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Case Number 205,2021

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE SMILEDIRECTCLUB, INC. DERIVATIVE LITIGATION	)	No. 205, 2021
	)	
	)	Court Below:
	)	The Court of Chancery
	)	of the State of Delaware
	)	C.A. No. 2019-0940-MTZ

APPELLEES' ANSWERING BRIEF ON APPEAL

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NATURE OF THE PROCEEDINGS

SmileDirectClub, Inc. ("SDC" or the "Company") undertook an initial public offering (the "IPO") in September 2019. Before the IPO commenced – and before any of the plaintiffs in the action below ("Plaintiffs") owned SDC stock – SDC issued a prospectus in connection with the IPO (the "Prospectus"). The Prospectus disclosed repeatedly and at length that, if the IPO was successful, substantially all of the IPO proceeds would be used to purchase "LLC Units" (representing interests in SDC Financial LLC, SDC's operating entity) from certain pre-IPO investors (the "Purchases"). The Prospectus disclosed that the LLC Units would be purchased for $21.85 each, equivalent to the IPO price minus an underwriting discount. It also provided specific details regarding how many LLC units would be purchased, who they would be purchased from and how much would be spent, both in total and on a per-LLC Unit basis. Thereafter, the IPO launched and Plaintiffs became SDC stockholders. A few days later, the Purchases were consummated on the exact terms that were disclosed in the Prospectus.

Plaintiffs then filed derivative actions against the current members of the SDC board of directors, and certain entities they purportedly control, for breach of fiduciary duty, aiding and abetting and unjust enrichment. But all of those claims were predicated on decisions made and disclosures issued ***prior to*** the IPO launch. Specifically, Plaintiffs challenged (i) the pre-IPO board's decision to allow pre-

IPO investors' securities to be purchased at an allegedly "grossly inflated" price in connection with the IPO; and (ii) the issuance of allegedly "false and misleading" disclosures made in the Prospectus issued at the time of the IPO.

Defendants moved to dismiss the action below, including on standing grounds. Defendants argued that Section 327 of the Delaware General Corporation Law (the "DGCL") prohibits Plaintiffs from challenging the purported pre-IPO wrongdoing because they did not own SDC stock at the time the terms of the Purchases were finalized and the Prospectus was issued. Thus, under well-settled Delaware law, Plaintiffs lacked standing. *See 7547 Partners v. Beck*, 682 A.2d 160, 162-63 (Del. 1996) (affirming dismissal of fiduciary challenge because the plaintiff lacked standing to challenge pricing terms of IPO set forth in prospectus because she was not a stockholder at the time the terms were established).

The Court of Chancery agreed. On May 28, 2021, the Court of Chancery issued a well-reasoned Memorandum Opinion (the "Opinion," OB[1] Ex. A) that dismissed all of Plaintiffs' claims with prejudice for lack of standing under Section 327 of the DGCL. The Opinion is now on appeal. Because the Vice Chancellor did not err in finding that the transactions that Plaintiffs challenged below (*i.e.*, the

[1] Plaintiffs' Opening Brief on Appeal (the "Opening Brief") is cited herein as "OB at __."

setting of all material terms regarding the Purchases) occurred before Plaintiffs became SDC stockholders, the Opinion should be affirmed.

SUMMARY OF ARGUMENT

1. Denied. Plaintiffs cite no authority establishing that the "time of the transaction" for purposes of Section 327 does not occur until a "binding and enforceable legal agreement or other similarly legally binding action which could have been the subject of a damages action" exists. Indeed, *Beck* – which is Delaware Supreme Court precedent directly on point and establishes the rule of law that governs here – does not even contain the words "binding" or "enforceable." 682 A.2d 160. In *Beck*, this Court noted that at the Court of Chancery level, the parties had "hotly contested" whether an agreement governing the stock sale at issue was executed before the plaintiff became a stockholder. *Id.* at 163. Finding that the parties' debate was "founded on an inaccurate premise," the Court explained that the time of the transaction occurs when allegedly wrongful terms are established, not when they become final and binding by way of an enforceable agreement. *Id.* That rule governs here.

2. Denied. Whether "a contract requiring the Company to go forward with the Insider Transactions" existed at *any* time is irrelevant, because all parties agree that the Purchases were consummated on the same terms that were established before Plaintiffs purchased SDC stock. For the same reason, standard caveats in the Prospectus regarding "intent" and "discretion" are irrelevant. The simple fact is that SDC publicly disclosed the terms of the Purchases before

Plaintiffs purchased their stock and then completed the deal afterward. In such circumstances, the "time of the transaction" is when the purportedly wrongful deal terms are set, not when the deal itself is executed.

3. Denied. The Court of Chancery properly determined that the terms of the Purchases must have been set before Plaintiffs became SDC stockholders, because those same, precise terms were disclosed in the Prospectus. As this Court held in *Beck*, "[t]his is the sort of uncontestable fact that may be considered at the pleading stage even if not admitted by the plaintiff." 682 A.2d at 163. Contrary to Plaintiffs' contention, the Court of Chancery would have erred had it assumed otherwise.

4. Denied. Plaintiffs failed to raise their "statutory purpose" and "policy" argument in the Court of Chancery,[2] and thus have waived it on appeal. *See Aikens v. State*, 147 A.3d 232, 2016 WL 4527578, at *3 (Del. 2016) (TABLE) ("[F]ailure to raise [an] issue below constitutes a waiver of the claim on appeal."); Del. Sup. Ct. R. 8. But even if they had preserved their argument, it would fail, as this Court rejected the same contention in *Beck*. *See* 682 A.2d at 163 ("Partners argues that 8 *Del. C.* § 327 should not be construed to apply in this case, since

[2] Indeed, at oral argument before the Court of Chancery, Plaintiffs expressly disclaimed the policy argument they now assert. (A943 ("I will point out that, you know, we're deciding the case before us and not a broad issue of Delaware policy."))

Partners did not purchase its stock for the purpose of filing this claim. ... The short answer to this argument is that the statute does not include any provision exempting 'good faith' purchasers from its terms."). And, in any event, the undisputed facts do indeed establish that "Plaintiffs acquired their SDC stock for the purpose of instituting this lawsuit." (*Contra* OB at 4) The terms of the Purchases were publicly disclosed on September 11, 2019, Plaintiffs bought SDC stock the next day, and two months later the lawsuits started rolling in. As the Court of Chancery found, Plaintiffs had "knowledge of the alleged wrong" (including the "dilutive and negative impact on the public stockholders" that would come after the IPO) "when they purchased stock." (Op. at 29-30, 33) Granting them derivative standing would only encourage future claim-buying, which would not comport with the purpose and policy underlying Section 327.

