual obligations were impairing the Company's ability to "conduct its operations in the normal course" as it previously disclosed. A54. This aspect of Plaintiff's claim was subsumed within the allegations of Plaintiff's Complaint and therefore was not waived. In any event, Plaintiff's contention respecting the Best Efforts Clause's omission from the 2015 10-K was raised in response to Defendants' efforts to cure the material omissions in the 2016 Proxy by reference to other disclosures.

The trial court's erroneous application of Delaware's reasonable stockholder standard should be reversed.

ARGUMENT

I. THE TRIAL COURT APPLIED THE REASONABLE STOCKHOLDER STANDARD INCORRECTLY

The trial court erred by concluding as a matter of law that the 2015 10-K's disclosures were incorporated into the 2016 Proxy by virtue of the documents being mailed together because it did not give due regard for the importance of the 2016 Proxy's omitted information to a reasonable Equus stockholder in the context of the specific request for stockholder approval of the EIP. Essential—possibly the most essential—inquiries for stockholders evaluating how Equus's directors and officers are to be compensated are how the Company is currently operating and its plans for the future.

There is no dispute that the 2016 Proxy was devoid of any facts pertaining to the Plan of Reorganization or the Company's lack of investment activity, despite Equus's prior disclosures stating it would “conduct its [investment] operations in the normal course.” A54. Nevertheless, the trial court accepted Defendants' contention that because the omitted information was supposedly set forth in Equus's 2015 10-K and, because a copy of that filing was mailed to stockholders along with the 2016 Proxy, it was fair to charge them with knowledge of the 10-K's contents. This is an erroneous application of Delaware's reasonable stockholder standard because it imposes an unreasonable burden on stockholders and creates substantial opportunities for mischief.

Delaware’s reasonable stockholder standard is applied based on an “analysis of the factual circumstances of the case and an inquiry into the potential for deception or misinformation.” *Zirn v. VLI Corp.*, 681 A.2d 1050, 1059 (Del. 1996). Where stockholders are requested to approve the compensation of directors, they rely on those directors to exercise their duties to include all material facts with the solicitation materials addressing such compensation. These material facts necessarily include all material facts concerning the company’s conduct of its operations. If the directors choose to rely on information contained outside the proxy, the directors need to tell stockholders where to look outside the proxy. It is not enough that, as the trial court found, stockholders might deem it “intuitive” that the information Defendants omitted from the 2016 Proxy could be found in the 2015 10-K. Opinion at 14; *see also Gilliland v. Motorola, Inc.*, 859 A.2d 80, 88 (Del. Ch. 2004) (Delaware’s protection of reasonable stockholders extends to unsophisticated stockholders who are “neither so well-informed nor so well-equipped”).

Here, because the 2016 Proxy omitted both facts and the references to where such facts could be found, information that was extremely relevant to the directors’ request for stockholder approval of their equity incentive compensation, it is likely that many stockholders based their decisions on the compensation on inadequate information. Indeed, a holding that the 2016 Proxy’s boilerplate incorporation provision operates as a matter of law to incorporate the entirety of prior SEC filings

threatens to “create a ‘super’ shareholder standard and create almost limitless opportunities for deception of the ‘reasonable’ shareholder.” *ODS Techs., L.P. v. Marshall*, 832 A.2d 1254, 1262 (Del. Ch. 2003).

Plaintiff’s application of the reasonable stockholder standard is consistent with Delaware authority. Delaware cases rejecting efforts to excuse material omissions in a proxy by incorporating prior disclosures have a common theme – the courts are skeptical of post-hac efforts to incorporate facts into a proxy where stockholders are told nothing of the operative fact in the proxy.

