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IN THE SUPREME COURT OF THE STATE OF DELAWARE

KATHERINE D. CROTHALL, *et al.* Defendants Below/Appellants, - and - ADHEZION BIOMEDICAL, LLC, a Delaware limited liability company, Nominal Defendant/Appellant, v. ROBERT ZIMMERMAN, Plaintiff Below/Appellee, - and - THE WILLIFORD FIRM, LLC and EVAN O. WILLIFORD, Intervenors Below/Appellees	)	No. 608, 2013

JOINT OPENING BRIEF OF DEFENDANTS BELOW/APPELLANTS, KATHERINE D. CROTHALL, MICHAEL GAUSLING, PETER MOLINARO, ROBERT TONI, STEVE BRYANT, ORIGINATE ADHEZION A FUND, INC., A DELAWARE CORPORATION, ORIGINATE ADHEZION Q FUND, INC., A DELAWARE CORPORATION, ORIGINATE VENTURES, LLC, A DELAWARE LIMITED LIABILITY COMPANY, LIBERTY VENTURES II, L.P., A DELAWARE LIMITED PARTNERSHIP, LIBERTY ADVISORS, INC., A DELAWARE CORPORATION, AND THOMAS R. MORSE AND NOMINAL DEFENDANT/APPELLANT ADHEZION BIOMEDICAL, LLC

Appeal from the Decision of the Court of Chancery, C.A. No. 6001-VCP

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NATURE AND STAGE OF THE PROCEEDINGS

This is an appeal from an attorneys' fee award erroneously entered by the Chancery Court. The intervenors below, The Williford Firm, LLC and Evan O. Williford (collectively, "Williford"), filed a derivative action on behalf of their former client, Robert Zimmerman, which proved to be a massive waste of resources for all involved. Williford lost all but a single claim, on which the Chancery Court erred as a matter of law. Thus, there was and is no legal basis to support an award of fees.

The sole issue on which Williford succeeded was his former client's claim that the defendants below had committed a technical, harmless breach of Adhezion Biomedical, LLC's operating agreement by approving certain financing transactions without the formal consent of Adhezion's common unitholders. For the more than two years in which this action was litigated in the Chancery Court, this issue had been nothing more than an afterthought. Instead, Williford's entire focus had been on the mistaken contention that the defendants had taken advantage of their supposed control over Adhezion to force it to enter into these financing transactions on purportedly unfair terms. The reality, as the Chancery Court found following a three-day trial, is that defendants infused desperately needed capital into Adhezion at a time when Zimmerman (a co-founder of Adhezion) refused to do so. Because these transactions were fair to Adhezion and benefited the

common unitholders, the Chancery Court upheld them, but awarded Zimmerman nominal damages of $1 for defendants' purported technical breach of the operating agreement.

Following this ruling, Zimmerman terminated Williford's services and abandoned the lawsuit, selling his units to another Adhezion investor who is not a defendant in this case. Because there was no longer any plaintiff with standing in the case, the Chancery Court declined to enter a judgment on the merits.

Nevertheless, Williford asked the Chancery Court for an award of attorneys' fees. Williford said that his lodestar, based on 581 hours of total work and total costs and expenses for all claims, was $337,359.59. Yet he requested an award of $400,000. Of this amount, $200,000 was supposed to reflect an alleged "common fund" that he said the lawsuit had created, based on purported "improvements" in later financing transactions that Zimmerman never challenged. The other $200,000 was supposed to represent the "corporate benefit" purportedly resulting from the Chancery Court's interpretation of Adhezion's operating agreement as requiring common unitholder approval of the transactions.

The Chancery Court properly rejected Williford's "common fund" argument, but erroneously found that its interpretation of the operating agreement had conferred a corporate benefit on Adhezion. The Chancery Court, with virtually no explanation, then awarded Williford $300,000, more than the $200,000

he himself attributed to the supposed corporate benefit, and nearly the entirety of his lodestar of $337,359.59.

The Chancery Court should be reversed. There was no legal basis to award Williford any fees, let alone an amount almost equal to the lodestar, when (i) the Chancery Court's interpretation of Adhezion's operating agreement was wrong as a matter of law; (ii) even if it were correct, the Chancery Court's interpretation of Adhezion's operating agreement did not confer a "benefit" on the company or its unitholders; and (iii) Williford spent very little time and effort on the interpretation of the operating agreement during the nearly two-years that this case was litigated in the Chancery Court.

SUMMARY OF ARGUMENT

The Chancery Court's fee award to Williford should be reversed for three reasons.