STATEMENT OF FACTS

A. SDC And SDC Financial's Pre-IPO Capital Structure.

SDC is a Delaware corporation that, through its operating subsidiary SmileDirect Financial LLC ("SDC Financial"), manufactures clear dental aligners and enables a revolutionary direct-to-consumer approach to orthodontic treatment. (A38 ¶ 2; A41 ¶ 12; A46 ¶ 34; Op. at 2) Prior to the IPO, SDC's business was conducted by SDC Financial, which at the time was owned by certain investors including defendants in the action below and Appellees here (the "Founders"). (A41-45 ¶¶ 13-31; A46 ¶ 34, Op. at 3) SDC was incorporated in 2019 to facilitate the IPO. (A46 ¶ 33; Op. at 3-4) Immediately prior to the IPO, membership interests in SDC Financial were represented by a single class of LLC units (the "LLC Units"), which was owned by the Founders and SDC. (A46 ¶¶ 34-35; Op. at 3-5)

B. SDC Issues An IPO Prospectus That Details The Purchases.

On September 11, 2019, the SEC declared effective the Prospectus, which was issued in preparation for the IPO. (A391; Op. at 5) The Prospectus disclosed that in the IPO SDC would offer 58,537,000 shares of SmileDirectClub, Inc. Class A Common Stock to the public at $23.00 per share, a price that had been set based on negotiations with the IPO's underwriters. (A142; Op. at 10) Those shares would be traded on the NASDAQ stock exchange. (*Id.*)

The Prospectus also disclosed that SDC would use substantially all of the proceeds from the IPO to buy LLC Units from the Founders (*i.e.*, undertake the Purchases). (*See* A210; Op. at 5-6) Indeed, its cover page made that obvious, explaining:

> We intend to use approximately $616.3 million of the net proceeds from this offering (or approximately $808.2 million if the underwriters' option to purchase additional shares of Class A common stock is exercised in full) to purchase limited liability company units of SDC Financial LLC, our subsidiary, and shares of our Class A common stock from existing holders thereof, as described herein.

(A142; *see* A161, A164-65, A210-13, A300-01 (explaining how proceeds from IPO would be used to undertake Purchases); Op. at 5-7)

(Remainder of page intentionally left blank)

The Prospectus detailed and explained all of the material terms of the Purchases as well. For example, it set forth the exact number of LLC Units that SDC would buy, and how much SDC would spend, as follows:

> The table below sets forth the number of LLC Units and/or shares of Class A common stock to be purchased by us from Pre-IPO Investors, assuming both no exercise and full exercise of the underwriters' option to purchase additional shares of Class A common stock. The information in the table below also includes amounts that will be purchased from the Pre-IPO Investors pursuant to the terms of the 2018 Private Placement….

	Assuming No Option Exercise		Assuming Full Option Exercise	
	# of LLC Units and shares of Class A common stock to be Purchased	Aggregate Purchase Price	# of LLC Units and shares of Class A common stock to be Purchased	Aggregate Purchase Price
David Katzman(a)(d)	8,998,951	$ 198,411,369	11,371,301	$ 251,732,079
Jordan Katzman(b)(d)	7,141,516	157,462,872	9,022,881	199,748,252
Alexander Fenkell(c)	6,521,446	143,790,803	8,239,513	182,405,937
Steven Katzman(d)	663,595	14,500,839	835,397	19,243,857
Susan Greenspon Rammelt	29,964	654,713	37,580	869,245
CD&R SDC Holdings, Inc.	2,275,857	49,727,475	2,996,467	66,021,790
Other(e)	5,990,646	131,941,093	7,460,357	168,323,024
Total	31,621,975	$ 696,489,166	39,963,496	$ 888,344,184

(A300-01; *see* Op. at 6) This is the same chart that Plaintiffs reproduce in part on page 7 of the Opening Brief – which is taken from the pre-IPO Prospectus. (OB at 7)

The Prospectus also set forth the exact price for which SDC would buy each LLC unit from the Founders, disclosing both that SDC would pay "a price per LLC Unit equal to the public offering price per share of Class A common stock in this

offering, less the underwriting discount" and that the public offering price, less the underwriting discount, was "$21.85." (A142; A161; A211; *see* Op. at 6)

C. SDC Commences And Closes The IPO, And Then Completes The Purchases On The Same Terms As The Prospectus Disclosed.

SDC commenced the IPO on September 12, 2019. (A52 ¶ 47; Op. at 10) Plaintiffs bought their SDC stock on the same day. (A41 ¶ 11; Op. at 1) The IPO closed on September 16, 2019. (A52 ¶ 50; Op. at 10)

Also on September 16, 2019, SDC completed the Purchases. (A52-53 ¶ 51; Op. at 11) Plaintiffs concede that the Purchases were undertaken on the same terms as were disclosed in the Prospectus. (*Id.* ("There was no material change in the use of proceeds as described in the Prospectus."); *see* Op. at 11 ("SDC did exactly what it disclosed it would do in the Prospectus.")) Specifically, as it said it would, SDC "us[ed] over $696 million of the [IPO's] proceeds to acquire [LLC] Units and Common Stock from corporate insiders for $21.85." (A52-53 ¶ 51; Op. at 11 (second alteration in original))

D. Plaintiffs File The Action Below And The Court Of Chancery Dismisses With Prejudice.

On November 22, 2019, one of the Plaintiffs filed a derivative lawsuit in the Court of Chancery, purporting to bring claims on behalf of SDC that challenged the Purchases. (A14; *see* Op. at 12) Others followed, and Plaintiffs filed a consolidated complaint (the "Complaint") on April 8, 2020. (A37; Op. at 12) In

the Complaint, Plaintiffs admitted that they did not own SDC stock before September 12, 2019. (A41 ¶ 11; *see* Op. at 1)

