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IN THE SUPREME COURT OF THE STATE OF DELAWARE

GILA DWECK, SUCCESS APPAREL, LLC and PREMIUM APPAREL BRANDS LLC, Plaintiffs/Counterclaim Defendants Below, Appellants/Cross-Appellees, v. ALBERT NASSER and KIDS INTERNATIONAL CORPORATION, Defendants/Counterclaim Plaintiffs Below, Appellees/Cross-Appellants, v. KEVIN TAXIN and BRUCE FINE, Third-Party Defendants Below, Appellants/Cross-Appellees.	No. 65, 2013 COURT BELOW: COURT OF CHANCERY OF THE STATE OF DELAWARE, CONS. C.A. NO. 1353-VCL

CROSS-APPELLANTS' REPLY BRIEF

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PRELIMINARY STATEMENT

Appellants' answer to Kids' cross-appeal ("Appellants' Ans. Br.") continues a pattern established in their opening brief. It once again attempts to recharacterize the proceeding below as one about misconduct on the part of Nasser and a damages award in favor of Nasser,[1] when, in fact, Appellants' misconduct and the resulting damages award in favor of Kids were at the heart of the case. And it continues to run from the Court of Chancery's extensive factual findings about Appellants' "striking breaches" of their duty of loyalty to Kids, Op. 46, focusing instead on "facts" that the Court of Chancery never found. Specifically, Appellants' arguments do not acknowledge, but instead directly contradict, the Court of Chancery's factual findings concerning:

- Appellants' egregious misconduct while still employed by Kids, *see, e.g.*, Appellants' Ans. Br. 22 (suggesting that Dweck and Taxin merely made reasonable preparations to compete with Kids while employed there, despite the Court of Chancery's factual findings that Dweck and Taxin's conduct while employed by Kids was "not competition at all" but rather "conversion and theft," Op. 30);

- the illegitimate manner in which Appellants departed Kids, *see, e.g.*, Appellants' Ans. Br. 24-26 (arguing that the conduct found by the Court of Chancery to constitute a breach of Appellants' fiduciary duties, *see* Op. 1, 19-21, 33-37, was not "malfeasance");

- the "crippl[ing]" effect, Op. 1, that Appellants' malfeasance had on Kids, *see, e.g.*, Appellants' Ans. Br. 24-26 (arguing that Appellants did not destroy Kids, despite the Court of Chancery's express factual finding to the contrary, Op. 19-21); and

[1] Indeed, the Court need look no further than the cover pages of Appellants' briefs—where Appellants claim that Kids is merely a "nominal defendant," even though Appellants "named Kids as a defendant, not simply a nominal defendant," below, Op. 45—for an example of Appellants' diversion tactic.

- the efforts made by Nasser and Djemal to revive Kids from the decimated state in which Appellants left it, *see, e.g.*, Appellants' Ans. Br. 26-27 (arguing that Nasser's malfeasance destroyed Kids, despite the Court of Chancery's factual findings regarding the propriety of Nasser's appointment of Djemal as CEO and Nasser's and Djemal's efforts to revive Kids, Op. 44-45).

These factual findings are fundamental to Kids' challenges to the damages award against Appellants. When appropriately considered, they establish the propriety of an award of valuation damages and attorneys' fees. Only this remedy would make Kids whole for the damage caused by Appellants' distressing breaches of fiduciary duty and hold them properly accountable for their serious misconduct.

By contrast, the damage award against Nasser improperly wrenched away profit distributions to which he was entitled under the parties' long-standing profit-sharing agreement. In arguing otherwise, Appellants elevate form over substance. Because the evidence and the Court of Chancery's own findings do not support either the Court of Chancery's characterization of the payments as consulting fees or its determination that the payments were not entirely fair, the Court should reverse the portion of the judgment ordering the return of $3.8 million in profit distributions. Alternatively, that portion of the judgment should be reversed because Dweck did not timely seek the return of those payments, and the Court of Chancery abused its discretion in allowing Appellants to pursue them through a belated amended complaint. Finally, the Court should reverse the Court of Chancery's order requiring Nasser to pay $2.4 million in accounted for expenses because it held Nasser to an unreasonably high standard and there was no evidence that the funds were misappropriated.