1. The Chancery Court's interpretation of Adhezion's operating agreement did not confer a corporate benefit on Adhezion or its common unitholders because that interpretation was wrong as a matter of law. The Chancery Court wrongly found Adhezion's operating agreement to be ambiguous and then ignored the only evidence presented at trial to resolve the ambiguity. The plain terms of the operating agreement make clear that the transactions Williford unsuccessfully challenged below did not require the approval of common unitholders.

2. Even if the Chancery Court's interpretation of Adhezion's operating agreement as requiring common unitholder approval of the transactions were correct, that ruling simply is not a corporate benefit that deserves an award of attorneys' fees, and certainly not an award of $300,000. To the extent that the interpretation "benefits" anyone, it benefits only the common unitholders, not Adhezion as a whole. And the value of the "benefit" is wholly speculative because there is no evidence that the common unitholders have ever needed, or will need, the additional leverage their new found approval rights are supposed to provide. Moreover, the more than two years of time, effort and money Adhezion was forced

to devote to this action were not a net benefit to anyone, not even the common unitholders.

3. The Chancery Court erred by awarding Williford almost the entire amount of his claimed lodestar, when the sole claim on which he and his former client prevailed at trial was an afterthought to which he devoted almost no time and effort. Instead, nearly all of Williford's effort — every interrogatory, document request and deposition taken in discovery, virtually all of the briefing, and every witness presented at trial — was focused solely on the contention that the financing transactions were unfair. That contention failed, resulting in a complete waste of time, effort and money for Adhezion, the defendants below and Williford.

STATEMENT OF FACTS

A. THE PARTIES

This action was filed on November 18, 2010 by Robert Zimmerman, a minority common unitholder in Adhezion Biomedical, LLC, a manufacturer of surgical adhesives. Oct. 14, 2013 Op., attached as Exhibit A, at 3. Zimmerman was a co-founder and former CEO of Adhezion. Jan. 31, 2013 Op., attached as Exhibit B, at 2. After the trial, but before judgment was entered, Zimmerman sold all of his units, depriving him of standing. Ex. A at 2. His former counsel, Williford, then intervened in the case. Ex. A at 4. Williford's only interest at this point is in being compensated for all of the fruitless time he spent in prosecuting the case.

This appeal is brought by nominal defendant below Adhezion and by the defendants below, the members of Adhezion's board of directors, Katherine D. Crothall, Michael J. Gausling, Peter Molinaro, Robert Toni, and Steven R. Bryant ("the Board"); two venture capital firms that invested in Adhezion, Liberty Advisors, Inc. ("Liberty"), and Originate Ventures, LLC ("Originate"), and their affiliates; and Thomas R. Morse, a Liberty principal.

B. ORIGINATE AND LIBERTY'S INITIAL INVESTMENTS IN ADHEZION

When it was founded, Adhezion had only common unitholders, one of whom was Zimmerman, and no cash resources to develop its products. In March

2008, Zimmerman negotiated a $3 million investment from defendant Originate. Ex. B at 4; A.399-A.400. As part of that investment, Zimmerman and his counsel negotiated a new operating agreement for Adhezion (the "Operating Agreement") with Originate and its counsel, Pepper Hamilton LLP.[1] Ex. B at 4-5. The Operating Agreement gave Originate a preferred equity position in Adhezion. Ex. B at 4-5. Its ownership units were denominated as "Series A preferred units." Ex. B at 4-5.

Although Zimmerman claimed at trial that there "wasn't ...any real negotiation" with Originate, because "they had us over a barrel," the record refuted these assertions. A.400. Christopher Miller, a lawyer at Pepper Hamilton, testified that Zimmerman insisted that certain provisions be included in the Operating Agreement, including provisions that were "specifically negotiated... so that the company could issue additional units without having to get the consent of the common unitholders." A.408; *see also* A.405. In addition, Zimmerman's own

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[1] In the time period at issue in this action, there were three versions of Adhezion's Operating Agreement: the March 2008 Operating Agreement, A.74-A.132, which was entered into when Originate made its initial investment; an amended October 2008 Operating Agreement, A.152-A.215, which was entered into when Liberty made its initial investment, discussed below; and a further amended February 2010 Operating Agreement, A.216-A.279, which was entered into in connection with a February 2010 Preferred Equity Transaction, also discussed below. Because the relevant provisions in these three versions of the Operating Agreement are virtually identical, we generally will refer to Adhezion's Operating Agreement in the singular, and distinguish among the three versions only when necessary.

testimony demonstrates that he had significant bargaining power in the transaction. For instance, he negotiated an employment agreement under which he would serve as Executive Vice President for Business Development. A.133-A.151; A.401. This employment agreement included an "equity incentive grant" under which Zimmerman would receive 2% of equity in Adhezion if he were able to accomplish certain milestones. A.401-A.405. Zimmerman specifically negotiated this agreement so that the equity interests he received under this incentive system would be calculated on a "fully-diluted basis," meaning that for each milestone reached he would receive, not 2% of the outstanding units in Adhezion, but 2% of the total number of units that would exist if all options and warrants for the purchase of Adhezion units were exercised. A.402; A.137. Zimmerman said that he insisted on this because "[t]hat's the way [he] wanted it." *Id.* at A.402. He testified that "[t]hey didn't want to give it to me that way, but that's how it happened." A.402.

