IN THE SUPREME COURT OF THE STATE OF DELAWARE

RICHARD BLANCH, VIVIANNA BLANCH, RED BRIDGE & STONE, LLC and CLOVIS HOLDINGS LLC Defendants, Nominal Defendant, Counterclaim and Third-Party Plaintiffs-Below / Appellants, v. STONE & PAPER INVESTORS, LLC, CLOVIS HOLDINGS, LLC, Plaintiffs and Counterclaim Defendants-Below / Appellees, and JAD TRADING LLC, DIAMOND CARTER TRADING, LLC, JOHN DIAMOND, KANOKPAN KHUMPOO, ALBERT CARTER, ELIZABETH CARTER, EISENBERG & BLAU CPAS, P.C., RICHARD EISENBERG, and DD & COMPANY, LLP Counterclaim and Third-Party Defendants-Below / Appellees.	No. 262, 2023 APPEAL FROM THE COURT OF CHANCERY FOR THE STATE OF DELAWARE C.A. No. 2018-0394-PAF

<u>APPELLANTS' SECOND CORRECTED OPENING BRIEF</u>

Dated: October 16, 2023

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NATURE OF THE PROCEEDINGS

The true story of this case is investor remorse or investment regret—the fear or guilt when an investment decision does not timely produce results.

Two relatively successful, long-time business partners, John Diamond ("Diamond") and Albert Carter ("Carter"), took a risk on starting a business in a new-to-them industry—the stone-paper market. They did so at the recommendation of Diamond's 15-year long business colleague and friend Brian Skinner ("Skinner"), who Diamond viewed and described as a "son." When that investment, conducted through Appellee Clovis Holdings LLC ("Clovis" or the "Company"), fell short of expectations, Diamond wanted his money back and used the Company's informal operations and an improper reading of the governing agreement to paint a picture of deceit and scandal. Seemingly enamored by such a depiction, and exceedingly frustrated by trial-counsel's miscues and missteps along the way, the trial court rendered a punitive decision contrary to the plain language of Clovis's Operating Agreement (the "Operating Agreement") and the facts established at trial. That punitive decision resulted in a judgment against Appellants for over $5 million—an amount entirely disproportionate to the $988,510 in compensation paid to Appellant Richard Blanch ("Blanch") for his undisputed four years of service as a manager of Clovis.

At its core, this case is a contract dispute over whether Clovis's payment of compensation to its managers violated the Operating Agreement. As the trial court found in its July 30, 2021 Post-Trial Memorandum Opinion (Ex. A, cited as "Op."), Blanch and Skinner undisputedly "spent 'four years doing nonstop testing, due diligence, paper trials, [and] client meetings" on behalf of Clovis. And, as recognized by the trial court, "Plaintiff does not contest that these meetings and this work actually occurred." Dissatisfied with Clovis's results, however, Diamond, through Appellee Stone & Paper Investors, LLC ("Stone & Paper" or "Plaintiff"), brought the underlying action and creatively argued Skinner and Blanch received unauthorized payments that either involved "major decisions" or "interested transactions" under the Operating Agreement. But, the Operating Agreement's plain language—as interpreted by the trial court itself—dictate that the compensation payments were proper and did not breach any provision of the Operating Agreement.

First, the compensation payments are not "major decisions." This case does not involve a corporate merger, bankruptcy or services outside of the scope of Clovis's business. Instead, as authorized by the Operating Agreement, Blanch and Skinner engaged in the stone-paper business, *i.e.*, received and distributed paper products, conducted product trials and developed customer relationships. In support of its claim, however, Plaintiff argued the only conduct authorized by the Operating Agreement was to acquire a stone-paper company called ViaStone and that engaging in any business beyond consummating such acquisition constituted an unauthorized "major decision." The trial court rejected that narrow and incorrect interpretation, yet inexplicably applied it to hold Blanch and Skinner liable for management fees they received after the ViaStone acquisition failed to materialize—despite the undisputed fact that the managers were engaged in the stone-paper business the entire time. The trial court's finding in this regard was reversible error.

Second, the compensation payments are not "interested transactions." Providing services as a manager is not an interested transaction under the plain terms of the Operating Agreement. The definition of "Interested Transaction" *expressly* carves out a manager's rendering of services "in the capacity of an employee or officer of the Company." The trial court's failure to address (or even mention) this key language constitutes reversible error. Further, Blanch and Skinner were entitled to a salary. The Operating Agreement appointed the managers and expressly provided: "management of the day to day operations of the business of the Company shall be vested in each of the Managers." The authority to manage the day-to-day operations of a business includes the authority to pay its officers and employees. Because Blanch and Skinner received compensation for managing Clovis, *i.e.*, providing services in their capacity as managers, such payments do not fall within the definition of an interested transaction.

Moreover, although the trial court found Diamond had acquiesced to the compensation payments to Skinner, the trial court failed to apply the same logic, based on similar facts, to the compensation paid to Blanch. The court's reasoning in that regard also constitutes reversible error.

The trial court's failure to apply the Operating Agreement's plain language led to further legal errors. Not only did the trial court base its breach of contract holdings on a misreading of the Operating Agreement, it based its breach of fiduciary duty holdings on the same theory—Skinner and Blanch were not authorized to receive salaries for their work managing Clovis. The court's fraudulent concealment holding was also based on this same finding—the management fees were unauthorized and concealed. Because Skinner and Blanch complied with the Operating Agreement and were entitled to compensation for the services they rendered over four years, those holdings also rest on legal errors and must be reversed.

SUMMARY OF THE ARGUMENT

I. The trial court committed reversible error by failing to apply the Operating Agreement's plain language. The Operating Agreement requires managers to obtain written approval before "[e]ngaging in any business other than" "the *paper business currently conducted* by Tier1 International, Inc.," which did business under the name "ViaStone." Despite the fact the Operating Agreement expressly states Clovis's business was "not limited to . . . the purchase of the ViaStone Business" and, instead, expressly includes "conduct[ing]" the paper business, the trial court nonetheless held that, without prior written approval, Clovis could only engage in business that *was limited* to purchasing ViaStone. The court made this finding after simultaneously rejecting such a narrow interpretation and recognizing Clovis's managers were engaged in the same business being conducted by ViaStone.

II. The trial court committed reversible error by failing to apply the Operating Agreement's plain language. The Operating Agreement defines interested transactions as any transaction including "the rendering of any service (*other than in the capacity of an employee or officer of the Company)*…." That plain language shows that paying an officer for rendering services to the Company is not an interested transaction. The court ignored this crucial language, even omitting it when quoting Section 5.2. Further, Section 4.1 of the Operating Agreement gives the managers authority over "the day to day operations of the business of the Company," and that day-to-day business includes paying those doing the daily work of the Company—Blanch and Skinner.

III. The trial testimony and contemporaneous documents showed Plaintiff acquiesced to the management fees. Although the trial court relied on that evidence to find acquiescence as to Skinner, the court refused to find acquiesced as to Blanch. That inconsistent ruling constitutes reversible error.

IV. The trial court's erroneous interpretation of the Operating Agreement, and erroneous conclusion that Clovis's managers were not permitted to receive compensation, served as the premise for its analysis of Plaintiff's remaining claims. Thus, upon reversal of the breach of contract rulings, the trial court's downstream rulings lose their foundation and must also be reversed.

V. The trial court erred in holding Plaintiff's claims were direct. If Blanch's and Skinner's receipt of compensation did breach the Operating Agreement (it did not), then any injury suffered was by Clovis directly, and Plaintiff was only injured indirectly. The court's holding that such claims were direct constitutes reversible error.