ARGUMENT

I. THE COURT OF CHANCERY'S DAMAGES AWARD AGAINST APPELLANTS FAILED TO ADEQUATELY COMPENSATE KIDS.

A. The Court of Chancery abused its discretion by refusing to award Kids its valuation damages.

As an initial matter, Appellants implicitly concede that, under Delaware law, valuation damages are the appropriate measure of relief where a defendant's misconduct causes the total destruction of a plaintiff's business.[2] *See Zaleski v. Mart Assocs.*, 1988 WL 77779, at *1 (Del. Super. Ct. July 25, 1988); *Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 902-05 (Del. Ch. 1999). They instead argue that this case is factually distinguishable from other Delaware cases awarding valuation damages. *See, e.g.*, Appellants' Ans. Br. 21 n.9 (suggesting *Zaleski* and valuation damages only apply where a wrongdoer physically destroys the business, such as destruction by fire). These cases, however, are not and cannot be limited to *the means* by which the defendant destroyed the plaintiff's business. Rather, they stand for the general principle that, where a defendant's misconduct destroys a plaintiff's business, "the proper measure of damages . . . is *not lost profits*, but the difference between the value of the business before and after the defendant's wrongful acts." *Zaleski*, 1988 WL 77779, at *1 (emphasis added); *see also Boyer*, 754 A.2d at 902-05.[3] This measure of damages furthers

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[2] Appellants made the same concession below, arguing that valuation damages are "recoverable [only] if [they] committed tortious acts which rendered Kids valueless and incapable of operating," B110-11, which is what the Court of Chancery found here. *See* Op. 1 (Appellants "crippled" Kids); Op. 19 (Appellants "destroy[ed] Kids' business").

[3] But even if these cases could be limited to their facts, this case mirrors *Boyer*, where the defendants' misconduct, in Appellants' own words, rendered the business "incapable of resuming operations," *see* Appellants' Ans. Br. 21 (citing *Boyer*, 754 A.2d at 893-94, 899); Op.

general principles of Delaware remedies law, *see* Kids' Br. 39-40, and it is consistent with the law of other jurisdictions, *id.* 39 (identifying cases).[4]

Unable to dispute that valuation damages are the appropriate measure of relief for the destruction of a business, Appellants instead argue that (1) Kids had no value apart from Dweck and Taxin, who had the right to leave and compete with Kids at any time, and (2) Nasser's conduct, rather than Appellants' gross breaches of fiduciary duty, caused Kids' destruction. *See* Appellants' Ans. Br. 21. Both arguments are meritless.

1. Dweck and Taxin's right to leave and compete does not preclude Kids, a well-established and long-profitable business, from recovering its valuation damages.

Appellants first argue that because Dweck and Taxin had the theoretical ability to properly leave the company and compete, Kids is not entitled to its valuation damages. *See* Appellants' Ans. Br. 22; Op. 35-37. But both the Court of

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21-22 (finding that, due to Appellants' wrongdoing, Kids "had to start over from scratch," "immediately encountered difficulties," and Nasser and Djemal "fail[ed] for over a year to restart Kids' business"); *infra* Part I.A.2, and thus, entitled the plaintiff to damages equal to his pro rata share in the company's going-concern value. *See Boyer*, 754 A.2d at 902-05.

4 Appellants fail to even address, much less distinguish, this extra-jurisdictional case law, which consistently holds that where a plaintiff's business is destroyed by a defendant's misconduct, the plaintiff is entitled to recover valuation damages. *See also Mattingly, Inc. v. Beatrice Foods Co.*, 835 F.2d 1547, 1559 (10th Cir. 1987) ("The proper measure of recovery for the destruction of a business is the difference between the market value of the business before and after the injury.") (internal quotation marks, emphasis, and alterations omitted), *vacated on other grounds*, 852 F.2d 516 (10th Cir. 1988); *Aetna Life & Cas. Co. v. Little*, 384 So. 2d 213, 216 (Fla. Dist. Ct. App. 1980) (recognizing that where a "business is totally destroyed," "the proper total measure of damages [is] the market value on the date of the loss"); *Taylor v. B. Heller & Co.*, 364 F.2d 608, 612 (6th Cir. 1966) ("Ohio . . . recognizes the action for damages for destruction of a business as measured by the difference between the value of the business before and after the injury or destruction."); *accord C.A. May Marine Supply Co. v. Brunswick Corp.*, 649 F.2d 1049, 1053 (5th Cir. July 1981) (rejecting valuation damages "because the business was not totally or almost totally destroyed" by the wrongdoing).