Adhezion consumed the $3 million invested by Originate quickly and in a few months it was virtually out of cash. In October 2008, Adhezion negotiated a new $2 million investment from Liberty, which, like Originate, received Series A preferred units. Ex. B at 6.

C. THE CHALLENGED TRANSACTIONS

The $2 million provided by Liberty was likewise quickly consumed. Unable to find any outside financing, Adhezion was forced repeatedly to turn to its existing unitholders for financing. Ex. B at 7-9. Over the next two years, the Board approved four financing transactions, which Zimmerman unsuccessfully challenged below as supposedly unfair to Adhezion. These four transactions (the "Challenged Transactions") were:

- A July 2009 Convertible Debt Transaction: Originate, Liberty, and other unitholders provided Adhezion with a total of $525,000 in return for promissory notes convertible into Series A preferred units at approximately $7.05 per unit. Ex. B at 9;
- A December 2009 Convertible Debt Transaction: Originate, Liberty and other unitholders provided Adhezion with a total of $315,000 in return for promissory notes convertible into Series A preferred units at approximately $7.05 per unit. Ex. B at 12;
- A February 2010 Preferred Equity Transaction: Originate, Liberty and other unitholders purchased a total of 625,000 of units of a new series of preferred equity in Adhezion (Series B preferred units) at $4 per unit. Additional units were reserved for common unitholders at the same price. Some common

unitholders chose to purchase them, but Zimmerman did not. Ex. B at 13-15;

- A January 2011 Convertible Debt Transaction: Originate and other unitholders provided Adhezion with a total of $1,285,000 in return for promissory notes convertible into Series B preferred units at $4 per unit. Ex. B at 17.

Zimmerman alleged that these transactions undervalued the company and involved unfair self-dealing. Ex. B at 18-19. The Chancery Court rejected these allegations. Ex. B at 18. The trial record established that Adhezion was in constant need of cash and constantly on the verge of collapse. Ex. B at 57-61. Defendants saw their initially risky investments grow increasingly more precarious as Adhezion struggled unsuccessfully to find outside financing, failed to secure contracts with strategic partners to distribute its only commercially available product, and then was forced to completely reformulate that product to avoid its competitor's patents. Ex. B at 57-61. Rather than allow the company to fail, which would have left Zimmerman and all other investors with nothing, defendants continued to shoulder the mounting risk by investing additional money that no one else was willing to provide, on terms that were more than fair to the company and its unitholders. Ex. B at 60-61, 65.

In addition to claiming, wrongly, that the Challenged Transactions were unfair, Zimmerman also claimed that Adhezion's Board breached the Operating Agreement because they did not obtain the approval of Adhezion's common unitholders for the transactions. Ex. B at 19-20. This lack-of-approval claim was based on a misreading of three provisions of Adhezion's Operating Agreement, Sections 3.2, 3.8 and 15.11. A.87-88, A.90-91, A.120, A.165-166, A.199, A.229-230, A.233-234, A.263.

Section 15.11 of Adhezion's Operating Agreement requires a vote of the common unitholders to adopt certain amendments. It states:

> **Except as otherwise provided in Section 3.8 hereof with respect to the issuance of additional Units**, this Agreement and any term hereof may be amended and the observance of any term hereof may be waived... with the written consent or vote of (a) a Required Interest of the Preferred Members, voting together as a single, separate class, and (b) a Majority-in-Interest of the Common Members, voting together as a single, separate class....

A.120, A.199, A.263 (emphasis added).

As the very first sentence of Section 15.11 states, the general requirement that Adhezion's common unitholders approve amendments to the Operating Agreement does *not* apply to amendments necessary to effectuate the issuance of additional units under Section 3.8 of the Operating Agreement. A.120, A.199, A.263. That section in turn provides:

> Subject to the provisions of Section 3.2 hereof, **the Board of Directors may, at any time and from time to time, issue additional Units** (including, without limitation, Class B Common Units pursuant to Section 3.3(b) hereof) or **create additional Classes or Series of Units having such relative rights, powers and duties as the Board of Directors may establish**, including rights, powers and duties **senior to the existing classes of Units**.

A.90-91, A.169, A.233-234 (emphasis added).