VI. The trial court erred in holding the Blanch and Skinner Defendants jointly and severally liable. Although the trial court awarded direct damages solely for breach of the Operating Agreement, it relied on the derivative breach of fiduciary duty claims to find joint and several liability. This inconsistency constitutes reversible error. Further, Blanch could only be held liable for management fees he received, and Vivianna Blanch and Red Bridge were only found to aid and abet payments to Blanch.

VII. Finally, if this Court reverses the breach of contract and other downstream rulings, it should also reverse the trial court's fee award, as Plaintiff would no longer be a prevailing party. This Court has consistently recognized the bad faith exception to the American Rule allows fee shifting against a losing party, and, if the Blanch Defendants prevail on appeal, they will no longer be losing parties.

STATEMENT OF FACTS

I. The Parties

Clovis is a Delaware limited liability company formed on November 12, 2013. (A000159.) Skinner and Blanch are its sole managers. (Op. 5 (citing A000275 ¶¶ 3, 6).) Plaintiff is the sole preferred member of Clovis and is owned by long-term business partners, Diamond and Carter. (*Id.* 6.)

Appellant Red Bridge & Stone, LLC ("Red Bridge") is a common member of Clovis owned by Vivianna Blanch. (Op. 6 (citing A000275 ¶5).) Skinner Capital, LLC ("Skinner Capital"), a company owned by Skinner, is also a common member of Clovis. (*Id.*) Red Bridge and Skinner Capital were both signatories to the Operating Agreement and collectively control 75% of Clovis's total voting units. (*Id.* (citing A000275, ¶5).) As the preferred member, Plaintiff contributed all of Clovis's capital ($3.5 million) and controls the remaining 25% of Clovis's voting units. (*Id.* 6.)

II. The Paper Business Conducted By ViaStone

When the parties negotiated the Operating Agreement, a company called Tier1 International, Inc. did business as ViaStone. (Op. 1–2.) Specifically, ViaStone was "a business that sold stone-based paper products" in the United States that were manufactured by Taiwan Lung Meng ("TLM"). (*Id.*)

As the U.S. distributor for a Chinese manufacturer, the conduct of ViaStone's business included receiving inventory, distributing that inventory, conducting paper trials, maintaining a relationship with TLM and developing potential clients in the stone-paper market to sell stone-paper to in the future. (Op. 28, 33, 50–52 & n.248, 82; *see also* A000583-A000586, 277:1-280:4.)

III. The Parties Create Clovis To Enter The Stone-Paper Market

Diamond and Carter are the founders of Diamond Carter Trading, LLC ("Diamond Carter Trading"). (Op. 6.) Skinner joined Diamond Carter Trading in 2001 after graduating from college and, around 2016, became a junior partner. (*Id.*; A000314, 8:16-12.) Over the years, Diamond, Carter and Skinner became as close as family—Carter described Skinner as a "brother" and Diamond described Skinner as a "son." (Op. 6-7; A000315, 9:15-17.) In 2013, Skinner presented Diamond with the potential investment in the stone-paper market, including through a company known as ViaStone: "ViaStone … is something we really need to look at" even though "this is not our normal thing." (A000157.)

In early 2014, Diamond, Carter, Skinner and Blanch began to form Clovis—the company they would use to enter the stone-paper market. (Op. 13.) In connection with drafting and negotiating Clovis's Operating Agreement, Diamond emailed Skinner requesting "[c]lear language" "limiting the use of the capital provided by [Plaintiff] solely to investment in the 'Viastone Business,'" which he defined as "the acquiring of the equity or assets of Tier1 International." (*Id.* 15 (citing A000192).) The parties rejected that restrictive "ViaStone Business" definition, opting instead for broader language allowing Clovis's managers latitude to operate within the stone-paper market.

On April 4, 2014, the parties executed Clovis's Operating Agreement. (Op 16.) The Operating Agreement broadly defines the managers' authority: "[e]xcept as specifically set forth in this Operating Agreement, the management of the day to day operations of the business of the Company shall be vested in each of the Managers…." (A000171, §4.1(c).) In practice, Skinner was in charge of Clovis's finances while Blanch devoted significant effort to developing customer contacts and conducting trial runs of stone-paper products. (Op. 5 (citing A000710, 404:20–23); *id.* 29.)

Section 5.1 of the Operating Agreement limited the managers' authority over a set of "major decisions," including merging with another entity, filing for bankruptcy, and—the one relevant here—"[e]ngaging in any business other than the ViaStone Business, including, *but not limited to*, the funding of the purchase and operations thereof through a subsidiary." (A000173-174, §5.1(c) (emphasis added).) "ViaStone Business," in turn, is defined as "the paper business currently conducted by Tier1 International, Inc., a California corporation that the Company is seeking to acquire through a subsidiary either pursuant to a stock or asset purchase." (A000168, §1.1(kk).) This language differed from the language Diamond had originally requested, as it was not limited to *acquiring* Tier1 International and instead applied to *conducting* the stone-paper business. Plaintiff agreed to this broader language and provided its investment. (A000190.) Under the Operating Agreement, Plaintiff is not entitled to a return of its investment unless "the amounts are available and approved by the" managers. (A000180, §9.6; Op. 86.)

The Operating Agreement also limits "interested transactions," including transactions between a manager and the Company "(a) . . . evidencing a loan to … any such Person, or (b) … [for] the rendering of any service (*other than in the capacity of an employee or officer of the Company* …) by any such Person to the Company …." (A000174, §5.2 (emphasis added).) After excluding services rendered in an employment or officer capacity, Section 5.2 addresses a potential future development: it acknowledges the parties agree, "in the event that the Company acquires the Viastone business," "Member entities, will be actively involved in the management thereof and will receive a fee or like compensation therefor." (*Id.*)

IV. The Trial Record Showed Skinner And Blanch Were Permitted To Engage In the Stone-Paper Business

Contrary to the broad authority vested in Blanch and Skinner as managers of Clovis, Plaintiff argued at trial that major decisions, which required pre-approval, included, "conducting stone paper trials, working to develop a stone paper market in Turkey, purchasing Terraskin paper inventory, seeking to work directly with [ViaStone's supplier] TLM and working on behalf of a separate entity named

AaronStone." (Op. 50-51.) The trial court rejected that argument, stating, "Plaintiff construes the contract too narrowly." (*Id.* 51.) The court further found the above-quoted, final definition of "'ViaStone Business' differed from Diamond's original proposal, which would have defined the term more narrowly to mean 'the acquiring of the equity or assets of Tier1 International.'" (*Id.* 50.) The court then found the Operating Agreement "does not require that Clovis must purchase ViaStone by a certain date or that Clovis's funds must first be spent on the purchase of ViaStone." (*Id.* 51.)

The trial court's finding that activities in the stone-paper market are not major decisions is entirely consistent with the record. Skinner described Clovis as "a venture deal that you put some cash in and you work and you try to create the market and you create the brand, and if it works out, it's going to be a big payday…. Clovis was formed … to be in the stone paper business … one of the things it could do was acquire Tier 1/Viastone [but it] could grow the stone paper market … conduct trials … [and] travel[.]" (AA000580, 274:18-24; A000669-A000670, 363:24-364:11.) And, in order to divide up the various aspects of Clovis's business, in early 2014, Diamond, Skinner and Blanch had a call where they:

> discussed the fact that we needed to run the business parallel to purchasing Tier1. We needed to find where we were going to scale the product, where we were going to put the product. We needed to work on a deal with Aaron Paper and Drew Aaron as well.