Chancery's observation of this point and Appellants' argument wholly ignore the manner in which Dweck and Taxin *actually left*—*i.e.*, after they usurped Kids' corporate opportunities, diverted all of Kids' existing orders and customers to Success, and stole Kids' suppliers, manufacturing facilities, and nearly all of its employees. Op. 19-21. Contrary to Appellants' suggestion, these actions do not constitute the kind of "reasonable preparations to compete while still employed and to compete thereafter" that are permissible under Delaware law.[5] *See* Appellants' Ans. Br. 22 (citing *Sci. Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957, 965 (Del. 1980)). Far to the contrary, and as the Court of Chancery found, they constitute textbook examples of fiduciary breaches that "destroyed Kids' business."[6] Op. 19-21.

The Court of Chancery, therefore, erred as a matter of law in determining that Dweck and Taxin's theoretical ability to leave and compete legitimately justified lost profits, as opposed to valuation damages, as the appropriate remedy.

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[5] Appellants also argue that Dweck and Taxin were not prohibited from "orchestrating a 'mass exodus of employees.'" Appellants' Ans. Br. 24 (citing *Summagraphics Corp.*, 425 A.2d at 965). Yet *Summagraphics Corp.* held exactly the opposite—*i.e.*, that a breach of fiduciary duty occurs when a fiduciary "conspir[es] to bring about [a] mass resignation of employer's key employees." 425 A.2d at 965 (citing *Duane Jones Co. v. Burke*, 117 N.E.2d 237, 245 (N.Y. 1954)); *Beard Research, Inc. v. Kates*, 8 A.3d 573, 602 (Del. Ch. 2010), *aff'd sub nom. ASDI, Inc. v. Beard Research, Inc.*, 11 A.3d 749 (Del. 2010).

[6] Appellants largely mischaracterize the evidence to suggest that Nasser and Dweck corresponded "openly [about Dweck's] . . . arrangements to compete" after her resignation but prior to her departure from Kids' offices. Appellants' Ans. Br. 22. First, Dweck's April 6, 2005 email stated that she was "planning to move some more personnel" to Success but gave no warning that she was actually orchestrating the resignation of virtually all of Kids' employees. *See* AR0120. Second, Nasser's April 8, 2005 email mentions only Dweck's departure and in no way alludes to an expected mass departure, *see* AR0122; rather, the email addressed only whether Kids could save on rental costs given the substantial amount of space that Dweck had devoted to Success. *See* AR0122.

This holding not only conflicts with Delaware law (and the law of most jurisdictions), it creates perverse incentives for breaching fiduciaries by encouraging them to destroy the very entities they serve so as to decrease their own future liability.

Moreover and importantly, the Court of Chancery's own factual findings substantially undermine Appellants' contention that Kids had no value apart from Dweck or Taxin. Indeed, the Court of Chancery expressly found that Kids could have continued operating profitably had Dweck and Taxin "resigned in an appropriate manner." Op. 36; *see also* Acct'g Op. 3; *see* Kids' Br. 40-41. Even assuming *arguendo* that Appellants (and the Court of Chancery) were correct that Kids' value would have been "minimal" without Dweck and Taxin,[7] Op. 36, Appellants provide no evidence to support their argument that valuation damages would be less than the future lost profits already awarded to Kids. *See* Appellants' Ans. Br. 23-24. And their reliance on *All Pro Maids, Inc. v. Layton*, 2004 Del. Ch. LEXIS 116, at *38 (Del. Ch. Aug. 9, 2004), to support an award of lost profits instead of valuation damages is misplaced. The defendant's breach of a non-compete covenant in *All Pro Maids, Inc.* resulted in the plaintiff's loss of 11 customers—a far cry from the total destruction of a business as was the case here. *Id.*

Because valuation damages are the appropriate measure of relief where a

[7] Kids and Nasser dispute that Kids, a well-established and long-profitable player in the industry, would have been devoid of value without Dweck and Taxin at its helm; in fact, the Court of Chancery's own findings suggest that Kids would have remained profitable for some time had it not been "crippled," Op. 1, by Appellants' "conversion and theft," Op. 30, which rendered Kids incapable of competing with Success and Premium. *See* Op. 36.

defendant's misconduct destroys a plaintiff's business, and because the Court of Chancery expressly found that Appellants' "destroy[ed] Kids' business," Op. 19, the Court of Chancery abused its discretion by refusing to ascertain and award Kids its valuation damages. *See infra* Part I.A.2; Kids' Br. 36-41.