Lastly, Section 3.2 states that the Board's ability to "create, authorize or reserve any Units or Derivative Rights," or "issue, sell or grant any Units or Derivative Rights," is subject to the approval of a "Required Interest" (*i.e.*, two thirds) of the preferred unitholders (the holders of Series A and Series B preferred units). A.87, A.165, A.229-230.

Zimmerman made two erroneous arguments about these provisions. First, he argued that because Section 3.2 refers to "creat[ing], authoriz[ing] or reserv[ing]" units, the drafters of the Operating Agreement must have meant to distinguish "authorizing" units from "creating" them. At the same time, Section 3.8 of the Operating Agreement says that the Board has the power to "create" and "issue" additional units, and additional series or classes of units, but does not expressly say that the Board can "authorize" them. Thus, Zimmerman contended, the drafters of the Operating Agreement must have intended not to give the Board the power to "authorize" units in Section 3.8. Ex. B at 25-26.

Second, Zimmerman argued that because the first sentence of Section 15.11 refers only to the "issuance of additional units," the exception to the requirement of common unitholder approval of amendments to the Operating Agreement embodied in that sentence must apply only to amendments related to "issuing" additional units, or classes or series of units. Ex. B at 31. According to Zimmerman, amendments related to other actions mentioned in Section 3.8, such as "creating" units, require common unitholder approval. Ex. B at 31.

After a three-day trial, Ex. B at 1, as shown below, the Chancery Court erroneously accepted Zimmerman's first argument and properly rejected the second.

D. PROCEDURAL HISTORY

Williford filed this action on Zimmerman's behalf in November 2010. A.73. In his original complaint, Williford asserted only that the Challenged Transactions were unfair and did not assert a separate count based on his later developed theory, described in the preceding section, that the Challenged Transactions supposedly breached the Operating Agreement because they were not approved by the common unitholders. A.280-A.298. In May of 2011, Williford filed an amended complaint, asserting this separate count for the first time. A.299-A.326. Even then, Williford took no discovery on the claim, choosing instead only to develop the unfairness claims. He did not serve a single discovery request or ask a single

question at a deposition about the claim that the common unitholders had not approved the Challenged Transactions.

Defendants moved for summary judgment, and the Chancery Court issued an opinion on March 27, 2012, attached as Exhibit C. In this opinion, the Chancery Court granted partial summary judgment to defendants on several of Zimmerman's claims. Ex. C at 1. However, with respect to the lack-of-approval claim, it found two ambiguities.

First, the Chancery Court found that the exception to the requirement that amendments be approved by a majority of common unitholders in the first sentence of Section 15.11 of the Operating Agreement could be understood in two different ways. As set forth above, that exception reads: "Except as otherwise provided in Section 3.8 hereof with respect to the issuance of additional Units ...." A.120, A.199, A.263. The Chancery Court concluded that, on the one hand, this language "reasonably could be read to mean, as Plaintiff urges, that only the issuance of Units under § 3.8 is exempted from the requirement under § 15.11 that a majority of the Class A Common Members must approve amendments to the Operating Agreement." Ex. C at 49-50. On the other hand, the Chancery Court concluded that "the proposed construction advanced by the Defendants also seems reasonable: *i.e.*, that § 15.11's reference to 'issuance of additional Units' with

regard to § 3.8 was meant as a shorthand reference to § 3.8 as a whole, inclusive of the provision regarding the creation of new securities." Ex. C at 50.

Second, the Chancery Court found that Section 3.8's reference to the power of the Board to create and issue new units and new series or classes of units also could be understood in two different ways. Ex. C at 50. On the one hand, the Chancery Court found that it could not "dismiss as unreasonable Zimmerman's more narrow interpretation of 'create' in § 3.8. Ex. C at 50. The use of both the terms 'create' and 'authorize' in § 3.2 suggests that 'create' was intended to carry a meaning distinct from 'authorize.'" Ex. C at 50. On the other hand, the Chancery Court recognized the "alternative, reasonable inference . . . that the parties intended the term 'create' in § 3.8 to include the power to 'authorize.'" Ex. C at 50.

Given these two ambiguities in the Operating Agreement, as found by the Chancery Court, the burden of proof was on plaintiff Zimmerman to present testimony at trial to resolve the ambiguities in his favor. He failed to do so.

The Chancery Court held a three-day trial in April 2012. At trial, Christopher Miller, Esq. was the only witness to testify about the meaning of the Operating Agreement. Miller testified that the drafters of the Operating Agreement intended to give the Board broad authority under Section 3.8 to create and issue additional units, or additional series or classes of units, and specifically

to do so *without common unitholder approval*. *See* A.405, A.408. Williford presented no evidence to rebut this, and indeed chose not to examine Miller at all.