> So at that time, we broke up the work requirements of the company…. So Brian and John said they would handle the finances and handle the accounting and taxes; and I was to do the marketing and try and get the … paperwork done for Tier1 and work with the various parties … to bind up Aaron Paper as an investor and also as a conduit for us for order flow and assist us with back-office logistics, things like that.

(A000911-A000912, 605:16-606:10; *see also* A000986-A000987, 680:19-681:20; A000997-A000998, 691:16-692:5.)

Skinner and Blanch frequently updated Diamond, including on those aspects unrelated to acquiring ViaStone. For example, at least in September or October 2016, Diamond testified Skinner informed him "the stone paper business was going very, very well" and that Blanch and Skinner were still trying to work out a deal with Aaron Paper. (A000431, 125:11-24; A000364, 58:1-11.) And, Diamond was "just as active in [Clovis] as anything else," as he "worked hand in hand" with Skinner and had "full control over" Skinner. (A000642, 336:2-7.) Diamond even admitted he was aware trial runs unrelated to the potential acquisition were being conducted. (A000426, 120:3-24.) Diamond also authorized the release of Clovis's funds for uses "that were not related to purchasing Tier1 International[.]" (A000483, 177:3-15.) Thus, the record is clear—all parties were aware, as the Operating Agreement permitted, that Clovis engaged in and spent capital on the stone-paper market in addition to negotiating a potential ViaStone acquisition. Reading the major decisions provision as precluding such activities is inconsistent with the trial court's interpretation of the Operating Agreement[1] and unsupported by the record.

Moreover, shortly after funding Clovis, Diamond was told "the purchase of ViaStone was imminent." (A000352, 46:6-14; *see also* A000436, 130:14-21.) Despite that, Diamond continued to support Clovis engaging in the stone-paper market for years, until sometime in 2018. (A000967, 661:1-8.) Indeed, if Diamond really believed Clovis was established only to engage in an acquisition, and the Operating Agreement prohibited any action outside of negotiating that acquisition (despite being aware of the various other activities), that raises the question: What did Diamond think was going on for four years after being told the acquisition was imminent?

Indeed, Diamond acknowledged the managers' efforts, over a lengthy period, were not in furtherance of a potential acquisition:

> Q. Would you expect the managers to do some due diligence before purchasing Tier1 International?
>
> A. Maybe. Not three years worth of due diligence. And I think they had already done a whole lot of diligence even before then.

(A000453, 147:13-18.)

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[1] "Plaintiff construes the contract too narrowly." (Op. 51.)

The only interpretation of the major decisions provision of the Operating Agreement supported by the provision's plain language, logic and the parties' actions (or inactions) is the interpretation the trial court adopted but failed to apply.

V. Blanch Works To Grow The Paper Business

After the formation of Clovis, Blanch and Skinner began developing the stone-paper business. They "spent 'four years doing nonstop testing, due diligence, paper trials, [and] client meetings." (Op. 82 n.328.) Blanch worked on "finding a supply chain into which they could insert and scale their stone product," bought stone-paper from Design and Source Production to make samples and met with large companies to pitch potential applications for stone-paper. (*Id* 25, 28.) Together, Blanch and Skinner "embark[ed] on trial runs for stone paper products in 2015." (*Id.* 29.) These included trials of stone-paper for Procter & Gamble, Pfizer, Biersdorf, and Dogan Group. (*Id.*) "These trials and sales pitches were Blanch and Skinner's primary focus, and the acquisition of ViaStone was a secondary objective." (*Id.*; *see also* A001360, 1054:18–23.)

By November 2015, Blanch had concluded the ViaStone acquisition was not going to happen and he worked on "establish[ing] a direct relationship with TLM," ViaStone's supplier. (Op. 32.) TLM rejected those overtures, concluding it wanted to maintain its relationship with ViaStone. (*Id.* 33.) After this development, Blanch and Skinner "continued to search for potential customers to buy stone paper products." (*Id.*) The services Blanch and Skinner performed were in-line with those challenged under the narrow reading of the Operating Agreement the trial court rejected. (*Id.* 50–51.)

VI. Blanch And Skinner Receive Management Fees

While Blanch and Skinner performed this work, they paid themselves management fees in the amount of $20,000 per month, "which were deposited into accounts of their affiliates[.]" (Op. 2, 5.) Those entities, Red Bridge and Skinner Capital, are signatories to Clovis's Operating Agreement. (A000190.)

The payment of management fees began in April 2014, when "Skinner requested permission from Diamond to draw a salary." (Op. 18.) And, as Skinner testified, Diamond approved such payments, including those to Blanch:

> [I]t was agreed upon in April '14 that – John Diamond agreed that Brian Skinner would be paid.… *He also agreed that Richard Blanch and Red Bridge would be paid.* And that was on the call that we had.

(A000576, 270:11-20; A000717, 411:6-20) (emphasis added).

Diamond admitted he agreed Clovis would pay Skinner: "maybe a few months after we had funded Clovis, [Skinner] told me that Clovis was much more work than he had imagined it would be, that it had turned into like a full-time job. And he thought that it was only fair that he be compensated…." (A000351-A000352, 45:23-46:11.)

Thereafter, in September 2015, Diamond received an email from his personal accountant, Richard Eisenberg ("Eisenberg"), who also worked for Clovis, stating, "Clovis paid a management fee to Red Bridge and Stone LLC, but did not issue a Form 1099 to them. Are they partners, or was the failure to issue a Form 1099 just an oversight … Are we going to issue a Schedule K-1 to Richard Blanch?" (A000196.) There is, therefore, no disputing that by September 2015 at the latest, Diamond was told, in writing, Clovis paid management fees to Red Bridge. (*Id.*) Those management fees were again documented in a November 2016 email to Diamond:

> One issue that we never fully resolved is a request to treat the money sent by Clovis Holdings LLC to Red Bridge & Stone LLC (Richard Blanche?) during the year as a loan instead of a guaranteed payment. As of now, the payments, totaling $280,000 made primarily through monthly disbursements of $20,000, were treated as guaranteed payments, and therefore a deductible expense to Stone & paper, and therefore to you.

(A000266.)

Diamond also admitted he was a signatory to Clovis's bank account, having full access to determine the amount of operating funds Clovis had (A000500, 194:16-20); received all Schedule K-1s after every tax year reflecting compensation payments (A000433-A000434, 127:16–128:24); and received Clovis's 2014 tax returns reflecting management payments to Blanch and Skinner (A000264).