2. The Court of Chancery found, and the evidence shows, that Appellants' gross fiduciary breaches destroyed Kids' business.

Second, Appellants unpersuasively argue that they "did not 'destroy' Kids," *see* Appellants' Ans. Br. 24, when in fact, the Court of Chancery expressly found that Appellants' misconduct "[d]estroy[ed] Kids' [b]usiness," Op. 19, and forced it to "start over from scratch." Op. 21. This finding, which is reviewed for clear error, *Cede & Co. v. Technicolor, Inc.*, 758 A.2d 485, 491 (Del. 2000), is amply supported by the record. Indeed, the evidence shows that Appellants, in breach of their fiduciary duties, successfully diverted all of Kids' existing orders, customers, suppliers, and manufacturing facilities to Success, orchestrated a "mass departure" of Kids' employees, stole "Kids' documents and materials," and "wiped clean" "a number of the hard drives from Kids' computers." Op. 20; *see, e.g.*, B599, 601-03 (Trial Tr. 1064-65, 1071-82). These actions left Kids "crippled" and unable to operate. Op. 1, 19-21.

Nevertheless, Appellants argue that "[n]one of these things . . . support a claim for valuation damages" because (1) Kids had "a full opportunity to do business" with its primary customers, despite Appellants' complete diversion of Kids' existing orders, (2) Appellants' efforts to steal Kids' documents were unsuccessful and "no material was removed from Kids," and (3) "the alleged wiping of hard drives never happened." *See* Appellants' Ans. Br. 24-25. These arguments, which are essentially evidentiary challenges to the Court of Chancery's factual findings, fail for a multitude of reasons.

First, Nasser and Djemal's testimony that Dweck and Taxin poisoned the well between Kids and its primary customers sufficiently supports the Court of Chancery's finding that Kids had no meaningful opportunity to do further business with these customers. *See* B511 (Trial Tr. 712-13), B602-03 (Trial Tr. 1075-81), B605-06 (Trial Tr. 1087-88); *see also* BR49-50 (Mulhair Dep. 50-53).[8] Second, former Kids employees, and even Dweck herself, testified that departing employees arranged to take Kids documents and work materials with them to Success.[9] *See* BR52-54 (Dweck Dep. 451-58); *see also* BR56 (Browndorf Dep. 65-66); BR59 (Cohn Dep. 82-83). And third, Djemal's trial testimony that a forensic expert determined that Kids' electronic files had been deleted sufficiently

[8] Documentary evidence from Kids' customers further corroborates this testimony. *See* BR74-75 (email from Target to Kids stating that "[w]ith all of the changes that have occurred and all of our orders and continued business flowing through Success Apparel, we will not flag Kids Int'l as active until after our meeting in January"); BR 71 (email from Taxin to Brenda Worley-McKinney at Wal-mart disparaging Kids as "trying to start up with the 81 year old partner good luck to them").

[9] Appellants concede that although Djemal stopped the truck containing "roughly 100 boxes of Kids' documents and materials," "[he] could not stop many of the former employees from taking boxes with them," Appellants' Ans. Br. 25 & n.12 (quoting Op. 20), and the evidence rebuts Appellants' contention that these boxes contained only personal property. *See* BR 63 (Pei Dep. 49) (Kids' employee testifying that she packed up her work materials, which contained Kids orders materials and information); BR 59 (Cohn Dep. 82-83) (Kids' employee testifying that he packed up Kids information concerning Target orders that were ultimately filled by Success). Moreover, the evidence shows that some of Kids' documents and work papers had been taken prior to May 18, 2005. *See* B598 (Trial Tr. 1062) ("I must tell you that a lot of stuff was already taken. Maybe there was an earlier delivery that we are not aware of. And a lot of the managers took a lot of things."); BR65-66 (Zobel Dep. 58-64) (Kids' employee testifying that she sent Kids order information to Dweck in April).

supports the Court of Chancery's finding that the hard drives had been "wiped clean."[10] *See* Op. 20; B622 (Trial Tr. 1152-54); BR61 (Djemal Dep. 393-94).