The Complaint made two primary claims: *first*, that "[m]embers of the Board breached their fiduciary duties by withholding material adverse information from the stockholders" that purportedly should have been disclosed in the Prospectus; and *second*, that the Board breached its fiduciary duties by "causing the Company to purchase Units … from corporate insiders at a price of $21.85, a grossly inflated price." (A40 ¶ 9; *see* Op. at 12-13) Defendants moved to dismiss, and in doing so argued that "Plaintiffs … lack standing to assert a breach of fiduciary duty based on the alleged wrongdoing because both the Company's decision to effectuate the Purchases and the issuance of the allegedly misleading prospectus occurred ***prior to*** the IPO" in which they became SDC stockholders. (A107) In their answering brief opposing Defendants' motion, Plaintiffs walked back their disclosure claims, conceding the "unremarkable proposition that investors purchasing stock in an IPO lack derivative standing to challenge the disclosures made in the prospectus for that same offering." (A777; *see* A819-20) But the damage was done: having alleged that the Board was aware *prior to the IPO* of material "adverse facts" proving that the "[LLC] Units … were *never* worth the $21.85 per share that the Company paid" (A53; A771), Plaintiffs conceded that

all of the alleged wrongdoing underlying their claims occurred before they became SDC stockholders. (A819-20; *see* Op. at 12-13, 29-33)

On May 28, 2021, the Court of Chancery issued its well-reasoned Opinion. (OB Ex. A) The Opinion held that Plaintiffs' claims, stripped of characterizations and legal argument, challenged the SDC board's pre-IPO conduct but failed to allege any independent wrongdoing that purportedly occurred after Plaintiffs bought SDC stock. (*See* Op. at 29-31) The Court of Chancery explained:

> As in *Beck*, Plaintiffs allege that SDC's Board knew, during the IPO pricing negotiations, that the stock was "*never* worth the $21.85 per share that the Company paid" in the Insider Transactions when it set that price before the IPO. The Board decided before launching the IPO to use the outsized IPO proceeds to repurchase insider equity, knowing the price was excessive. Unlike *Maclary*, *Leung*, and *Nine Systems*, Plaintiffs do not allege the Board made a conscious decision, modified any terms, or delayed in carrying out their disclosed plans to complete the Insider Transactions after the IPO closed and the market price dropped. Plaintiffs do not allege, for example, that the Board learned the price was too high only upon the market's unfavorable response to the IPO. Rather, the Complaint alleges the Board implemented its pre-IPO plan to repurchase pre-IPO investors' equity at the inflated IPO price, which the Prospectus fully disclosed would have a dilutive and negative impact on the public stockholders.… The Complaint's allegations do not give rise to the reasonable inference that the Board "caused" the Insider Transactions after the IPO closed by doing anything other than implementing its set and disclosed plan.

(*Id.*) On that basis, the Court of Chancery correctly found that Plaintiffs lacked standing to maintain their derivative claims and dismissed the Complaint with prejudice. (Op. at 1-2, 31-33)

This appeal followed.

ARGUMENT

I. THE COURT OF CHANCERY PROPERLY HELD THAT THE "TIME OF THE TRANSACTION" OCCURS, FOR PURPOSES OF SECTION 327, WHEN THE CHALLENGED TRANSACTION TERMS ARE ESTABLISHED.

A. Question Presented.

Did the Court of Chancery err in following this Court's precedent, which establishes that when a plaintiff challenges the terms of a transaction, rather than the technicality of its consummation, the plaintiff must prove that he or she was a stockholder at the time that the terms were established in order to satisfy Section 327?

B. Scope Of Review.

The Court "review[s] a decision to grant a motion to dismiss under Rule 12(b)(6) *de novo* to 'determine whether the trial judge erred as a matter of law in formulating or applying legal precepts.'" *Clinton v. Enter. Rent-A-Car Co.*, 977 A.2d 892, 895 (Del. 2009) (citation omitted). However, in doing so the Court does not "simply accept conclusory allegations unsupported by specific facts," nor does it "draw unreasonable inferences in the plaintiff's favor." *Id.*

C. Merits Of Argument.

The Court of Chancery correctly held that Section 327 of the DGCL requires that a plaintiff in a derivative suit be a stockholder of the corporation at the time of

the challenged conduct in order to maintain a derivative suit on the corporation's behalf. 8 *Del. C.* § 327; (*see* Op. at 16-18). Specifically, Section 327 provides:

> In any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law.

8 *Del. C.* § 327; *see also* Ct. Ch. R. 23.1(a) (requiring a derivative plaintiff to allege that he or she was a "shareholder or member at the time of the [wrongdoing] of which the plaintiff complains").

In this case, the Court of Chancery's Opinion correctly stated Delaware law in explaining that "[w]here the plaintiff complains of the transaction's terms, rather than the technicalities of its actual consummation, the 'time of the challenged transaction' is the time when the transaction's terms were established." (Op. at 20) On that basis, the Court of Chancery properly found that Plaintiffs lack standing to pursue their claims because "they purchased their stock in the IPO" but "the Board established the [Purchases'] terms … before the IPO." (Op. at 32; *see id.* at 29-30 ("[T]he Complaint allege[d] the Board implemented its pre-IPO plan to repurchase pre-IPO investors' equity at the inflated IPO price, which the Prospectus fully disclosed would have a dilutive and negative impact on the public stockholders.")).

On appeal, Plaintiffs argue that the Court of Chancery "erred in its analysis because it has long been Delaware law that 'the term 'transaction' … [means] the

wrongful acts which plaintiffs want remedied and which are susceptible to being remedied in a legal tribunal.'" (OB at 10 (alterations in original; citation omitted)) Thus, they say, "the relevant time to evaluate standing pursuant to Section 327 is when 'the transactions … were 'executed' or 'consummated.'" (*Id.* (alterations in original; citation omitted)) Plaintiffs are wrong.

1. *Beck* Provides The Rule For Determining The "Time Of The Transaction."

In the Opinion, the Court of Chancery correctly determined that this Court's *Beck* opinion sets forth the default rule to be applied in determining "the time of the transaction" for purposes of Section 327's contemporaneous ownership requirement. (*See* Op. at 19-21) Accurately summarizing *Beck*, the Vice Chancellor held that "[w]here the plaintiff complains of the transaction's terms, rather than the technicalities of its actual consummation, the 'time of the challenged transaction' is the time when the transaction's terms were established." (Op. at 19-20 (citation omitted)) The Opinion further explained that although "an exception to *Beck*'s general rule" may be "applied sparingly when a plaintiff specifically challenges the mechanics of delayed implementation of a transaction," that exception only applies when the involved board (i) "failed to disclose" the transaction "before the plaintiff became a stockholder"; *and* (ii) "modified" the transaction "after the plaintiff became a stockholder." (Op. at 26-27) Because those circumstances are not present here, the Vice Chancellor correctly applied

Beck's default rule and dismissed the Complaint for lack of standing, and the Opinion should be affirmed.