VII. The Trial Court Concludes Blanch and Skinner Breached the Operating Agreement

In its post-trial opinion, the trial court rejected Plaintiff's claim that Skinner and Blanch fraudulently induced Plaintiff to invest in Clovis, but ruled in favor of Plaintiff on the breach of contract claims (for breaching the major decisions and interested transactions provisions) and the breach of fiduciary duty and fraudulent concealment claims. (Op. 3.) The court also held Skinner Capital, Vivianna Blanch, and Red Bridge liable for civil conspiracy and aiding and abetting the managers' breaches of fiduciary duty and fraudulent concealment. (*Id.*) In reaching these conclusions, the court found Blanch to be "the least credible witness" and so "afforded his testimony minimal weight." (*Id.* 4.)[2]

A. The major decisions provision

In addressing the major decisions provision, the trial court rejected Plaintiff's theory that the only work Clovis was authorized to do, without prior approval, was work towards acquiring ViaStone. (Op. 51 ("Plaintiff construes the contract too narrowly.") The court found Blanch's and Skinner's work was in furtherance of the business ViaStone was conducting, which did not require consent: they were "attempting to create demand for ViaStone's stone-paper products with a number of prospective customers" and "working on paper trials," and that "[t]hat conduct

[2] The trial court's view of Blanch was based, at least in part, on unproven allegations in a complaint in an unrelated action. (*See* Op. 7–8.)

readily constituted 'engaging' in the 'paper business [then] currently conducted by . . . [the] corporation that [Clovis] is seeking to acquire." (*Id.* 51–52 (quoting A000168, A000173-74, §§1.1(kk), 5.1(c)).)

The trial court then drew a line between conduct that occurred while the ViaStone acquisition remained possible and the same conduct that occurred after the acquisition was unlikely: "[o]nce Blanch and Skinner knew that purchasing ViaStone was no longer an option, any action or commitment of Clovis resources to any business was action that required Stone & Paper's written approval." (Op. 53.)

B. The interested transactions provision

On the interested transactions provision, the trial court concluded Blanch and Skinner engaged in interested transactions by paying themselves a salary. In doing so, however, the court failed to analyze the exception in the interested transactions definition that permits managers to pay for services rendered to Clovis. (Op. 55–56.) In fact, when the court quoted the definition it only quoted the following:

> An Interested Transaction is 'any transaction between a member, a manager, … or any Affiliate thereof, on the one hand, and the Company, on the other.'

(*Id.* (ellipsis in original).) The court omitted the key language, "other than in the capacity of an employee or officer of the Company," which expressly allowed payments to managers. (A000174, §5.2.) The court also did not address Section 4.1, which provides "the management of the day to day operations of the business of the Company shall be vested in each of the Managers," further authorizing compensation payments for services rendered. (A000171.)

The trial court next addressed certain payments Blanch requested be loans rather than management fees. (*Id.* 63.) The court noted Section 5.2 "defines 'Interested Transaction' to include 'any transaction evidencing a loan' to a manager or a manager's affiliate" (*id.*), but then concluded, "the loans were not, in fact loans." (*id.* 65.) The court nonetheless held the "purported loans" were also breaches of the Operating Agreement. (*Id.* 66.) The court then found a breach of Sections 4.10 and 10.7 (*i.e.*, recordkeeping provisions), but did not address damages. (*Id.* 71–72.)

C. Diamond's acquiescence

Relying on his admission, the trial court found Diamond acquiesced to $400,000 in management fees paid to Skinner from April 2014 to November 2015 (when the court found the ViaStone acquisition was no longer viable). (*Id.* 61–62 n.281.) But, as to Blanch, the court concluded Diamond was unaware of the payments and disregarded a mountain of evidence to the contrary, including Skinner's and Blanch's testimony and the contemporaneous documents identified in Section VI above. Blanch did not receive management fees for *four full years* without Diamond's knowledge.

As to the loans, the trial court held Diamond did not acquiesce because they were "sham documents" and "Diamond could not have acquiesced to loans that were not, in fact, loans." (Op. 64–65.) After finding such payments were not loans, however, the court did not consider whether they were a continuation of the management fees both Skinner and Blanch were receiving.

D. Blanch's and Skinner's fiduciary duties

Turning to the alleged breach of fiduciary duty, the trial court stated, "Blanch and Skinner acted in bad faith by approving the Management Fees and the Purported Loans," when "these payments were not authorized in the manner required by the LLC Agreement, did not advance Clovis's interests, and were often made to support Blanch's and Skinner's personal expenses." (Op. 75.) The court further concluded Blanch attempted to conceal the management fees by filtering them through his wife, Vivianna Blanch, and Red Bridge, and that paying the management fees constituted breaches of the duty of loyalty. (*Id.* 75–76.)[3]

E. The trial court rejects the fraudulent inducement claim, but holds defendants committed civil conspiracy and aided and abetted

As to the fraud claims, the trial court rejected Plaintiff's fraudulent inducement theory and, specifically, "the premise that Clovis was a sham entity *ab initio*." (Op. 80.) Returning to the premise that the management fees were unauthorized, however, the court found characterizing some of the management fees

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[3] The trial court made this finding while simultaneously recognizing, "Blanch and Skinner signed the LLC Agreement as Managers of Clovis, Vivianna Blanch signed on behalf of Red Bridge, Skinner signed on behalf of Skinner Capital, and Diamond signed on behalf of Stone & Paper." (Op. 16 n.73.)

as loans "worked a fraud on the Plaintiff because they were not loans." (*Id.* 85.) Finally, the court found a civil conspiracy, held Vivianna Blanch and Red Bridge aided and abetted Blanch's breaches, and Skinner Capital aided and abetted Skinner's breaches. (*Id.* 87, 90-91.)

VIII. The Trial Court Awards Damages Directly to Plaintiff

Defendants initially moved to dismiss Count I of the complaint,[4] which asserted breaches of Sections 4.9 (reimbursements for expenses) and 5.2 (interested transactions), because, *inter alia*, Plaintiff failed to make a pre-suit demand or plead demand futility. In its May 31, 2019 Memorandum Opinion (Ex. B, cited as "May Op."), the trial court found Count I was both direct and derivative. (*Id.*)

With regard to Section 5.2, the trial court found it was direct based on its disclosure requirement: "Section 5.2 requires the Company to disclose terms and conditions of any interested transaction to its members, including Stone, before carrying it out. This is a personal right belonging to the members, and Stone may bring its claim directly." (*Id.* 11.) The court did not analyze what potential damages would result from such a breach or to whom damages should flow.

The court held Section 4.9 was derivative, because: (1) "the Company suffered harm by reimbursing expenses without assessing whether they were

[4] After the trial court's ruling on the motion to dismiss, Plaintiff amended the complaint and added a request for disgorgement of ill-gotten gains. (Ex. C Redline for Amended Complaint, ¶92.)

reasonable and without board approval for large expenses" and (2) the Court must determine who would receive the benefit of a recovery. (*Id.*)

The trial court also found that Counts II, III and IV, for breaches of contract and fiduciary duties and aiding and abetting, were asserted derivatively. (*Id.* 11.) After finding Clovis's board was "interested" with respect to those claims, the court held demand was futile. (*Id.* 13–14.)

The trial court seemingly applied these prior rulings in its post-trial opinion. (*See, e.g.,* Op. 54.) Specifically, the court held, because "Plaintiff's claim for breach of contract pursuant to Section 5.2 … is a 'personal right belonging to the members' of Clovis[,]… [Plaintiff] is entitled to recover directly from Blanch and Skinner…." (Op. 71 (citations omitted); *id.* 104.) The court's damages award against the Blanch Defendants was based solely on Section 5.2, failing to mention claims under other sections of the Operating Agreement or any other legal theory. (*Id.* 104.)

IX. The Trial Court Awards Plaintiff Attorneys' Fees And Enters Final Judgment

On April 6, 2023, the trial court awarded Plaintiff attorneys' fees based on the bad faith exception to the American Rule. (Ex. D, cited as "Fee Op.") In doing so, the court concluded the Blanch Defendants engaged in bad faith tactics and disregarded discovery deadlines without explanation. (*Id.* 8.) In rejecting a cross request for fees, the court found the Blanch Defendants "cite[d] no authority supporting an award of fees to a losing party under the bad faith exception," and emphasized, by quoting their brief, “that ‘a *prevailing party* may obtain an award of attorneys’ fees.’” (*Id.* 21 & n.61 (emphasis in original).)