But even if the above evidence were somehow insufficient, Appellants fail to contest the Court of Chancery's most critical findings: that Appellants completely diverted Kids' corporate opportunities, existing orders, customers, suppliers, manufacturing facilities, and nearly all of its employees to Success. *See* Appellants' Opening Br. 34. These uncontested findings alone support the Court of Chancery's conclusion that Appellants destroyed Kids' business. Op. 19.

Appellants' additional argument that it was Nasser's conduct, and not their own gross fiduciary violations, that caused Kids' destruction, *see* Appellants' Ans. Br. 26, is baseless and, once again, ignores the express (and well-supported) findings of the Court of Chancery. Contrary to Appellants' arguments, Djemal "[w]ith more than forty years experience in the apparel industry, . . . was a qualified candidate" to replace Dweck as CEO. Op. 44; B593 (Trial Tr. 1039-41). He "hir[ed] new employees and attempted to solicit orders from . . . Kids' [primary] customer base," but "immediately encountered difficulties," and ultimately "fail[ed] to revive Kids," despite significant efforts to restart the business. Op. 21; B602-03 (Trial Tr. 1075-82); *see also* B736 (Acct'g Tr. 229). "After failing for over a year to restart Kids's business," Nasser and Djemal, in yet another attempt to save Kids, entered into a joint venture with Seabreeze Apparel,

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[10] Appellants' arguments that this evidence should not have been considered by the Court of Chancery because it was presented for the first time at trial is belied by Djemal's deposition testimony concerning an invoice paid to the forensic computer company he had hired to analyze the hard drives. *See* BR61 (Djemal Dep. 393-94). Defendants can hardly be blamed for Appellants' failure to follow up on this testimony.

Op. 22, which despite Dweck's challenges, the Court of Chancery determined was entirely fair. Op. 44. These findings, and the underlying evidence, fully rebut Appellants' contention that Nasser and Kids somehow failed to mitigate their damages after Appellants destroyed the business.[11]

Accordingly, none of Appellants' arguments undermines Kids' challenge to the Court of Chancery's damages award, and this Court should remand the case with instructions that the Court of Chancery calculate and award Kids its value as a going concern as of May 18, 2005.

B. The Court of Chancery's lost profits calculation does not fully compensate Kids.

Even if the Court of Chancery could have properly rejected valuation damages in favor of lost profits, the Court of Chancery's lost profits award, for both the destruction claim and the Stub period portion of the corporate usurpation claim, improperly failed to fully compensate Kids for the profits that it actually lost. *See* Kids' Br. 41-43. Appellants offer three responses to Kids' argument that the Court of Chancery improperly based the lost profits awards on the profits that Appellants gained, rather than the profits that Kids lost: (1) Kids did not present the argument to the Court of Chancery; (2) Kids can point to no legal authority for

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[11] Appellants' arguments that Djemal did not attempt to retain Kids' employees or timely attempt to resurrect Kids' business are disingenuous at best. First, when asked if he tried to "secure employment arrangements with [any of Kids' employees prior to their departure]," B628 (Trial Tr. 1178), Djemal testified that he "had no reason to" because he "thought everything was in place," and "if the company [was] run properly, everything would be in order," B628 (Trial Tr. 1178-79), and not because he did not intend "to keep Kids' business functioning," as Appellants contend. Appellants' Ans. Br. 26. Further, any delay in reviving Kids' operations after Appellants' breaches resulted from the parties' ongoing settlement negotiations, *see Dweck v. Nasser*, 959 A.2d 29, 33 n.7 (Del. Ch. 2008); BR67-70, and not a failure to mitigate.

its argument; and (3) Kids cannot show (a) that it would have earned any profits under Nasser's management, "much less more profits than the Appellants could have earned," or (b) that Success and Premium were start-up businesses. Appellants' Ans. Br. 27-28. Each argument lacks merit.