At issue in *Beck* was a transaction whereby, concurrent with its IPO, Boston Chicken sold shares of its common stock to several of its directors and executive officers at a price equal to the IPO offering price less the underwriter discount (the "Private Placement"). 682 A.2d at 161. Similar to the facts here, Boston Chicken "specified the pricing terms of the IPO and the Private Placement in its Prospectus." *Id.* After Boston Chicken's prospectus was filed and publicly disseminated, plaintiff acquired Boston Chicken stock in the IPO. *Id.* The plaintiff then initiated a derivative action alleging that the board had mispriced the IPO and impermissibly allowed insiders to acquire shares in the Private Placement at a discounted price (*i.e.*, the IPO price minus the underwriter's discount, which was less than half of the market price on the day the IPO commenced). *Id.*; *see 7547 Partners v. Beck*, 1995 WL 106490, at *2 (Del. Ch. Feb. 24, 1995), *aff'd*, 682 A.2d 160 (Del. 1996).

The Court of Chancery in *Beck* dismissed the plaintiff's complaint for lack of standing under Section 327, finding that "any wrongs arising from the pricing of the IPO must have occurred before [the plaintiff] purchased its stock." 682 A.2d at 161. The plaintiff then sought leave to file an amended complaint, but the *Beck* court denied the motion to amend because the proposed amended complaint would

not cure the plaintiff's lack of standing. *7547 Partners v. Beck*, 1995 WL 1799140, at *1 (Del. Ch. Oct. 3, 1995). Of note, the *Beck* court rejected the plaintiff's conclusory allegation that the wrongs occurred at the time the stock was delivered to the directors (*i.e.*, when the private placement at issue was consummated), which took place at the same time that the plaintiff became a Boston Chicken stockholder. *Id.* Rather, the Court of Chancery there explained that "the wrong alleged occurred at the latest when the corporation entered into and disclosed the private placement agreement." *Id.*

On appeal, this Court determined that the date on which Boston Chicken entered into the private placement agreement (which the parties had contested) was irrelevant for purposes of determining standing under Section 327, because the Court of Chancery had correctly determined that since the terms of the challenged private placement had been disclosed in the pre-IPO prospectus, it was obvious that those terms had been established before the plaintiff bought its stock. *Beck*, 682 A.2d at 163. Specifically, this Court held:

> Partners argues that the Court of Chancery ignored *Santa Fe* by using the Prospectus to establish a hotly contested fact—that the Private Placement Agreement was executed before the Prospectus was issued. The problem with this argument is that it is founded on an inaccurate premise. The trial court made no findings about the date on which an agreement was signed. The court ruled that the wrongs alleged in the Amended Complaint occurred at the time the decision was made to sell the directors stock at $18.60 per share in the Private Placement. The Court of Chancery deduced that the wrongful decision must have been made prior to the date on which the Prospectus was issued, since the

> fact that there would be a Private Placement and the terms thereof were disclosed in the Prospectus. This is the sort of uncontestable fact that may be considered at the pleading stage even if not admitted by the plaintiff.

Id. Ultimately, this Court agreed with the Court of Chancery that because the plaintiff challenged "'the terms of the [Private Placement] rather than the technicality of its consummation,'" the plaintiff was required to "establish that it was a stockholder of Boston Chicken at the time the terms of the Private Placement were established." *Id.* (alteration in original; citation omitted). Because the plaintiff could not possibly do so in light of the fact that the terms at issue were disclosed in the pre-IPO prospectus, this Court affirmed the decision below. *Id.*

The Opinion here accurately summarized *Beck*'s applicable facts and holding, carefully considered and distinguished other precedent and correctly determined that *Beck* mandated dismissal here. (*See* Op. at 19-33)

On appeal, Plaintiffs completely mischaracterize *Beck*, and on that basis falsely argue that Delaware law requires a "binding agreement" before the "time of the transaction" under Section 327 can attach. Specifically, the Opening Brief argues as follows:

> In *7547 Partners v. Beck*, this Court applied the same definition of "transaction" for the purposes of Section 327 as had been adopted in *Newkirk* and *Lavine*.[3] 682 A.2d at 162 (quoting *Newkirk, supra).* Specifically, in *Beck,* this Court found that the plaintiff lacked standing

[3] This assertion is false, as explained *infra* Argument § I.C.2.

> because the transaction, which consisted of a ***binding agreement*** in a private placement between the defendants, on the one hand, and the corporation, on the other hand, "was ***completed*** with the approval of the allegedly misleading Registration Statement, which went into effect ***the day before the IPO***[.]"

(OB at 11 (citation omitted))

As an initial matter, the emphasized quote appears nowhere in any of the *Beck* opinions. Rather, it is from *In re Facebook, Inc., IPO Securities & Derivative Litigation*, a federal case that correctly explained that in *Beck* "[t]he Court emphasized that … the transaction for which the plaintiff sought a remedy took place at the time of the terms, rather than at the execution of the sale." 922 F. Supp. 2d 445, 464 (S.D.N.Y. 2013), *aff'd sub nom. In re Facebook, Inc., Initial Pub. Offering Derivative Litig.*, 797 F.3d 148 (2d Cir. 2015).

Moreover, neither *Beck* nor *Facebook* held that the existence of a purported "binding agreement" is of any relevance to a Section 327 standing analysis. In *Beck*, this Court in fact *rejected* that argument. *See* 682 A.2d at 163; (Op. at 31 (rejecting Plaintiffs' argument that Section 327 confers standing because terms of Purchases were "subject to change," as that "does not change the fact that the pricing of those transactions – which is Plaintiffs' principal complaint – was set" before IPO commenced)). And in *Facebook*, the federal court found that the time of the transaction for purposes of Section 327 was the date on which Facebook publicly disclosed the terms of the IPO – that is, "the approval of the …

Registration Statement, which went into effect the day before the IPO." 922 F. Supp. 2d at 465-66. That is exactly what happened here when the Prospectus was approved by the SEC and issued before Plaintiffs became SDC stockholders.