After post-trial briefing and oral argument, the Chancery Court issued a Post-Trial opinion on January 31, 2013. The Chancery Court found that all of the Challenged Transactions "provided the Company with crucial capital on fair terms," and rejected Zimmerman's arguments that defendants had breached their fiduciary duties. Ex. B. at 67. However, the Chancery Court found as a technical matter that amendments necessary to effectuate the Challenged Transactions required approval of the common unitholders under Section 15.11, which was not obtained. Accordingly, the Chancery Court concluded that Adhezion's Board had exceeded their authority in engaging in the financing transactions, and awarded nominal damages of $1 for this technical breach, but otherwise denied all of Zimmerman's requested relief. Ex. B at 65-73.

E. WILLIFORD'S PETITION FOR ATTORNEYS' FEES

After the Chancery Court's post-trial rulings, Zimmerman abandoned this action and sold all of his units to another Adhezion investor. The defendants below filed a motion to dismiss the case because Zimmerman's sale of units had divested him of standing. Ex. A at 5-7, 10-13. The court granted this motion. Ex. A at 5-7, 10-13.

The Chancery Court permitted Williford to intervene to file a petition for attorneys' fees. Williford's petition requested that the court award him $200,000 based on the theory that his legal work had created a "common fund" for Adhezion stockholders due to supposed improvements in subsequent transactions that Williford never challenged, and another $200,000 based on the theory that the Chancery Court's conclusion that the Challenged Transactions required common unitholder approval had conferred a "common benefit" on Adhezion. Ex. A at 29; A. 593. Williford claimed that the lodestar for the litigation, which covered all of Zimmerman's claims (including the claims that the Chancery Court rejected) totaled 581 hours of work and expenses, amounting to $337,359.59. Ex. A at 29. The court granted Williford's petition for fees and awarded him $300,000. Ex. A at 13-32; *see* Oct. 15, 2013 Final Order, attached as Exhibit D.

ARGUMENT

I. WILLIFORD DID NOT CREATE A CORPORATE BENEFIT BECAUSE THE CHANCERY COURT'S INTERPRETATION OF THE OPERATING AGREEMENT IS WRONG AS A MATTER OF LAW.

A. QUESTION PRESENTED

Whether the Chancery Court's interpretation of Adhezion's Operating Agreement as requiring common unitholder approval of the Challenged Transactions is wrong as a matter of law. A.380-A.382, A.405-A.409, A.462-A.467, A.561-A.564, A.671-672.

B. STANDARD AND SCOPE OF REVIEW

The interpretation of Adhezion's Operating Agreement is a question of law that "that this Court reviews *de novo* for legal error. To the extent the Chancery Court's interpretation of the contract rests upon findings extrinsic to the contract, or upon inferences drawn from those findings, . . . [the Court] defer[s] to the trial court's findings, unless the findings are not supported by the record or unless the inferences drawn from those findings are not the product of an orderly or logical deductive reasoning process." *Honeywell Int'l Inc. v. Air Prods. & Chems., Inc.*, 872 A.2d 944, 950 (Del. 2005). That is the situation here.

C. MERITS OF THE ARGUMENT

The Chancery Court erred in holding that the Challenged Transactions required the approval of Adhezion's common unitholders.

First, despite holding at the summary judgment stage that the Operating Agreement is ambiguous, the Chancery Court ignored the only testimony presented at trial to resolve the ambiguity.

Second, the Operating Agreement simply is not ambiguous. Rather, by its plain terms, the Board had the authority to amend the Operating Agreement to create, authorize and issue the preferred units involved in the Challenged Transactions, without the consent of Adhezion's common unitholders.

1. THE CHANCERY COURT ERRONEOUSLY CONCLUDED THAT THE OPERATING AGREEMENT IS AMBIGUOUS, THEN IGNORED THE ONLY TESTIMONY PRESENTED AT TRIAL TO RESOLVE THE AMBIGUITY.

Because it held that Adhezion's Operating Agreement was ambiguous, the Chancery Court correctly recognized that the burden of proof was on Williford and his former client, Zimmerman, to present testimony at trial to establish that their proposed interpretation of the Operating Agreement was correct. *See* Ex. B at 22 ("As the party seeking enforcement of his interpretation of the Adhezion Operating Agreement, Zimmerman bears the burden to prove his breach of contract claim by a preponderance of the evidence."); *see also Lillis v. O'Leary,* 2008 Del. Ch. LEXIS 233, *11-*12 (May 22, 2008) ("As the party seeking judicial enforcement of their interpretation of the an ambiguous contract, the plaintiffs bear the burden of proof in this action."), attached as Exhibit E.