1. Kids did not waive its challenge to the Court of Chancery's lost profits calculation.

Appellants' waiver argument rests on a false premise: namely, that Kids was required to ask the Court of Chancery to reconsider its decision to award lost profits generally, and "lost profits" based on the profits gained by Success and Premium specifically, *see* Op. 33-37, as the remedy for the destruction claim and Stub Period portion of the corporate usurpation claim. It is undisputed that Kids had no reason to anticipate that the Court of Chancery would award future lost profits in lieu of valuation damages. Appellants never advocated a lost profits theory, the parties' damages experts and post-trial briefing focused exclusively on the appropriate methodology for calculating valuation damages, and the Court of Chancery itself indicated on the last day of trial that any damages award would be based on some kind of valuation method. *See* B676-77 (Trial Tr. 1369-73). Future lost profits became an issue for the first time when the Court of Chancery issued its post-trial opinion awarding them, and Appellants cite no authority for the proposition that a post-trial motion is necessary to preserve for appeal challenges to the damages awarded in a post-trial opinion. *See* Appellants Ans. Br. 27.[12]

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[12] Although Appellants cite *Delaware Electric Cooperative, Inc. v. Duphily,* 703 A.2d 1202, 1206 (Del. 1997), for the proposition that "[p]arties are not free to advance arguments for the first time on appeal," Appellants' Ans. Br. 27 n.13, nothing in that case suggests that a litigant must file a post-trial motion to challenge a damages calculation on appeal. *See Duphily*,

But even assuming that some sort of post-trial motion were necessary, Kids' response to Appellants' accounting and motion for reargument of the accounting opinion "fairly presented" the deficiency in the lost profits calculation to the Court of Chancery. SUP. CT. R. 8. After the Court of Chancery reversed course in the post-trial opinion in awarding lost profits instead of valuation damages (and ordering an accounting of Success' and Premium's profits), Kids implored the Court to make the lost profits award meaningful relief for Kids by, among other things, excluding Success' and Premium's expenses and losses from the lost profits calculation. *See* BR1-4, 6-8. Later, in Kids' motion for reargument of the accounting opinion, Kids argued that it had become evident that "the Court's definition of profits was unworkable under the circumstances" because the definition, among other things, failed to account for "Kids' historical profit margins" and the disparity between Kids' expenses and Success' and Premium's much greater expenses. *See* BR24-30. Accordingly, Kids asked the Court to "adopt[] an alternative calculation of lost profits" rather than adhering to the definition it previously adopted. BR29. More broadly, Kids complained that the Court of Chancery's ruling meant that "there were essentially no damages from [Appellants'] wholesale theft of Kids' business." BR38. These arguments fairly presented Kids' complaint that the lost profits calculation did not reflect Kids' actual losses and, thus, satisfied Supreme Court Rule 8. *Cf. Sears, Roebuck & Co. v. Midcap*, 893 A.2d 542, 547 n.4 (Del. 2006) (holding that argument was fairly

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703 A.2d at 1206-07 (noting that "[p]arties are not free to advance arguments for the first time on appeal" in the context of analyzing what constitutes record on appeal following jury trial).

presented to trial court even though appellant did not "present clearly to the trial court the specific argument it now raises on appeal").

2. Delaware law supports the measure of lost profits advocated by Kids.

Appellants' suggestion that there is no authority for Kids' position, *see* Appellants' Ans. Br. 27, ignores the general damages principles of Delaware law cited in Kids' opening brief, all of which are contravened by the Court of Chancery's lost profits measure. *See* Kids' Br. 39-40 (citing *Triton Constr. Co. v. E. Shore Elec. Servs., Inc.*, 2009 WL 1387115, at *28 (Del. Ch. May 18, 2009), *aff'd*, 988 A.2d 938 (Del. 2010)); *Thorpe ex rel. Castleman v. CERBCO, Inc.*, 676 A.2d 436, 444 (Del. 1996)); *see also Thorpe*, 676 A.2d at 445 ("Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly. . . . The strict imposition of penalties under Delaware law are designed to discourage disloyalty."); *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 441 (Del. 2000) (recognizing that, "where . . . issues of loyalty are involved, potentially harsher rules come into play"). It also ignores cases upon which Appellants themselves rely. *See* Appellants' Ans. Br. 23 (citing *All Pro Maids*, 2004 Del. Ch. LEXIS 116, at *38) ("The proper measure of damages for breach of a covenant not to compete is [*the plaintiff's*] lost profits." (citing *RHIS, Inc. v. Boyce*, 2001 Del. Ch. LEXIS 118, at *24 (Del. Ch. Sept. 26, 2001) (awarding damages based on *plaintiff's* historical profit margin))). All of this authority amply supports Kids' argument that the Court of Chancery's lost profits calculation improperly fails to measure the profits that Kids actually lost.