2. None Of Plaintiffs' Lower-Court Authority Contradicts Or Alters *Beck*'s Default Rule.

In addition to mischaracterizing this Court's decision in *Beck*, Plaintiffs also point to and mischaracterize a number of Court of Chancery opinions. But the Court of Chancery here correctly determined that none of those opinions render the *Beck* rule inapplicable here or supersede this Court's binding precedent. (*See* Op. at 21-33)

First, Plaintiffs say that *Newkirk v. W. J. Rainey, Inc.* – a Court of Chancery opinion issued 46 years before *Beck* (and before Section 327 was even adopted) – establishes that "[t]he relevant time to evaluate standing pursuant to Section 327 is when 'the transactions … were 'executed' or 'consummated.'"" (OB at 10 (citation omitted)) Plaintiffs misstate *Newkirk*'s holding. In fact, in that case the Court of Chancery was describing how *states other than Delaware* harmonize the general contemporaneous ownership requirement and the "continuing wrong" exception. *Newkirk v. W. J. Rainey, Inc.*, 76 A.2d 121, 123 (Del. Ch. 1950) ("In states where such a statute exists and the rule is recognized, there is no inconsistency in application because those courts do not permit a stockholder to attack transactions which were 'executed' or 'consummated' prior to the date he

acquired his stock."). The *Newkirk* court, however, rejected plaintiffs' continuing wrong theory, finding that "allegation[s] of a conspiracy cannot obscure the hard fact that the stock purchases [which occurred before plaintiffs bought their stock] are the wrongs which plaintiffs want rectified." *Id.* at 123 ("Those wrongful acts cannot by the specious device of employing appropriate language be transferred into continuing wrongs for the purpose of overriding Sec. 51A of the General Corporation Law of Delaware."). Nothing about *Newkirk* establishes a general "execution" or "consummation" benchmark for purposes of Section 327, as the Court of Chancery correctly explained. (*See* Op. at 20 n.60 (noting that in *Newkirk* "the wrongful act occurred when the defendants diverted three corporate opportunities to purchase stock, not when the merger was subsequently consummated"))

Second, Plaintiffs argue that *Lavine v. Gulf Coast Leaseholds, Inc.* is of relevance here, because in that case the Court of Chancery held that an allegedly illegal exchange of stock was "legally completed" for purposes of Section 327 upon stockholder approval (which approval occurred after the plaintiff became a stockholder). 122 A.2d 550, 552 (Del. Ch. 1956). As later cases explained, however, *Lavine* represents a narrow application of the continuing wrong doctrine applicable only in the case of a transaction subject to stockholder approval. *See Kaufman v. Albin*, 447 A.2d 761, 764 (Del. Ch. 1982) ("In *Lavine v. Gulf Coast*

Leaseholds … it was held that where exchanges of stock are contingent upon shareholder approval, the transaction is not completed until the shareholder vote takes place."); *Levien v. Sinclair Oil Corp.*, 261 A.2d 911, 923 (Del. Ch. 1969) (distinguishing *Lavine* because there "the Court found as a fact that the exchange offer specifically required stockholder approval and that was not given until after plaintiff acquired his shares"), *aff'd in part, rev'd in part*, 280 A.2d 717 (Del. 1971); *Desimone v. Barrows*, 924 A.2d 908, 924-25 (Del. Ch. 2007) (citing *Lavine* for the proposition that "the continuing wrong doctrine, as applied to § 327" is "a narrow one that typically is applied only in unusual situations"). As this case does not involve a stock exchange contingent upon stockholder approval,[4] *Lavine* is irrelevant.

Third, Plaintiffs allege that *Leung v. Schuler* is "on point" because it held that "the critical time for determining standing under Section 327 is when the transaction complained of is completed." (OB at 12 (citation omitted)) *Leung* is

[4] Delaware courts have further cabined *Lavine*'s narrow application of the continuing wrong exception by deeming it inapplicable in the analogous context of a merger requiring stockholder approval. *See, e.g.*, *Brown v. Automated Mktg. Sys., Inc.*, 1982 WL 8782, at *2 (Del. Ch. Mar. 22, 1982) (when unfairness is alleged, "it is not the merger itself that constitutes the wrongful act of which plaintiff complains, but rather it is the fixing of the terms of the transaction which will be finalized by the consummation of the merger which provides the foundation for the suit"); (*see also* Op. at 20 n.60 (explaining same))

not on point. Indeed, it expressly distinguishes the situation at play here, as explained in the Opinion. (*See* Op. at 23-25 (explaining that *Leung* represents a "narrow exception" to *Beck* and noting that "the *Leung* court distinguished *Beck*" on grounds not applicable here)) In *Leung*, the "transaction" at issue was only completed upon the issuance of stock to certain insiders, because the plaintiff challenged the issuance itself (rather than its terms). *Leung v. Schuler*, 2000 WL 264328, at *8 (Del. Ch. Feb. 29, 2000). Specifically, the *Leung* plaintiff alleged that the stock issuance violated positive law (specifically, Sections 152 and 153 of the DGCL), was wasteful and was made in bad faith. *Id.* By contrast, the *Leung* court explained that "[i]n *Beck*, the alleged wrong was the board's decision to fix a below-market price for the stock being offered in the IPO. Once that price was fixed, the transaction was completed, and there was nothing further for the board to do." *Id.* That is exactly what the Court of Chancery correctly held below here. (Op. at 29-31) Thus, by its own terms, *Leung* is inapplicable.