For example, in *ODS Technologies*, 832 A.2d at 1262, the court rejected the defendants’ efforts to stave off a disclosure violation by reference to prior disclosures because the proxy was silent as to the operative facts defendants sought to incorporate. Defendants’ attempt to distinguish *ODS* on the grounds that the omitted disclosure there was not actually in the prior filing but was merely incorporated by reference is unavailing. AB at 16.² For purposes of applying Delaware’s reasonable stockholder standard here, the salient principle from *ODS* is that Delaware courts should be leery of efforts to incorporate items from separate disclosures when the proxy itself makes no mention of the operative fact.

² Citations to “AB at” refer to Appellee’s Answering Brief [Filing ID 63008385].

In *In re Trans World Airlines, Inc. Shareholders Litigation*, 1988 WL 111271 (Del. Ch. Oct. 21, 1988) the court similarly afforded little weight to the defendants' efforts to incorporate a separate disclosure concerning the company's business operations because the proxy was silent as to the operative fact. *Id.* at *11. Defendants' efforts to distinguish *Trans World* are misguided. AB at 16-17. First, Defendants' observation that *Trans World* concerned separate disclosures that were not mailed together does not change the fact that *Trans World* emphasizes how Delaware courts apply the reasonable stockholder standard. Second, Defendants criticize Plaintiff's reliance on *Trans World* because the relief ultimately sought by the plaintiffs, a preliminary injunction, was denied. AB at 16. However, the request for a preliminary injunction was denied on grounds unrelated to the merits of the plaintiffs' disclosure claim, namely that an award of damages to the class post-merger would be adequate to address any injury sustained. *In re Trans World*, 1988 WL 111271, at *8. Indeed, as to the merits, the *Trans World* court "concluded that the claims asserted [we]re plausible and d[id] have some reasonable likelihood of success." *Id.* at *2.

Finally, Defendants criticize Plaintiff's reliance on *Trans World* because there the court was willing to look to disclosures beyond the proxy. But Plaintiff is not advocating for a categorical bar against incorporating prior disclosures into a proxy by reference. Rather, Plaintiff's contention is that whether in a specific case the

omission of material facts in a proxy can be cured by reference to other disclosures requires a qualitative application of Delaware's reasonable stockholder standard based on the "factual circumstances of the case and an inquiry into the potential for deception or misinformation." *Zirn*, 681 A.2d at 1059. In other words, application of Delaware's reasonable stockholder standard to disclosures incorporated by reference requires a qualitative analysis and is not as simple as whether items are mailed together.

The court's reluctance to credit prior disclosures where the operative fact is absent from the proxy itself is apparent in *Brinckerhoff v. Texas Eastern Products Pipeline Co., LLC*, 2008 WL 4991281 (Del. Ch. Nov. 25, 2008), which is cited by Defendants. *See* AB at 17. In *Brinckerhoff*, the plaintiff claimed proxy materials solicited to request unitholder approval of a general partner's relinquishment of distribution rights in exchange for limited partnership interests were materially incomplete because they omitted any discussion of a letter to unitholders relating to the proposals included with prior proxy materials. *Id.* at *2. The court found that prior disclosures could be considered along with the proxy because the proxy indicated it was intended to be a supplemental disclosure for the requested unitholder action and specifically provided the date of the prior disclosure unitholders should look to "for additional information [prior] to voting." *Id.* at *5 & n.30.

Wolf v. Assaf, 1998 WL 326662 (Del. Ch. June 16, 1998), Defendants' showcase authority, is not contrary to Plaintiff's position. AB at 14-15. In *Wolf*, the omitted disclosure from the proxy concerned a statement attributed to the company's Chief Executive Officer in an Answer filed in a pending class action related to accounting irregularities. 1998 WL 326662, at *3. The court ultimately concluded that the disclosure violation was excused because the class action was fairly disclosed in a Form 10-K that was mailed to stockholders along with the proxy. *Id.* However, *Wolf* is readily distinguishable from the instant case based on the necessity of Equus's stockholders having the omitted information in order to make an informed decision on the EIP.