On July 7, 2023, the trial court entered a final order awarding Plaintiff $988,510 in damages from the Blanch Defendants and $1,082,500 in damages from Skinner and Skinner Capital. (Ex. E, Final Judgment.) The court awarded such damages jointly and severally. (*Id.*) The court also awarded Clovis $510,124.34 in damages solely from Skinner, which it by $21,000 to offset the amount awarded to Clovis from Plaintiff. (*Id.*) The court awarded attorneys’ fees against the Blanch Defendants in the amount of $2,150,691.84. (*Id.*)

ARGUMENT

I. Engaging In Business Within The Stone-Paper Market Without Purchasing ViaStone Was Not A “Major Decision”

A. Question Presented

Was it error for the trial court to hold the managers were only authorized to engage in actions in furtherance of purchasing ViaStone?[5]

B. Scope of Review

This Court reviews “‘questions of law and contractual interpretation, including the interpretation of LLC agreements, *de novo*.’” *In re Shorenstein Hays-Nederlander Theaters LLC Appeals*, 213 A.3d 39, 56 (Del. 2019) (citations omitted).

C. Merits of the Argument

Under the Operating Agreement’s plain language, managers are expressly vested with broad authority to manage “the day to day operations of the business of the Company….” (A000171, §4.1(c).) There is no dispute this authority included paying officers and employees, and for Blanch and Skinner to receive compensation for their services. (*Id.*) Conducting Clovis’s business was primarily defined to include engaging in the “ViaStone Business.” The Operating Agreement’s major decisions provision recognized this, stating a major decision would be to “engag[e] in any business *other than* the ViaStone Business, including, but not limited to, the

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[5] Preserved, *inter alia*, at A000272-273 & Defendants’ Pre-Trial Brief at 1, 19-22 (Nov. 30, 2020).

funding of the purchase and operations thereof through a subsidiary." (A000174, §5.1(c) (emphasis added).) The Operating Agreement defines the ViaStone Business as "the paper business currently conducted by Tierl International, Inc., a California corporation that the Company is seeking to acquire through a subsidiary either pursuant to a stock or asset purchase." (A000168, §1.1(kk).) Thus, the Operating Agreement broadly authorized Blanch and Skinner to manage the "day to day operations" of Clovis's engagement in the paper business then conducted by ViaStone.

That raises the question, what was the paper business then conducted by ViaStone? As the trial court recognized in the first sentence of its opinion, ViaStone was "a business that sold stone-based paper products." (Op. 1; *accord* A000670, 364:6–11 (Skinner testifying that Clovis was formed "to be in the stone paper business," which included "operat[ing]" and working to "grow the stone paper market").) The managers, therefore, would be engaging in the "ViaStone Business" if they worked to sell stone-based paper products.

Section 5.1(c) also makes clear engaging in the ViaStone Business is not limited to purchasing ViaStone. It states "engaging in any business other than the ViaStone Business, *including, but not limited to*, the funding of the purchase and operations thereof through a subsidiary." (A000174, §5.1(c) (emphasis added).)

Thus, conducting the ViaStone Business can include, but certainly is not limited to, conduct solely related to purchasing ViaStone. (*Id.*)

The trial court actually rejected Plaintiff's argument to the contrary, that conducting the ViaStone Business was limited to services in furtherance of acquiring ViaStone. (Op. 50.) As the court found Blanch and Skinner were actively engaged in the business of selling paper products, it was reversible error to find they were improperly compensated for their services.

Indeed, despite questioning Blanch's credibility on other points, the trial court specifically quoted Blanch's testimony that Blanch and Skinner "spent 'four years doing nonstop testing, due diligence, paper trials, [and] client meetings" and further noted "Plaintiff does not contest that these meetings and this work actually occurred." (Op. 82 n. 328 (quoting A000932, 626:9–13); *see also id.* 29 (listing trials for Proctor & Gamble, Pfizer, Biersdorf, and Dogan Group).) The court found "Blanch had Clovis pay $150,000 to purchase stone paper inventory from a company named Design and Source Production a/k/a Terraskin" and "[t]he paper was to be used to make samples for prospective clients." (*Id.* 28.) The court further recognized Blanch worked to "find[] a supply chain into which they could insert and scale their stone paper product." (*Id.* 25.) And, the court found Blanch obtained "meetings with several large companies to pitch potential applications for stone paper." (*Id.* 28.) Indeed, Plaintiff admitted Blanch "conduct[ed] stone paper trials, work[ed] to develop a stone paper market in Turkey, purchas[ed] Terraskin paper inventory," and sought "to work directly with TLM," as Plaintiff alleged these steps of conducting a stone-paper business were not steps to purchasing ViaStone. (*Id.* 50–51.)

This uncontested work that Blanch and Skinner did was engaging in the ViaStone Business; it was conducting the same business ViaStone conducted at the time the Operating Agreement was executed. Again, the trial court acknowledged this conduct "readily constituted 'engaging' in the 'paper business [then] currently conducted by . . . [the] corporation that [Clovis] is seeking to acquire." (*Id.* 52 (quoting A000168, A000173-74, §§1.1(kk), 5.1(c)).)

Despite having correctly concluded that *conducting* the ViaStone Business was not limited to *purchasing* the ViaStone Business, the court veered off course when it tied Blanch and Skinner's right to compensation to purchasing ViaStone. In this regard, the court stated, "there came a point in time when [the managers] no longer harbored a legitimate interest in purchasing ViaStone." (Op. 52.) The court then concluded, "[o]nce Blanch and Skinner knew that *purchasing* ViaStone was no longer an option, *any* action or commitment of Clovis resources to any business was action that required Stone & Paper's written approval." (*Id.* 53 (emphasis added); *compare id.* 1 (trial court asserting that "[t]he LLC Agreement required Blanch and Skinner to devote the Company's resources to *acquiring* the stone paper business of

Tier1") (emphasis added), *with* A000173, §5.1(c) (requiring them to "[*e*]*ngag*[*e*]" in "the Viastone Business") (emphasis added).)

The assertion that conducting "any business" required written approval directly contradicted the trial court's earlier finding that "[t]he terms of the LLC Agreement do not require consent to engage in activities in furtherance of ViaStone's business" and that such business was not limited to services in furtherance of purchasing ViaStone. (Op. 51.) It also contradicted the trial court's later finding that the Operating Agreement "does not expressly require Blanch and Skinner to exclusively use Clovis's investment to first purchase and then operate ViaStone." (*Id.* 84.)

In other words, simply conducting the paper business somehow no longer counted as conduct that "readily constituted" engaging in the paper business. The court based its conclusion that a breach occurred on the idea that the managers' efforts to conduct the same paper business ViaStone conducted, instead of purchasing ViaStone, was a major decision even though the court had just rejected that very idea. (*Id.* 52 (acknowledging that Blanch and Skinner's work of conducting paper trials and of working to increase customer demand "readily constituted 'engaging' in the 'paper business'" that ViaStone was then currently conducting).)

Because the trial court failed to apply its own interpretation of what work constituted engaging in the paper business, it failed to apply the plain language of the Operating Agreement, which is reversible error. *See Eugene A. Delle Donne & Son, L.P. v. Applied Card Sys., Inc.*, 821 A.2d 885, 887 (Del. 2003) ("if the contract language is unambiguous, it must be given its plain meaning").