Fourth, plaintiffs say that *Maclary v. Pleasant Hills, Inc.* (another Chancery opinion from the 1950s) is a "special case." (OB at 12) Indeed. That is why this Court expressly cabined it in *Beck*, as did the Court of Chancery in the Opinion below. 682 A.2d at 162 (finding that *Maclary* "was a special case in which a rule was crafted to meet unusual circumstances"); (Op. at 22 ("[I]n *Beck*, the Delaware Supreme Court echoed the trial court's conclusion that *Maclary* 'was a special case

in which a rule was crafted to meet unusual circumstances.'") (citation omitted)); *see Facebook*, 922 F. Supp. 2d at 465 ("[T]he *Beck* Court confined *Maclary* to the 'facts of that case,' in which plaintiffs were seeking cancellation of the stock and alleging that the issuance of the shares was unlawful."). But contrary to what Plaintiffs claim, *Maclary* was not unique because "a disputed share issuance … t[ook] place prior to the plaintiff becoming a shareholder of the company." (OB at 12) Rather, it was unique because the share issuance in question, albeit authorized, was not executed until years later, and in the interim, the company's stockholders appear not to have known about it.[5] *Maclary v. Pleasant Hills, Inc.*, 109 A.2d 830, 833 (Del. Ch. 1954). Thus, the *Maclary* court deemed the transaction to have occurred upon issuance of the shares in question, because doing so would avoid perverse incentives. *Id.* ("[W]hile the statute should be construed so as to reasonably effectuate its primary purpose – to discourage a type of strike suit – it should not be construed so as to unduly encourage the camouflaging of transactions and thus prevent reasonable opportunities to rectify corporate

[5] Plaintiffs say that "the defendants in *Maclary* failed to issue the relevant stock certificates at the same time as the transaction was authorized, which was the way matters were handled in the 1940s." (OB at 13) That assertion is ambiguous at best – Plaintiffs might mean that stock issuances were routinely delayed in the 1940s, or that the usual practice was to issue stock immediately upon authorization. Either way, what Plaintiffs think about how corporate boards "handled matters" eight decades ago is completely irrelevant here.

aberrations."). In any event, as the *Beck* court and the Court of Chancery here correctly found, the special rule in *Maclary* does not apply. (Op. at 27-33)

Fifth, Plaintiffs say that *In re Nine Systems Corp. Shareholders Litigation* "constitutes an even stronger statement and application of [the] principal [sic] of law" they advocate (namely, "that the plaintiffs had standing to sue derivatively where they purchased stock prior to the time that the transaction with respect to which they were complaining became legally binding"). (OB at 13) It does not, as the Court of Chancery correctly explained. (*See* Op. at 26) *Nine Systems* cited *Beck* and explained that "[a]s a general matter, when the terms of a transaction are established – not when the transaction is carried out – is the proper time for assessing whether a breach of fiduciary duty occurred." *In re Nine Sys. Corp. S'holders Litig.*, 2013 WL 771897, at *7 (Del. Ch. Feb. 28, 2013). But the *Nine Systems* court declined to grant summary judgment as to the plaintiffs' standing not because the transaction at issue became "legally binding" after they became stockholders (as Plaintiffs say; *see* OB at 13), but rather because whether or not the terms of the transaction at issue were, in fact, set before plaintiffs bought their stock was not clear from the record. *Nine Sys.*, 2013 WL 771897, at *7 ("[Plaintiffs] were owed fiduciary duties no later than the end of May, but this is not a matter where events occurring after that date were simply a matter of implementing a transaction with previously fixed terms. … Perhaps the changes

were not material, but that is an analysis that should be assisted by a trial record."); (*see* Op. at 26 (distinguishing *Nine Systems*)). Here, of course, no one disputes that the terms announced in the Prospectus were the same as those that ultimately governed the Purchases.

In short, the Opinion correctly recognized that *Beck* is the governing, default standard to be applied in determining "the time of the transaction" for purposes of Section 327. None of Plaintiffs' cited cases – all of which are from lower courts, and all of which are easily distinguishable (and were distinguished in the Opinion below) – demonstrate otherwise.[6] And none of them establish, or even suggest, that a transaction must be "final and binding" in order to satisfy the statute. The Court of Chancery did not err, and the Opinion should be affirmed.

[6] Plaintiffs say that merger cases such as *In re Beatrice Companies Litigation*, cited by the Court of Chancery, are "consistent with a 'transaction' under Section 327 requiring a binding legal agreement because a merger agreement is precisely such a binding legal agreement." (OB at 15 n.4) That is not true. As *Beatrice* explains, the time that matters even in the case of a merger is "the time the terms … were agreed upon." *In re Beatrice Cos. Litig.*, 522 A.2d 865, 1987 WL 36708, at *3 (Del. 1987) (TABLE). *Beatrice* does not suggest that the terms of a merger cannot be "agreed upon" before a merger agreement is formally signed. *See id.* And even if it did, a merger agreement in no way obligates the closing of the contemplated transaction (as Plaintiffs purport to require for purposes of Section 327), as any number of closing conditions or eventualities could occur that would excuse the parties from closing.

II. DISCLAIMERS IN THE PROSPECTUS ARE IRRELEVANT BECAUSE THE PURCHASES WERE ACCOMPLISHED ON THE TERMS DISCLOSED THEREIN.

A. Question Presented.

Did the Court of Chancery err in determining that, notwithstanding boilerplate disclaimers provided in every SEC filing, the Prospectus disclosed the same terms on which the Purchases were ultimately accomplished, thereby establishing the "time of the transaction" for purposes of Section 327?

B. Scope Of Review.

The Court "review[s] a decision to grant a motion to dismiss under Rule 12(b)(6) *de novo* to 'determine whether the trial judge erred as a matter of law in formulating or applying legal precepts.'" *Clinton*, 977 A.2d at 895 (citation omitted). However, in doing so the Court does not "simply accept conclusory allegations unsupported by specific facts," nor does it "draw unreasonable inferences in the plaintiff's favor." *Id.*

C. Merits Of Argument.

In dismissing Plaintiffs' claims, the Court of Chancery correctly concluded that, although the Prospectus contains appropriate disclaimers designed to ensure

the protections of the PSLRA's safe harbor for forward-looking statements,[7] those disclaimers and related caveating language are irrelevant here because the Purchases were, in fact, accomplished on the same terms announced in the Prospectus. (*See* Op. at 31)

Plaintiffs now say that the Prospectus's disclaimers and caveating statements regarding SDC's "intent" establish that the Purchases were "not mandatory" before Plaintiffs became SDC stockholders. (OB at 17-18) This argument is merely a rehash of Plaintiffs' first appeal point, which argues, unsuccessfully, that for purposes of Section 327 a "transaction" only occurs when the involved corporation enters into a "binding and legally enforceable agreement." (OB at 15; *cf.* OB at 17 ("There not having been a binding contract to proceed with the Insider Transactions is further evidenced by, as Plaintiffs have alleged, the Prospectus repeatedly stating that the Company 'intends' to purchase the LLC Units in the Insider Transactions with the proceeds of the IPO….")) It fails for the same