The omitted facts here concern the Company's conduct of its operations notwithstanding that the 2016 Proxy was sent for purposes of soliciting stockholder approval of director equity incentive compensation. The importance to stockholders of presenting them with information respecting the Company's operations when being asked to vote on director compensation cannot be overstated. By contrast, in *Wolf*, the omitted disclosure concerned positions the company and its executives were taking in litigation when asked to approve certain directors and the amount of shares available for equity incentive compensation, a consideration more tangential than evaluating a company's operations for purposes of voting on director

compensation. *See id.* at *2 (discussing the defendants' efforts to incorporate prior disclosure about a federal class action).

Accordingly, *Wolf* does not, as Defendants suggest, represent a categorical holding that directors need not include all material facts in a proxy so long as it is mailed along with a prior disclosure containing the missing information. Rather, application of Delaware's reasonable stockholder standard is a qualitative analysis guided by the factual circumstances and potential for misinformation and deception. In addition, Plaintiff's claim is a direct challenge to the Defendants' failure to include facts pertaining to the Plan of Reorganization and Equus's conduct of its business operations when soliciting stockholder approval of the EIP and it is not a mere quibble with how Defendants elected to organize the disclosure materials. *Cf.* AB at 18-19.

Plaintiff's contentions touch on issues of public policy that are of vital importance to stockholders of Delaware corporations. Stockholders rely on directors to fairly provide them with all material facts when soliciting stockholder action, particularly where that action concerns stockholder approval of the directors' compensation. The 2016 Proxy was the document Equus's directors provided to stockholders to solicit approval of their equity incentive compensation. Requiring Equus's stockholders to independently review the 2015 10-K to gather information that should have already been prominently included in the 2016 Proxy is an effort

by Defendants to shift their disclosure burden onto the stockholders they are meant to serve. This is not consistent with Delaware law. *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, 532 A.2d 1324, 1340 (Del. Ch. 1987) (warning against impermissible efforts to “thrust” “the disclosure burden owed by the fiduciary ... upon the beneficiary to whom the duty is owed”); *see also In re Trans World*, 1988 WL 111271, at *10 (“[The] failure to disclose [a material fact] is [not] necessarily cured by reason that it could be uncovered by an energetic shareholder by reading an SEC filing.”) (citation omitted). Protecting the reasonable stockholder’s ability to make an informed decision on approval of the EIP is all the more salient here because the burden on Defendants to either provide the information relating to Equus’s conduct of its business operations, or at least a reference thereto, was minimal to non-existent. The information was readily available to Defendants given the 2015 10-K and 2016 Proxy were prepared in close proximity.³

Similarly, requiring stockholders to parse through prior SEC filings in addition to the proxy statement, which they might reasonably expect to provide them with all material facts in itself, threatens to “bury the shareholders in an avalanche of trivial information, a result that is hardly conducive to informed decisionmaking.” *In re Micromet, Inc. S’holders Litig.*, 2012 WL 681785, at *11 (Del. Ch. Feb. 29,

³ The 2015 10-K was filed with the SEC on March 20, 2016 and the 2016 Proxy was filed with the SEC on April 18, 2016.

2012) (citation omitted). This is to say nothing about the endless possibilities for mischief that can arise from combined mailings. *ODS Techs.*, 832 A.2d at 1262.

Accordingly, because the 2016 Proxy did not indicate where the omitted material facts going to the heart of the request for stockholder approval of the EIP could be found (or that they even existed outside the 2016 Proxy in the first place), the trial court erred in holding that the disclosure violation was remedied because the 2016 Proxy and 2015 10-K were mailed together.