II. The Management Fees Did Not Violate The Interested Transactions Provision

A. Question Presented

The Operating Agreement specifically provides an interested transaction is not a payment to a manager for rendering services to or on behalf of the Company. Given this, did the trial court err in concluding the management fees were interested transactions?[6]

B. Scope of Review

This Court reviews "'questions of law and contractual interpretation, including the interpretation of LLC agreements, *de novo*.'" *In re Shorenstein*, 213 A.3d at 56 (citations omitted).

C. Merits of the Argument

The trial court also erred in concluding the managers breached the interested transactions provision of the Operating Agreement. The most obvious evidence showing the court's departure from the Operating Agreement's plain language is its complete omission of the most relevant language of Section 5.2. The language the court omitted from Section 5.2 is dispositive, as it expressly excluded the payments at issue from the definition of interested transactions:

[6] Preserved, *inter alia*, at A000272-273, 290 & Defendants' Pre-Trial Brief at 21 (Nov. 30, 2020).

Trial court's version:	Actual version:
An Interested Transaction is "any transaction between a member, a manager, … or any Affiliate thereof, on the one hand, and the Company, on the other. (Op. 55–56 (ellipsis in original).)	An Interested Transaction is "any transaction between a member, a manager, … or any Affiliate thereof, on the one hand, and the Company, on the other, including … the rendering of any service (other than in the capacity of an employee or officer of the Company or any Affiliate of the Company) by any such Person to the Company or any Affiliate of the Company. (A000174, §5.2.)

The trial court simply failed to apply—or even acknowledge—the plain language of Section 5.2. As its shows, that provision expressly provides paying a manager for "the rendering of any services" "in the capacity of an employee or officer of the Company" is *not* an interested transaction. (*Id.*)

That is all the analysis needed—the court erred in finding a breach of Section 5.2.

But, there is also additional language in the Operating Agreement that shows paying management fees is not prohibited. Section 4.1(c) provides, "[e]xcept as specifically set forth in this Operating Agreement, the management of the day to day operations of the business of the Company shall be vested in each of the Managers

. . . ." (A000171, §4.1(c).) Managing the day-to-day operations of a business includes paying those who do the work for the business, just as the managers did here by paying themselves management fees.

The trial court also considered whether certain payments the managers asked to be treated as loans were also interested transactions. (Op. 63–66.) The court made a finding of fact that the purported loans *were not* loans. (*See*, *e.g.*, *Id.* 59 ("[T]he $240,000 paid to Red Bridge was not, in fact, a loan."); *id.* 65.) Nonetheless, the court concluded they were "impermissible Interested Transactions," because "Section 5.2 defines 'Interested Transaction' to include 'any transaction evidencing a loan' to a manager…." (*Id.* 63.) In other words, the court applied the ban on loans despite concluding the payments were not actually loans.

What the trial court should have done is to treat those payments as additional management fees for the upcoming year and then recognized Section 5.2 does not consider payments for "the rendering of any service … in the capacity of an … officer of the Company" to be interested transactions. (A000174, §5.2.) By failing to apply the plain language of Section 5.2, the trial court again erred in finding a breach of the interested-transactions provision. *See Eugene A. Delle Donne & Son*, 821 A.2d at 887.

III. The Trial Court Erred In Failing To Find Diamond Acquiesced As To Blanch

A. Question Presented

In 2014, Diamond approved the management fees in conversations with Skinner, which the trial court relied on, among other things, to find Diamond had acquiesced as to Skinner. Was it error for the court not to similarly find Diamond acquiesced to the payment of management fees to Blanch?[7]

B. Scope of Review

This Court will disturb findings of fact only if "they are clearly wrong and justice requires their overturn." *Wife (J.F.V.) v. Husband (O.W.V., Jr.)*, 402 A.2d 1202, 1204 (Del. 1979). The Court will "draw [its] own inferences and deductions only if [it] find[s] they are not supported by the record and are not the product of an orderly and logical deductive process." *Id.*

C. Merits of the Argument

Acquiescence bars a party from arguing a position contrary to prior conduct where a party "has full knowledge of his rights and the material facts" and, with such knowledge, "(1) remains inactive for a considerable time; or (2) freely does what amounts to recognition of the complained of act; or (3) acts in a manner inconsistent with the subsequent repudiation." *Klaassen v. Allegro Dev. Corp.*, 106 A.3d 1035,

[7] Preserved, *inter alia*, at A000274-279 & Defendants' Pre-Trial Brief at 2-5, 21, 22 (Nov. 30, 2020).

1047 (Del. 2014) (citations omitted). A claim will be barred where the party has engaged in conduct that "acknowledged the legitimacy" of the transaction. *Clements v. Rogers*, 790 A.2d 1222, 1238 n. 46 (Del. Ch. 2001). For acquiescence to apply, conscious intent to approve the act is not required, *Frank v. Wilson & Co.*, 9 A.2d 82, 87 (Del. Ch. 1939), nor is a change of positions or resulting prejudice. *Nevins v. Bryan*, 885 A.2d 233, 254 (Del. Ch. 2005).

In finding Diamond had acquiesced to the management fees to Skinner, the trial court relied on a verbal conversation between Diamond and Skinner that occurred shortly after Clovis was funded. (Op. 61.) In addition to that conversation, the court also cited a series of emails in July 2015 where Skinner notified Diamond that his income from Clovis was $20,000 per month. (*Id.* (citing A000193; A000194; A000195).) The court, however, ignored the same conversation and similar written correspondence when finding Diamond had not similarly acquiesced to the management fees to Blanch.

Skinner described the verbal conversation the court relied on, as follows:

> [I]t was agreed upon in April '14 that – John Diamond agreed that Brian Skinner would be paid. He also – or Skinner Capital. *He also agreed that Richard Blanch and Red Bridge would be paid.* And that was on the call that we had.

(A000576, 270:11-20) (emphasis added).)

Diamond also received a copy of Clovis's 2014 tax returns showing Clovis *paid Blanch* $180,000 in management fees for April through December 2014—

$20,000 a month. (A000264; *see also* A000198, A000214.) Similarly, Diamond testified he received Clovis's K-1s for every fiscal year, including 2014, which reflected *Blanch's management fees*. (A000433, 127:16-22; *see also* A000212.) Additionally, much like the correspondence the trial court relied on for Skinner, in September 2015, Eisenberg emailed Diamond stating, "Clovis paid a management fee to Red Bridge and Stone LLC" and asking, "[a]re we going to issue a Schedule K-1 to Richard Blanch?" (A000196.)

The trial court found Diamond acquiesced to the payment of management fees to Skinner. The court's failure to apply the same reasoning and logic to find Diamond had acquiesced to the management fees paid to Blanch constitutes reversible error.

IV. Because The Trial Court's Remaining Rulings Rest On The Flawed Breach Of Contract Analysis, Those Rulings Should Also Be Reversed

A. Question Presented

The trial court based its remaining holdings on legal error: on the mistaken conclusion the managers were not authorized to pay themselves. If the payments were authorized under the Operating Agreement, did the trial court err in finding a breach of fiduciary duty, fraudulent concealment, civil conspiracy and aiding and abetting?[8]

B. Scope of Review

Errors of law are reviewed *de novo*, regardless of the nature of the claim. *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 439 (Del. 2000) (in review of a breach of fiduciary duty action: "[o]ur review of legal issues is *de novo*"). For example, even under an abuse-of-discretion standard, a decision-maker who bases the exercise of its discretion on a legal error has committed an abuse of discretion. *McLane Co. v. E.E.O.C.*, 581 U.S. 72, 81 n.3 (2017).