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[7] "Wishing to encourage responsible forward-looking disclosure, Congress created a safe harbor for projections and other forward-looking statements in the Private Securities Litigation Reform Act of 1995. In general, that safe harbor insulates an issuer of securities for liability for a forward-looking statement if it: a) was accompanied by meaningful cautionary language, b) was immaterial, or c) was made without scienter." *In re Oracle Corp., Derivative Litig.*, 867 A.2d 904, 935 (Del. Ch. 2004), *aff'd*, 872 A.2d 960 (Del. 2005) (TABLE); (*see* Op. at 8 (describing Prospectus's cautionary statements as "customary"); *id.* at 31 (explaining that it was "necessary" for the Prospectus to use the word "'intends' to describe future transactions")).

reasons. (*See supra* Argument § I.C) The Court of Chancery correctly explained that, under *Beck*, it does not matter when a transaction becomes certain to occur; what matters is when its terms become definite. *Beck*, 682 A.2d at 163 (rejecting argument that transaction occurred at the time contract was signed for purposes of Section 327 and instead finding that time of the transaction was when "the decision was made to sell the directors stock at $18.60 per share in the Private Placement"); (*see* Op. at 29-32).[8]

[8] Plaintiffs' own authority confirms that the establishment of material terms of the transaction at issue triggers Section 327, not the formalities surrounding its adoption and eventual consummation. *See Nine Sys*, 2013 WL 771897, at *7 (finding "an informal process" irrelevant to standing but setting Section 327 issue for trial in order to determine whether "material" changes to transaction terms were made after plaintiffs bought stock). The Court of Chancery correctly recognized this in the Opinion. (*See* Op. at 26 (explaining that in *Nine Systems* "[t]he board formally reviewed and approved the dilutive transaction's terms before the plaintiffs became stockholders, but modified those terms after the plaintiffs became stockholders. That the board did so informally did not matter")).

III. THE COURT OF CHANCERY DID NOT ERRONEOUSLY INTERPRET OR DRAW INAPPROPRIATE INFERENCES FROM THE COMPLAINT.

A. Question Presented.

Did the Court of Chancery err by inferring, as expressly permitted by *Beck*, that the purportedly wrongful price at which the Purchases were accomplished must have been established before Plaintiffs became SDC stockholders because it was publicly disclosed in the Prospectus?

B. Scope Of Review.

The Court "review[s] a decision to grant a motion to dismiss under Rule 12(b)(6) *de novo* to 'determine whether the trial judge erred as a matter of law in formulating or applying legal precepts.'" *Clinton*, 977 A.2d at 895 (citation omitted). However, in doing so the Court does not "simply accept conclusory allegations unsupported by specific facts," nor does it "draw unreasonable inferences in the plaintiff's favor." *Id.*

C. Merits Of Argument.

In issuing the Opinion, the Court of Chancery correctly drew all relevant facts from the Complaint and documents attached and integral thereto and made all reasonable inferences in Plaintiffs' favor. (Op. at 2 n.1) In addition, as expressly required by this Court's opinion in *Beck*, the Vice Chancellor found as a matter of "uncontestable fact" that the wrongful decision Plaintiffs sought to challenge – specifically, the decision to pay $21.85 per LLC Unit in the Purchases – must have

been made before Plaintiffs became SDC stockholders, because those transactions and that price were explained in the pre-IPO Prospectus. 682 A.2d at 163; (*see* Op. at 31-33). In doing so, the Court of Chancery acted properly in all respects.

Plaintiffs now argue that the Court of Chancery erred by making numerous purported factual findings supposedly unsupported by the pleadings or evidence, and by allegedly drawing inferences against them. Plaintiffs are wrong, and the Court of Chancery did not err. At most, Plaintiffs themselves pled away any claim they might otherwise have had. But that is nobody's fault but their own. *See Acker v. Transurgical, Inc.*, 2004 WL 1230945, at *4 n.30 (Del. Ch. Apr. 22, 2004) ("If a plaintiff chooses to plead particulars, and they show he has no claim, then he is out of luck – he has pleaded himself out of court.") (internal quotation marks and citation omitted).

First, Plaintiffs say that the Court of Chancery determined, as a matter of fact, that "the Board approved the $21.85 price for each LLC Unit *prior* to the IPO." (OB at 20; *see* Op. at 31-32) Of course it did.[9] *Beck* instructed it to. *See*

[9] Plaintiffs argue that the post-IPO disclosure of certain information is somehow relevant here (*see* OB at 1), but their allegations in this regard – that Board was aware *prior to the IPO* of material "adverse facts" proving that the "[LLC] Units … were *never* worth the $21.85 per share that the Company paid" (A53; A771) – actually demonstrates only that all of the alleged wrongdoing underlying Plaintiffs' claims occurred before they became SDC stockholders. (A819-20; *see* Op. at 12-13, 29-33)

682 A.2d at 163 ("The Court of Chancery deduced that the wrongful decision must have been made prior to the date on which the Prospectus was issued, since the fact that there would be a Private Placement and the terms thereof were disclosed in the Prospectus. This is the sort of uncontestable fact that may be considered at the pleading stage even if not admitted by the plaintiff."). Plaintiffs also say that "there exists no record evidence that final Board approval to proceed with the Insider Transactions took place before the IPO," but the Court of Chancery did not make that factual determination (and, in any event, Plaintiffs did not plead the opposite[10]). (OB at 20 (emphasis omitted); *cf.* Op. at 31) And the Vice Chancellor did not need to, as only the establishment of material terms of a transaction is required to set "the time of the transaction" for purposes of Section 327. (*See supra* Argument § I.C)

Second, Plaintiffs allege that the Court of Chancery found as a matter of fact that "the only contingency relating to the Insider Transactions was that they were 'dependent on raising capital.'" (OB at 20 (citation omitted)) It did not. Rather, the Vice Chancellor explained that uncertainty as to whether the Purchases would actually close (and any other uncertainty that may exist) is irrelevant, because any

[10] One of the Plaintiffs initially sought to inspect books and records, but then dropped its Section 220 demand. (*See* A100-01) Thus, any lack of evidence that could have supported a sufficient pleading (which evidence, in any event, does not exist) is Plaintiffs' own fault.

such uncertainty or contingency "does not change the fact that the pricing of those transactions – which is Plaintiffs' principal complaint – was set." (Op. at 31) The Court of Chancery was correct in so holding. (*See supra* Argument § I.C) In any event, Plaintiffs themselves alleged that the Purchases occurred "immediately" after the IPO closed. (Op. at 11 (citing Compl. ¶ 5)) Given that fact, one cannot infer that any material contingencies existed because there would have been no time to resolve them.