3. The Court of Chancery’s own factual findings support the measure of lost profits advocated by Kids.

Appellants’ attacks on the evidentiary support for Kids’ argument, Appellants’ Ans. Br. 27-28, fare no better. First, Appellants assert that Kids cannot establish that it would have been able to generate any future profits under Nasser’s management because he and Djemal were incapable of running the Company (pointing to Kids’ significant decline in value after May 18, 2005) and unwilling to hire someone who could (citing nothing at all). *Id.* 27. But that argument completely ignores the fundamental finding that underpins the entire post-trial opinion: that *Appellants* “destroy[ed]” and “crippled” Kids through the improper manner in which they departed the Company. Op. 1, 19-21. It also ignores the Court of Chancery’s findings with respect to Djemal’s decades of experience and qualifications for running Kids. Op. 21, 44. And it wholly ignores the Court of Chancery’s findings about the reason that Nasser and Djemal were not able to “revive” Kids—*Appellants*’ diversion of Kids’ employees, order pipeline, manufacturing facilities, and customers put Kids in the position of having to start from scratch. *E.g.*, Op. 21-22. As the Court of Chancery found, “[i]f Dweck and Taxin had left Kids legitimately,” then they, not Kids, would have been the ones who had to “start from scratch.” *Id.* 36. The fact that Appellants’ duty of loyalty breaches left Kids in a devastated and unprofitable state has no bearing on whether Kids would have been profitable in an “alternative universe” in which Dweck and Taxin “had left Kids legitimately” and “Kids would have had an intact employee base, access to its records, and a much better shot at preserving some element of its relationships with Wal-Mart and Target." *Id.*

Second, Appellants argue that Kids cannot establish that it would have generated greater future profits than those generated by Success and Premium and awarded to Kids. *See* Appellants' Ans. Br. 27-28. But while Appellants assert that they "had every reason to make Success and Premium *successful*," *id.* 27 (emphasis added), they do not claim that they were incentivized to make Success and Premium more *profitable*. In fact, as the Court of Chancery observed on the last day of trial, Appellants' incentive with respect to the competing companies' profitability was just the opposite:

> Part of what I'm also not comfortable with, though, is what I do with these net sales figures for Success and Premium, when I know I'm dealing with private companies who have incentives to minimize income, or indeed show negative income and therefore not pay profits and therefore not pay taxes, and therefore I'm not comfortable just looking at the sales and net income loss chart and just saying, okay, there weren't any profits--lost profits for '05 through '08 because the combined Success and Premium seems to have lost money, or almost lost money during that period.

B677 (Trial Tr. 1372). That perverse incentive is precisely why using Success's and Premium's profitability as a proxy for how profitable Kids would have been in the absence of Appellants' fiduciary breaches undercompensates Kids.

Finally, Appellants chastise Kids for characterizing Success and Premium as "start-ups," given that the competing companies had been operating out of Kids' premises for years before Appellants departed Kids. Appellants' Ans. Br. 28. But Appellants miss Kids' point. Before Appellants' departure, Success and Premium "operated out of Kids' premises using Kids' employees" but reimbursed Kids for only a fraction of the rent that they would have otherwise had to pay on their own, as well as employee compensation and benefit packages. Op. 13. And they "drew on Kids' letters of credit, sold products under Kids' vendor agreements, used Kids' vendor numbers, and capitalized on Kids' relationships," all for an "administrative fee" of a mere 1% of sales. *Id.* When Appellants departed Kids, there was a fundamental shift in the nature of Success and Premium—they went from being parasitic companies with minimal expenses to exactly what Kids described them as in its opening brief—"*essentially* two start-up companies with high operating costs, in part due to the substantial salaries and bonuses the companies paid to Appellants." Kids' Br. 42 (emphasis added). While there was every reason to treat Kids, Success, and Premium as one and the same before the split, there was simply no reason to do so after the split.

In short, none of Appellants' arguments undermines Kids' challenge to the Court of Chancery's failure to remedy the harm to Kids. Thus, even if the Court finds that lost profits is an appropriate measure of damages, it still should remand the case with instructions that the Court of Chancery calculate the profits actually lost by Kids for both the destruction claim and Stub Period portion of the corporate usurpation claim.