Williford made no attempt whatsoever to satisfy this burden. He called no witness to testify regarding the meaning of any provision of the Operating Agreement. Williford did not ask Zimmerman a single question regarding either ambiguity found by the Chancery Court. Nor did he cross-examine Christopher Miller, the Pepper Hamilton lawyer representing Originate with whom Zimmerman negotiated the relevant provisions of the Operating Agreement. *See* A.411. For this reason alone, the Chancery Court should have concluded that Zimmerman failed to prove his proposed interpretations of the Operative Agreement and therefore should have resolved both of the putative ambiguities in defendants' and Adhezion's favor.

In any event, the undisputed evidence presented at trial showed that defendants' interpretation of Section 15.11 and 3.8 of the Operating Agreement was correct.

With respect to the first of the two putative ambiguities the Chancery Court found at the summary judgment stage — the ambiguity in the reference to Section 3.8 and the "issuance of additional Units" in the first sentence of Section 15.11 — the Chancery Court properly considered Miller's testimony and resolved that ambiguity in defendants' favor. The Chancery Court concluded that "the language 'with respect to the issuance of additional Units' is not meant as limiting language. Rather, it broadly refers to the subject matter of the provision (Section 3.8) that it

references." Ex. B at 32-33. Thus, the Chancery Court correctly concluded, the approval of Adhezion's common unitholders is *not* required for amendments to the Operating Agreement to effectuate the Board's authority under Section 3.8.

However, with respect to the second of the two putative ambiguities the Chancery Court identified in its summary judgment opinion — whether "create" in Section 3.8 "include[s] the power to 'authorize,'" Ex. C at 49 — it ignored Miller's trial testimony altogether. First, because Section 3.2 refers both to "creating" and "authorizing" units, the Chancery Court inferred that the parties "could have expressly provided the Board with authority to authorize units" in Section 3.8 as well, yet "did not do so." Ex. B at 30. Thus, rather than consider the evidence actually presented at trial, the Chancery Court chose to rely solely on a canon of interpretation — "expressio unius est exclusio alterius" — ungrounded in any evidence at all. This was wrong for two reasons.

First, extrinsic evidence "outweighs" "canons of interpretation." *Delaware Express Shuttle, Inc. v. Older,* 2002 Del. Ch. LEXIS 124, *30 (Oct. 23, 2002), attached as Exhibit F; *cf. Shiftan v. Morgan Joseph Holdings, Inc.,* 2012 Del. Ch. LEXIS 11, *21-*22 (Jan. 13, 2012) (explaining that interpretive principles should not be used to "prevent a court from consulting parol evidence, if that is available"), attached as Exhibit G; *Huong Que, Inc. v. Luu,* 150 Cal. App. 4th 400, 411 (Sixth Dist. 2007) (explaining that "the maxim expressio unius exclusio

alterius est" "can only be invoked if a contract is ambiguous, in which case other legal techniques for the resolution of ambiguities . . . also come into play, *including the admission of extrinsic evidence*" (internal quotation marks omitted)). Here Miller explained why there was no separate reference to "authorizing" units in Section 3.8:

> Q. Okay. So at the risk of being slightly redundant, let's talk about where does the board get the authority to *authorize* new units of any class?
>
> A. Okay. So I think that needs clarifying because I think there's been some confusion about the concept of authorization.
>
> . . .
>
> Different than the act of issuing units, which both corporate statutes and this operating agreement give to the board, and the power to create units, those are powers given to the board subject to the consent of the preferred. *Authorization of units is subsumed within the act of amending the agreement.*
>
> So the question was, what does it take to amend the agreement?
>
> [W]hen issuing additional units, whether of an existing class or series or creating a new series, 15.11 says that you don't follow the requirements of 15.11. Instead, the board has broad authority to issue units, whether of an existing class or a new class, subject to the consent of the preferred under Section 3.2.

A.407.

In short, as Miller testified, "authorizing" additional units, or series or classes of units, is not a separate act requiring a specific grant of authority to the Board, distinct from the authority the Board already possesses to amend the Operating Agreement to issue additional units, or create additional series or classes of units. The Chancery Court simply ignored this testimony.

Second, the Chancery Court erroneously speculated that Zimmerman "would have understood the term 'authorize' to place a limit on the level of dilution he would face before the Board was required to obtain his consent to increase that level." Ex. B at 37-38. But Zimmerman and his then-counsel, Williford, presented no evidence to support that conclusion. Williford asked Zimmerman no questions about whether, or when, he expected his consent as a common unitholder to be obtained prior to dilution, and he offered no testimony whatsoever about what he understood the word "authorize" in the Operating Agreement to mean.