Third, Plaintiffs say that "the Court of Chancery ignored well pleaded facts and misconstrued the gravamen of Plaintiffs' claims," because "Plaintiffs did not take issue with the consummation of a transaction the terms of which had been set before the IPO." (OB at 21) That is an odd concession, as it demonstrates that dismissal was appropriate. *See Beck*, 682 A.2d at 163 (because the plaintiff challenged "'the terms of the [Private Placement] rather than the technicality of its consummation,'" the plaintiff was required to "establish that it was a stockholder of Boston Chicken at the time the terms of the Private Placement were established") (alteration in original; citation omitted). Regardless, Plaintiffs' own authority establishes that they may not avoid the application of Section 327 by artful pleading, because at base the Complaint alleges that the Purchases were undertaken at an unfair price. *See Newkirk*, 76 A.2d at 123-24 ("[T]he specious device of employing appropriate language" in a complaint "cannot obscure the

hard fact that the stock purchases are the wrongs which plaintiffs want rectified."). The Court of Chancery correctly applied controlling Delaware law to determine that Plaintiffs in this action attempted to challenge transaction terms set before they became SDC stockholders, and thus lacked standing to maintain their derivative claims. (*See* Op. at 30-31 (rejecting Plaintiffs' "attempt to hang their claim on the mechanics of the post-IPO consummation by alleging the Board 'caus[ed]' the Company to pursue the Insider Transactions at the inflated IPO price after the IPO closed and the stock price continued to drop," because "[t]he Complaint's allegations do not give rise to the reasonable inference that the Board 'caused' the Insider Transactions after the IPO closed by doing anything other than implementing its set and disclosed plan") (first alteration in original))

Fourth, Plaintiffs argue that even if the Court of Chancery correctly determined the facts of this case, "they still do not add up to the binding agreement necessary to constitute a 'transaction' within the meaning of Section 327." (OB at 21; *see id* at 22-23 (arguing that, absent a legally binding contract governing the Purchases, Defendants owed fiduciary duties)) Section 327 does not require a "binding agreement." (*See supra* Argument §§ I.C, II.C)

IV. THE STATUTORY PURPOSE OF SECTION 327 IS BEST SERVED BY AFFIRMING THE OPINION.

A. Question Presented.

Should Plaintiffs, who bought their SDC stock with full knowledge of the terms of the Purchases, be permitted to pursue derivative claims alleging that those terms were unfair to SDC on policy or statutory-purpose grounds?

B. Scope Of Review.

Plaintiffs failed to raise this argument below; accordingly it is waived and should not be considered on appeal. *See Aikens*, 2016 WL 4527578, at *3 (waiver below waives issue on appeal); Del. Sup. Ct. R. 8. Plaintiffs say that they mentioned it at oral argument in the Court of Chancery (*see* OB at 24), but in fact they disclaimed it. (A943 ("I will point out that, you know, we're deciding the case before us and not a broad issue of Delaware policy.")) And even if Plaintiffs' oblique reference to policy at oral argument could be construed as a contention of law or fact, general or cursory arguments are insufficient to preserve specific issues for appeal. *See* Del. Sup. Ct. R. 8 ("Only questions fairly presented to the trial court may be presented for review…."); *see also Roca v. E.I. du Pont de Nemours & Co.*, 842 A.2d 1238, 1242 (Del. 2004) ("'[C]asual mention of an issue in a brief is cursory treatment insufficient to preserve the issue for appeal.'") (citation omitted).

If Plaintiffs did adequately preserve this issue for appeal, it will be reviewed *de novo*. *See Clinton*, 977 A.2d at 895.

C. Merits Of Argument.

Plaintiffs say that "*Newkirk* held that in close cases the Court should look to whether allowing standing to sue is consistent with the statutory purposes of Section 327." (OB at 24) *Newkirk* did not so hold. Instead, it held that the "continuing wrong" exception to the predecessor statute to Section 327 should not be construed broadly so as to defeat the policy of that statute, which is "the prevention of the evil of purchasing stock in order to maintain a derivative action designed to attack a transaction which occurred prior to the purchase of the stock." *Newkirk*, 76 A.2d at 123.

Nor did *Beck* "call[] into question the importance of the plaintiff having pure motives" (OB at 24), because "motives" have never mattered for purposes of Section 327. *See Beck*, 682 A.2d at 163. Standing is determined at the pleadings stage, and a plaintiff will of course never allege that he or she bought a claim. That is why the purposes for which the statute was enacted are relevant to the extent that *the statute itself* must be interpreted, but not to whether *any particular plaintiff* should be granted standing to sue. *See Maclary*, 109 A.2d at 833. ("[T]he statute should be construed so as to reasonably effectuate its primary purpose – to discourage a type of strike suit.").

To the extent that any interpretation of Section 327 is necessary here, its statutory purpose and policy suggest that the Opinion should be affirmed. Plaintiffs chose to participate in an IPO pursuant to a prospectus that clearly and repeatedly explained the terms of the Purchases and "fully disclosed" that the Purchases would have a "dilutive and negative impact on the public stockholders." (Op. at 29-30) After Plaintiffs became stockholders – again, with full knowledge of what was to come – the Purchases closed on the exact same terms that were advertised. The Opinion strongly suggests that Plaintiffs knew exactly what they were doing. (*See* Op. at 32-33 ("In view of the Prospectus's thorough disclosures about the Company's plans to complete the Insider Transactions at the IPO price, 'it would seem to follow that plaintiff would be barred from suing by reason of its knowledge of the alleged wrong when it purchased the stock.'") (citing *Beck*, 1995 WL 106490, at *3)) But whether or not these specific Plaintiffs bought SDC shares in hopes of litigating claims regarding the Purchases is ultimately irrelevant, because the deterrent effect of a dismissal and affirmance is essential to reinforcing the policy behind Section 327 given the facts and timeline here. To reverse the Opinion would only open the floodgates to claim buying, in contravention of Section 327.

CONCLUSION

For all of the foregoing reasons, the Opinion below should be affirmed.

Respectfully submitted,

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