C. The Court of Chancery abused its discretion in refusing to award Kids its attorneys' fees.

Appellants conclusorily argue that fee shifting is not warranted here because Nasser breached his fiduciary duty to Kids. Appellants' Ans. Br. 28. Yet this argument tellingly ignores the standard for fee shifting, Dweck's "striking breaches of the duty of loyalty," "her frequently non-creditable testimony," Op. 46, and the substantial evidence that she acted in bad faith during this litigation. *See* Kids' Br. 43-44. Indeed, the Court of Chancery described Dweck's testimony as "particularly suspect," noting that she "repeatedly contradicted her deposition testimony, responded evasively, and suffered convenient failures of memory," and at times "appeared to have invented entirely new accounts for trial." Op. 2. Because Dweck exhibited bad faith, the Court of Chancery abused its discretion in refusing to award Kids its reasonable attorneys' fees.

II. THE COURT OF CHANCERY ERRED IN ORDERING NASSER TO RETURN $3.8 MILLION IN PROFIT DISTRIBUTIONS.

Appellants argue that the Court of Chancery correctly ordered Nasser to disgorge the RAJN payments because Nasser "'characterized' the payments as consulting fees," and "RAJN was not a shareholder at Kids and thus was not entitled to any profit distributions." Appellants' Ans. Br. 29-30. These arguments should be rejected because they elevate form over substance. *See* Kids' Br. 45-48. Although labeled "consulting fees," the evidence conclusively established that the RAJN payments were pro rata profit distributions made to RAJN on Nasser's behalf pursuant to a profit-sharing arrangement of which Dweck wholly acquiesced. *See* Kids' Br. 45-48. Indeed, the Court of Chancery's characterization of the payments contradicts its own factual findings that the parties understood the payments to have been made as profit distributions in proportion to Nasser's stock ownership in Kids. *See* Op. 11; Kids' Br. 45-48. Thus, the Court of Chancery erred in characterizing these payments as "consulting fees," and its order requiring Nasser to return $3.8 million in profit distributions should be reversed.

Moreover, there is no support for Appellants' argument that Dweck "vehemently opposed" these payments. *See* Appellants' Ans. Br. 30. The Court of Chancery found that "Dweck knew of the RAJN payments since 1996" but failed to challenge them. Op. 42; Kids' Br. 47-48. She even signed the checks making the pro rata distributions for which she now complains. *See, e.g.*, A1373 (2001 check signed by Dweck making pro rata profit distribution from Kids to RAJN).[13]

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[13] Appellants assert that "Nasser alone received [these distributions]," Appellants' Ans. Br. 30, yet concede that only $903,333.37 of the $3.8 million in RAJN payments ordered disgorged

Dweck's failure to formally challenge these payments also rebuts Appellants' arguments that their claims concerning the RAJN payments were timely. Appellants' Ans. Br. 31. Nothing in the original complaint gave Nasser fair notice of these claims, *see* Kids' Br. 48, and Appellants fail to explain how their request for appointment of a custodian or their allegations of the dissipation of assets would have apprised Nasser of their complaints concerning the business's well-established and long-standing profit-sharing arrangement. *See* Appellants' Ans. Br. 31. Thus, the Court of Chancery abused its discretion in allowing Appellants' amended complaint, which raised the RAJN claims for the first time, to relate back to the original complaint.

Because there is insufficient evidence to support the Court of Chancery's characterization of these payments and its entire fairness determination, or alternatively, because these claims were untimely, this Court should reverse the judgment ordering the return of $3.8 million in profit distributions.

This Court should similarly reverse the Court of Chancery's order requiring Nasser to pay $2.4 million in accounted for expenses because it held Nasser to an unreasonably high standard by requiring his accounting to conform to GAAP principles, without any evidence that the funds were misappropriated. *See* Kids' Br. 49. Because Appellants fail to present any authority that conformity with GAAP principles is required under the circumstances, the Court of Chancery's order should be reversed.

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was paid after Dweck's departure in 2005. *Id.* at 31.

CONCLUSION

For all the foregoing reasons and those set forth in Appellees' Answering Brief and Cross-Appellant's Opening Brief, this Court should reverse and remand the Court of Chancery's damages award against Appellants for the corporate destruction claim and for the Stub Period portion of the corporate usurpation claim, as well as the attorneys' fee decision, for further proceedings, and reverse the Court of Chancery's decision directing Nasser to reimburse certain fees and expenses.

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