II. THE DISCLOSURES IN THE 2015 10-K, EVEN IF DEEMED TO BE INCORPORATED BY REFERENCE, FAILED TO INFORM A REASONABLE STOCKHOLDER OF ALL MATERIAL FACTS

Even assuming, *arguendo*, that the trial court correctly determined that the 2015 10-K's contents were incorporated into the 2016 Proxy, the disclosures still failed to inform reasonable stockholders of all material facts respecting the conduct of Equus's operations. Specifically, the 2015 Proxy made no mention of the fact that Equus's contractual obligations were impairing the Company's ability to "conduct its operations in the normal course" as it claimed would occur in connection with announcing the Plan of Reorganization. A54. Equus's lack of meaningful investment activity is inconsistent with the Company's purpose as a BDC and would therefore be important to stockholders being asked to vote on the EIP. *Appel v. Berkman*, 180 A.3d 1055, 1060 (Del. 2018) ("Information is material if there is a [] substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote....").

In an effort to demonstrate Equus is investing its cash-on-hand as stockholders expect that a BDC would (*it is not*), Defendants point to the 2015 10-K's disclosure of approximately \$3 million dollar in investment activity. AB at 9. In reality, however, over \$2 million of the investment activity was passive. Specifically, in January 2015 Equus invested \$2,013,000 in Biogenic Regents, LLC, which is a company in which MVC itself heavily invests. Compl. ¶18. Moreover, by way of

the Plan of Reorganization, MVC seeks to combine one of the operating companies in its portfolio with Equus so that shares of such MVC portfolio company will trade on the NYSE in place of Equus's stock. Compl. ¶3; A56. Thus, Equus's investment into an MVC-preferred investment appears to serve MVC's goal in the Plan of Reorganization rather than reflecting an instance of Equus exercising its independent investment judgment. Compl. ¶18.

The existence of the Best Efforts Clause was material to Equus stockholders being asked to approve the EIP because it explains why the Company has ceased to "conduct its operations in the normal course" at odds with its prior disclosure. *See* A54. Stockholders may have been aware that Equus had entered into the Plan of Reorganization but, absent disclosure of the Best Efforts Clause, stockholders would have mistakenly understood that Equus was still operating its investment-based operations in the normal course until another path forward was announced. Accordingly, disclosure of the Best Efforts Clause (and the change in the Company's operations) was material to a reasonable stockholder because it would have "shed light on the depth" of Equus's contractual commitment to remain in limbo until MVC decided to proceed with the Consolidation on its terms. *Morrison v. Berry*, 191 A.3d 268, 275 (Del. 2018).

Defendants' reliance on *The Williams Cos. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682 (Del. Ch. June 24, 2016) for support that the Best Efforts Clause

was immaterial because it required nothing more than commercially reasonable efforts is inapposite. AB at 25. *The Williams Cos.* decision did not pronounce a categorical ruling as to the operation of any clause similar to the Best Efforts Clause but instead reflects the court’s analysis of a discrete contract. 2016 WL 3576682, at *16 (noting the term “commercially reasonable efforts ... is not addressed with particular coherence in [Delaware] case law” and evaluating the term “in the context of the contract at issue”).

Defendants do not dispute that the Best Efforts Clause was never disclosed outside being set forth in the Share Exchange Agreement that was, in turn, attached as an exhibit to the 2014 8-K. Yet Defendants claim, and the trial court agreed, that information pertaining to the Best Efforts Clause was somehow within the total mix of information. Opinion at 11-12; AB at 17. It is unreasonable to charge Equus’s stockholders with not only parsing through prior SEC filings, but also rummaging through the exhibits thereto to ascertain facts that Defendants had a fiduciary obligation to disclose in their subsequent public filings. *ODS Techs.*, 832 A.2d at 1262; *Gilliland*, 859 A.2d at 88; *In re Trans World*, 1988 WL 111271, at *11. Accordingly, the trial court erred by concluding that information respecting the Best Efforts Clause was in the total mix of information disclosed to Equus’s stockholders for purposes of voting on the EIP.