The Chancery Court also erred by applying the principle of *contra proferentem* and construing the Operating Agreement against the defendants and Adhezion. Like *exclusio alterius*, this principle cannot trump extrinsic evidence. Indeed, *contra proferentem* is supposed to be a principle of "last resort" that applies only if extrinsic evidence fails to resolve the ambiguity in the contract. *Sodano v. American Stock Exchange,* 2008 Del. Ch. LEXIS 92, at *46 n.71 (Jul. 15, 2008), attached as Exhibit H. The evidence at trial here showed that Sections

15.11 and 3.8 of Adhezion's Operating Agreement were specifically drafted to permit the Board to create, authorize and issue additional units and additional classes of units without approval of common unitholders. Zimmerman presented absolutely *no* evidence to contradict this.

Moreover, "[t]he *contra proferentem* doctrine is not applicable here because the terms of [Adhezion's operating agreement] were negotiated by sophisticated parties who were represented by counsel." *Sodano,* 2008 Del. Ch. LEXIS 92, at *46 n.71; *see* A.400, A.405. Indeed, as Miller testified, "the purpose of Section 15.11 [governing amendments to the operating agreement] and the reference to or the exception regarding the issuance of additional units was *specifically negotiated*" with Zimmerman in March 2008 "so that the company could issue additional units without having to get the consent of the common holders." A.405; A.408 (emphasis added). The Chancery Court acknowledged these negotiations but concluded that defendants "had the upper hand in those negotiations." Ex. B at 37 n.124. That conclusion is belied by Zimmerman's testimony that he extracted significant concessions in connection with his Adhezion employment agreement, which he negotiated simultaneously with Originate's March 2008 investment.

In sum, there was no evidence to support the Chancery Court's conclusion that the Challenged Transactions required the approval of Adhezion's common unitholders under the Operating Agreement.

2. THE PLAIN MEANING OF THE OPERATING AGREEMENT ESTABLISHES THAT THE BOARD HAD THE POWER TO AUTHORIZE UNITS WITHOUT THE CONSENT OF THE COMMON UNITHOLDERS.

Adhezion's Operating Agreement is not ambiguous. Rather, its plain terms make clear that the Board had the authority to issue and create additional units, and additional series or classes of units, and therefore, by definition, could "authorize" such units as part of that process — subject of course to the consent of the preferred unitholders, which was obtained for each of the transactions.

As already explained, while Section 15.11 of Adhezion's Operating Agreement requires a vote of the common unitholders to adopt certain amendments, the very first sentence of that section exempts the Board's authority under Section 3.8 from that requirement: "**Except as otherwise provided in Section 3.8 hereof with respect to the issuance of additional Units** . . . ." A.120, A.199, A.263 (emphasis added). Section 3.8 in turn gives the Board the power to "issue" and "create" additional units and additional series or classes of units. A.90-91, A.169, A.233-234. If the Board did not have the power to make all necessary amendments to accomplish these acts, then the grant of authority to it in Sections 3.8 and 15.11 would be meaningless.

The Chancery Court erroneously concluded that the Operating Agreement requires a separate act of "authorizing" units, apart from "creating" and "issuing" them, which it concluded was not "expressly provided" for in Section 3.8. Ex. B at

30. That interpretation cannot be correct because, under Delaware law, there is not a separate act of authorizing units. Indeed, the Chancery Court itself acknowledged that "there is no statutory requirement that there be an amendment to the Operating Agreement to increase the number of authorized LLC interests." Ex. B at 28.[2] In any event, the Chancery Court's interpretation of Section 3.8 is based on a misreading of Section 3.2 of the Operating Agreement, which states that the Board cannot "create, authorize or reserve any Units or Derivative Rights" without the consent of a "required interest" (*i.e.*, two thirds) of the preferred unitholders. Ex. B at 30. Section 3.2 gives the *preferred* unitholders, *not* the common unitholders, certain protective consent rights. Section 3.2 therefore cannot be construed to carve out from the Board's powers under Section 3.8 the authority to "authorize" units, in order to then make that authority subject to the general requirement in Section 15.11 that amendments be approved by *common* unitholders. To the contrary, even assuming that "authorizing" units is supposed to

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[2] Under the General Corporation Law, a board of directors may not issue more shares of stock in a corporation than are authorized in its certificate of incorporation. 8 Del. C. § 102(a)(4); 8 Del. C. § 161. By contrast, under the Limited Liability Company Act, there is no provision that limits the issuance of ownership interests in an LLC to some number of interests authorized in its certificate of formation. *See* 6 Del. C. § 18-201. To the contrary, the Act broadly allows "for the future creation in the manner provided in the limited liability company agreement of additional classes or groups of members having such relative rights, powers and duties as may from time to time be established, including rights, powers and duties senior to existing classes and groups of members," without subjecting such additional ownership interests to any separate requirement that they be authorized. 6 Del. C. § 18-302(a).

be a separate act from "creating" or "issuing" units, the sensible reading of Section 3.8 and Section 3.2 together is that the Board does indeed have authority to "authorize" units under Section 3.8, but this authority simply is "subject to" the consent of the preferred, just as the Board's authority to create and issue units is so subject.