C. Merits of the Argument

The trial court's breach of duty analysis rests on an error of law: the Operating Agreement precludes managers from receiving management fees for services

[8] Preserved, *inter alia*, at Defendants Opening Brief in Support of Their Motion to Dismiss at 29 (July 11, 2018), Defendants' Pre-trial Brief at 23-27 (December 1, 2020) & Defendants' Supplemental Answering Brief in Opposition to Plaintiff's Supplemental Opening Brief at 7-8 (September 10, 2021).

rendered in their capacity as officers. (Op. 75.) The court found paying the managers who did the actual work of conducting the stone-paper business was "designed to enrich Blanch and Skinner at Clovis's expense and were not intended to 'advanc[e] the best interests' of Clovis." (*Id.*) The trial court based this conclusion on the theory that "these payments were not authorized in the manner required by the LLC Agreement…" (*Id.*) But, if (as explained above) the Operating Agreement did allow for the management fees, there was no breach of fiduciary duty.

Indeed, there is nothing unlawful about receiving compensation for performing services. If that were the case, every employee would be putting his or her interests before the company simply by receiving a salary. There is also nothing unlawful about using compensation to pay one's personal expenses. And, the purported "subterfuge designed to conceal their conduct," based on payment to defendants' companies, is a complete fiction. (*Id.*) If Blanch and Skinner were entitled to receive compensation, it made no difference whether that compensation was paid to them personally or to their companies.

The payments the trial court found Diamond acquiesced to were paid to Skinner's company, Skinner Capital. Further, that Vivianna Blanch formed Red Bridge due to unrelated litigation, is irrelevant. It was no secret Vivianna Blanch owned Red Bridge and Skinner owned Skinner Capital. Both signed the Operating

Agreement in their respective capacities as members of those entities, as did Diamond as a member of Plaintiff. (A000190.) In recounting the conversation in which Diamond agreed to the management fees, Skinner specifically referenced the entities (A000576, 270:11-20), and Eisenberg referenced Red Bridge by name in his September 2015 email to Diamond (A000196). The effort to paint the Blanch Defendants as "bad guys" based on the payment of management fees to Red Bridge is entirely misplaced.

Similarly, the trial court's fraudulent concealment analysis rests on the same mistake of law. The sole finding the court relied on in holding the managers had fraudulently concealed was "their self-dealing" in the payments they received. (Op. 85.) The court concluded the managers were actively concealing "their misappropriation of funds from Clovis" (*id.* 86), but, as explained above, it was not misappropriation for the managers to pay themselves a salary for the day-to-day work rendered in their capacity as officers of Clovis. In fact, the Operating Agreement expressly allowed them to do just that. (A000171, §4.1(c).)

And, the same holds true for the trial court's civil conspiracy and aiding and abetting analysis. Again, based on its breach of contract finding, the court found "a civil conspiracy to misappropriate Clovis's funds." (Op. 88.) It stated, they "misappropriated funds from Clovis in breach of their fiduciary duty of loyalty and, in so doing, committed fraud." (*Id.* 89.) Without the improper breach of contract ruling, the basis for the court's holdings on civil conspiracy and aiding and abetting collapse. Accordingly, this Court should reverse all counts against Blanch, Vivianna Blanch, and Red Bridge, as they rest on clear errors of law.

V. The Trial Court Erred In Awarding Damages Directly to Plaintiff

A. Question Presented

Did the trial court err when it ordered all damages were to be paid directly to Plaintiff?[9]

B. Scope of Review

Determining whether a claim is direct or derivative is a question of law. *Citigroup Inc. v. AHW Inv. P'ship*, 140 A.3d 1125, 1126 (Del. 2016). Errors of law are reviewed *de novo*. *Int'l Telecharge, Inc.*, 766 A.2d at 439.

C. Merits of the Argument

The trial court's holding that the claims were direct rest on legal error. In *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, this Court created "a simple test of straightforward application to distinguish direct claims from derivative claims." *Brookfield Asset Mgmt., Inc. v. Rosson*, 261 A.3d 1251, 1263 (Del. 2021) (citing *Tooley,* 845 A.2d 1031 (Del. 2004)). Under that test, "the determination of whether a stockholder's claim is direct or derivative 'must turn *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy

[9] Preserved, *inter alia*, at Defendants Opening Brief in Support of Their Motion to Dismiss at 21–23 (July 11, 2018), Defendants' Supplemental Answering Brief in Opposition to Plaintiff's Supplemental Opening Brief at 22-27 (September 10, 2021) & Counterclaim Plaintiff Clovis Holdings LLC's Post-Trial Reply Brief at 2-4 (March 12, 2021).

(the corporation or the stockholders, individually)?" *Id.* (quoting *Tooley*, 845 A.2d at 1033). If either inquiry points to the entity, then the claim is derivative. *Tooley*, 845 A.2d at 1039. The same analysis is applicable in the alternative entity context, like here, where the company is a limited liability company. *See Allen v. El Paso Pipeline GP Co., L.L.C.*, 90 A.3d 1097 (Del. Ch. 2014).

First, the trial court's determination that Plaintiff's claims were direct relied entirely on an incorrect holding in its prior opinion on defendants' motion to dismiss. (*See* Op. 54 ("The court previously held that Plaintiff's claims under Section 5.2 are direct claims.").)

The trial court's ruling on the motion to dismiss analyzed a pre-amended complaint, found Count I was both direct (as to informational rights) and derivative (as to reimbursements) and did not fully address both *Tooley* factors. It was therefore legal error for the court to rely exclusively on this prior holding in awarding damages directly to Plaintiff.

Specifically, in its May 2019 Opinion, the court determined Count I was partially direct, because, "Section 5.2 requires the Company to *disclose terms and conditions* of any interested transaction to its members, including Stone, before carrying it out" and, since that was "a personal right belonging to the members." (May Op. 11 (emphasis added).) But, the court's analysis stopped there and failed to analyze what damages would flow from a non-disclosure and "who would receive the benefit of any recovery." (*Id.)*

The May 2019 Opinion, however, shed some light on how such damages should be handled. In determining whether a breach of Section 4.9 was a direct claim, the trial court noted, "the Company suffered harm by reimbursing expenses without assessing whether they were reasonable and without board approval for large expenses" and thereby held "[a]ny recovery related to improperly paid expenses would flow to the Company." (*Id.* 11.)

The trial court's holding with regard to Section 4.9 applies equally to any damages from Section 5.2's prohibition on interested transactions and the damages ultimately awarded by the court. As this Court has held, when a company is alleged to have improperly paid, or overpaid, amounts, such claims "are normally treated as causing harm solely to the corporation and, thus, are regarded as derivative." *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248, 1261 (Del. 2016) (citations omitted). More specifically, such claims "naturally assert that the corporation's funds have been wrongfully depleted, which, though harming the corporation directly, harms the stockholders only derivatively so far as their stock loses value." *Protas v. Cavanagh*, 2012 WL 1580969, at *6 (Del. Ch. May 4, 2012) (citation omitted).