The trial court further erred in finding that Plaintiff waived his disclosure claim respecting the Best Efforts Clause by not including the contention in his Complaint. Opinion at 8-9; *see also* AB at 22-24. Plaintiff's Complaint fairly provided Defendants with notice that he intended to challenge Defendants' disclosure concerning Equus's investment activity (or lack thereof), together with any reasons for a change in the conduct of the Company's operations, in the context of seeking stockholder approval of the EIP. Hence, this is not a situation where Defendants received no notice in the pleadings that Plaintiff intended to state a disclosure claim based on the 2015 10-K's omission of any reference to the Best Efforts Clause. Rather, Defendants opened the door by claiming that the disclosure violations Plaintiff complained of in the 2016 Proxy could be cured by reference to the 2015 10-K.

Plaintiff originally brought this action challenging Defendants' compliance with their fiduciary duty to provide stockholders with all material facts in the 2016 Proxy they sent to Equus's stockholders for purposes of obtaining stockholder approval of the directors' equity incentive compensation. Compl. ¶38 (pleading that Defendants breached their fiduciary duty of disclosure because the 2016 Proxy omitted and/or failed to disclose (a) the "current status" of the Consolidation with MVC and (d) the "process" by which MVC and Equus are carrying out the Plan of Reorganization). In response, Defendants contended that they were permitted to

reference Equus's prior disclosures, including the 2015 10-K, to excuse the 2016 Proxy's material omissions. Plaintiff, in turn, contended that even if that were the case under Delaware law (*and it is not*), the 2015 10-K failed to disclose all material facts respecting Equus's conduct of its operations because it omitted reference to the Best Efforts Clause.

In any event, the Best Efforts Clause, which provides the undisclosed reason for why Equus's investment activities have ground to a halt, can be inferred from Plaintiff's "short and plain statement of [his] claim" in the Complaint. Ct. Ch. R. 8(a)(1); Compl. ¶38; *see also Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1104 (Del. 1985) ("A complaint need only give general notice of the claim asserted...."); *Brinckerhoff*, 2008 WL 4991281, at *4 n.13 ("[T]he court must give the pleader 'the benefit of all reasonable inferences that can be drawn from its pleading.'") (citations omitted). Defendants' contention that Plaintiff waived any claim respecting the Best Efforts Clause because the specific term is not expressly included in the Complaint fails for similar reasons.

Moreover, Defendants unfairly criticize Plaintiff's Complaint for focusing its disclosure claims on the contents of the 2016 Proxy. AB at 7. Plaintiff's claim is grounded in his contention that as the solicitation document provided to stockholders in connection with seeking stockholder approval of the directors' equity incentive compensation, the 2016 Proxy was required to plainly include all material facts.

Plaintiff was not required to plead facts in support of Defendants' erroneous mailing defense.

CONCLUSION

For all the foregoing reasons, the trial court's Opinion of November 13, 2018 must be REVERSED.

PRICKETT, JONES & ELLIOTT, P.A.

By: /s/ Samuel L. Closic

Ronald A. Brown, Jr. (#2849)

J. Clayton Athey (#4378)

Samuel L. Closic (#5468)

1310 King Street

Wilmington, Delaware 19801

(302) 888-6500

Attorneys for Plaintiff-Below/Appellant

OF COUNSEL:

Jeffrey S. Abraham

ABRAHAM, FRUCHTER &

TWERSKY, LLP

One Penn Plaza

Suite 2805

New York, New York 10119

(212) 279-5050

Dated: March 14, 2019

CERTIFICATE OF SERVICE

I, Samuel L. Closic, do hereby certify on this 14th day of March, 2019, that I caused a copy of Appellant Samuel Zalmanoff's Reply Brief to be served by eFiling via File & ServeXpress upon counsel for Appellees as follows:

David J. Teklits, Esquire
D. McKinley Measley, Esquire
Morris, Nichols, Arsht & Tunnell
1201 North Market Street
Wilmington, Delaware 19801

/s/ Samuel L. Closic

Samuel L. Closic (#5468)