Thus, although payments may diminish the value of an individual's holdings in a company, such "harms are merely the unavoidable result . . . of the reduction in the value of the entire corporate entity, of which each share of equity represents an equal faction. In the eyes of the law, such equal 'injury' to the shares resulting from a corporate overpayment is not viewed as, or equate with, harm to specific shareholders individually." *Id.* (quotation and citation omitted). *See also In re TerraForm Power, Inc. S'holders Litig.*, 2020 WL 6375859, at *9 (Del. Ch. Oct. 30, 2020) ("[C]orporate overpayment is the quintessence of a claim belonging to an entity: that fiduciaries, acting in a way that breaches their duties, have caused the entity to exchange assets at a loss.").

The damages awarded in this case were just that, harms purportedly resulting from a wrongful depletion of Clovis's funds, which would harm Clovis directly and its shareholders derivatively. In fact, the trial court acknowledged this very point: "Blanch and Skinner misappropriated funds from Clovis in breach of their fiduciary duty of loyalty and, in so doing, committee fraud…. These unlawful acts *caused damage to Clovis*." (Op. 90 (emphasis added).) The post-trial opinion further states: "The misappropriations proximately caused damage to Clovis" (*id.* 61) and "Blanch and Skinner breached their fiduciary duties owed to Clovis" (*id.* 90).

Finally, awarding damages from Red Bridge and Vivianna Blanch directly to Plaintiff constituted further legal error, as the court's damages award was based entirely on a breach of Section 5.2. (*See* Op. 104–105 (awarding damages for "breaches of Section 5.2 of the LLC Agreement.").) However, Plaintiff had no claims against Red Bridge and Vivianna Blanch for breach of the Operating Agreement. (Ex. C.) Thus, the court's award of direct damages constitutes legal error.

VI. The Trial Court Erred In Awarding Damages Jointly And Severally

A. Question Presented

Did the trial court err when it awarded certain damages jointly and severally?[10]

B. Scope of Review

Errors of law are reviewed *de novo*. *E.g.*, *Int'l Telecharge, Inc.*, 766 A.2d at 439.

C. Merits of the Argument

The trial court awarded damages directly to Plaintiff solely under Section 5.2. (Op. 104.) However, citing *In re Rural/Metro Corp. S'holders Litig.*, the court relied on the fiduciary duty claims to hold all defendants jointly and severally liable. (*Id.* 105-106) ("[a] defendant who aids and abets a breach of fiduciary duty is jointly and severally liable for the damages resulting from the breach.") As the court did not award damages for breach of fiduciary duty—and, under its own reasoning, could not, because such claim is derivative, not direct—its finding of joint and several liability must be reversed.

Further, even had the court awarded damages for breach of fiduciary duty, its opinion shows joint and several liability is unavailable. In its analysis, the court

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[10] Preserved, *inter alia*, at Motion for Reargument at 11-12 (August 6, 2021), Defendants' Pre-Trial Brief at 22 (December 1, 2020), Defendants' Supplemental Answering Brief in Opposition to Plaintiff's Supplemental Opening Brief at 15 (September 10, 2021).

acknowledged Section 7.1(a) only permitted liability when a manager, *inter alia*, "personally gained in fact a financial benefit to which he or she is not entitled." (Op. 78 (quoting A000176).) In that regard, the court held Blanch liable for breach of fiduciary duty for the management fees paid to him—not those paid to Skinner: "each, through their respective LLCs, gained a financial benefit to which they were not entitled" and, therefore, were "personally liable for their breaches of fiduciary duty." (*Id.*)

Likewise, in finding Viviana Blanch and Red Bridge liable for aiding and abetting, the court relied on the fact that Blanch's fees were paid to Red Bridge. (*Id.* 90.) Such a holding did not, and could not, apply to the payments made to Skinner—there were no facts presented that the Blanch Defendants personally benefited in any way from the management fees paid to Skinner or that the Blanch Defendants were the mechanism through which they were obtained. Thus, the court's joint and several liability finding must be reversed.

VII. Because No Breach Occurred, Plaintiff Is Not Entitled To Fees

A. Question Presented

If this Court reverses on the merits, should the fee award also be reversed?[11]

B. Scope of Review

This Court reviews a trial court's attorneys' fee award for an abuse of discretion. *Bako Pathology LP v. Bakotic*, 288 A.3d 252, 266–67 (Del. 2022). It will not disturb the trial court's factual findings unless they are clearly erroneous. *Id.* at 267.

C. Merits of the Argument

"Delaware follows the so-called 'American Rule.'" *Brice v. State, Dep't of Correction*, 704 A.2d 1176, 1178 (Del. 1998). "[T]he American Rule requires that 'a litigant must, himself, defray the cost of being represented by counsel.'" *Dover Hist. Soc., Inc. v. City of Dover Planning Com'n*, 902 A.2d 1084, 1089 (Del. 2006). But, Delaware also recognizes a few limited exceptions arising from contract, fee-shifting statutes and common law equitable exceptions. *Brice*, 704 A.2d at 1178.

The common law equitable exception at issue here provides that a court may shift attorneys' fees to a losing party for bad faith litigation. As this Court has explained, "[o]ne of the well-recognized common law exceptions to the American

[11] Preserved, *inter alia*, via arguments on the merits, *e.g.*, A272–274, Defendants' Supplemental Answering Brief in Opposition to Plaintiff's Supplemental Opening Brief at 1, 7-8, 21-22 (September 10, 2021) & Fee Op. 21 & n.61.

Rule is the power of a court or an administrative tribunal, otherwise vested with equitable authority, to award attorney's fees when the '*losing* party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons.'" *Id.* at 1179 (quoting *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 258–59 (1975)) (some internal quotation marks omitted; emphasis added). And in describing the bad-faith exception, this Court has repeatedly limited it to bad faith by the losing party. *See, e.g.*, *Dover Hist. Soc.*, 902 A.2d at 1093 ("Delaware courts have the power to shift attorneys' fees where a '*losing* party has acted in bad faith….'") (citation omitted; emphasis added); *Kaung v. Cole Nat. Corp.*, 884 A.2d 500, 506 (Del. 2005) (same); *Blue Hen Mech., Inc. v. Christian Bros. Risk Pooling Tr.*, 117 A.3d 549, 558 n.38 (Del. 2015) (same); *RBC Cap. Markets, LLC v. Jervis*, 129 A.3d 816, 877 (Del. 2015) (same).

Here, the trial court made clear it would not award fees to a losing party. It based its rejection of the Blanch Defendants' motion for attorneys' fees in part on the fact they "cite[d] no authority supporting an award of fees to a losing party under the bad faith exception." (Fee Op. 21.) The court even emphasized, by quoting from Blanch Defendants' brief, "that 'a *prevailing party* may obtain an award of attorneys' fees.'" (*Id.* 21 & n.61 (emphasis in original).)

The fact the trial court concluded a losing party may not be awarded attorneys' fees is relevant even on review, as this Court has made clear it will "not substitute

[its] own notions of what is right for those of the trial judge if that judgment was based upon conscience and reason, as opposed to capriciousness or arbitrariness." *EMAK Worldwide, Inc. v. Kurz*, 50 A.3d 429, 432 (Del. 2012) (citation omitted). Put simply, if the court had applied the law correctly on the merits and recognized the Blanch Defendants did not breach the Operating Agreement, then when it exercised its discretion it would not have awarded fees to Plaintiff as a losing party. Thus, should this Court find reversal error on the issues raised above, this Court should also reverse the trial court's award of fees.

CONCLUSION

For these reasons, this Court should reverse the judgment of the trial court and enter judgment in favor of Defendants.

Dated: October 16, 2023

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