Moreover, Section 15.11 already requires that amendments not subject to the Board's authority under Section 3.8 must be approved by a "Required Interest" of the preferred unitholders. A.199, A.263. If the power to "authorize" units were subject to this requirement, then the preferred unitholders' right to consent to the authorization of units under Section 3.2 would be superfluous. As the Chancery Court recognized, "[c]ourts . . . attempt to give meaning and effect to each word in a contract, assuming that the parties would not include superfluous verbiage in their agreement." Ex. B at 22. Yet the Chancery Court's analysis ignores this very precept.

In short, the plain meaning of Sections 3.2, 3.8 and 15.11 of the Operating Agreement establishes that the Board had the authority to amend the Operating Agreement as necessary to exercise its authority to create and issue units, and therefore, to "authorize" them, without the consent of the common unitholders. The Chancery Court's interpretation to the contrary was wrong.

II. THE CHANCERY COURT'S AWARD OF ATTORNEYS' FEES SHOULD BE REVERSED BECAUSE WILLIFORD'S EFFORTS CONFERRED NO COMPENSABLE CORPORATE BENEFIT ON ADHEZION OR ITS UNITHOLDERS.

A. QUESTION PRESENTED

Whether the Chancery Court erred in awarding attorneys' fees to Williford on the basis that his efforts conferred a compensable corporate benefit on Adhezion or its unitholders. A.603-A.605, A.657-659, A.671-672.

B. STANDARD AND SCOPE OF REVIEW

Although this Court reviews an award of attorneys' fees for abuse of discretion, it reviews the Vice Chancellor's interpretation of a contractual provision *de novo*, *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68 A.3d 665, 675 (Del. 2013), and it reviews *de novo* all the legal principles applied in reaching a decision on attorneys' fees, *Alaska Elec. Pension Fund v. Brown*, 988 A.2d 412, 417 (Del. 2010).

C. MERITS OF THE ARGUMENT

Contrary to the Chancery Court's October 14, 2013 opinion, the "corporate benefit" doctrine does not support an award of attorneys' fees here because Williford has failed to identify any substantial economic benefit conferred on Adhezion or its unitholders by this litigation. Accordingly, the Chancery Court erred as a matter of law by applying the corporate benefit doctrine.

As the Chancery Court recognized, "prevailing litigants normally are responsible for their own attorneys' fees." Ex. A at 13 (internal quotation marks omitted). The "corporate benefit" doctrine is a common law exception to this rule, and requires that the litigation confer a "benefit on the stockholders as a whole." *In re First Interstate Bancorp Consolidated S'holders Litig.*, 756 A.2d 353, 358 (Del. Ch. 1999). The benefit must be "substantial" and not "speculative in character." *Richman v. DeVal Aerodynamics, Inc.*, 185 A.2d 884, 885 (Del. Ch. 1962).

Here, the Chancery Court wrongly determined that Williford's "efforts...conferred a significant corporate benefit on [Adhezion] and its unitholders." Ex. A at 21. But the sole "benefit" it identified was the declaratory judgment that the Board technically breached the Operating Agreement because it did not obtain common unitholder approval for the Challenged Transactions. This is not a "benefit" that warrants an award of attorneys' fees under Delaware law.

First, the declaratory judgment was never entered, because Zimmerman sold his Adhezion units and abandoned the action.

Second, Williford's argument, which the Chancery Court apparently adopted, was that by clarifying the common unitholders' approval rights, the Chancery Court had given them more "leverage" that might help to ensure that any future transactions are fair to the company. But that is, at most, a benefit to

Adhezion's common unitholders, not a benefit to Adhezion, and certainly not a benefit to all of its unitholders, as Delaware law requires. *Weinberger v. UOP, Inc.*, 517 A.2d 653, 656 (Del. Ch. 1986). Moreover, the Chancery Court held that all of the transactions at issue below *were fair*, and Williford and his former client offered not a shred of evidence to suggest that future transactions would not likewise be fair. Thus, the "benefit" to the common unitholders of having the additional approval rights the Chancery Court erroneously read into the Operating Agreement is based on nothing more than speculation about what might occur in a hypothetical scenario in which the defendants below were somehow inclined in the future to propose unfair financing transactions for Adhezion. That type of speculative benefit is insufficient to support an award of attorneys' fees.

Third, no Delaware court has ever held that a bare (and unentered) declaratory judgment, without any actual alteration of the operations or governance of the corporation, is a "benefit" that could support an award of attorneys' fees. The Chancery Court's declaratory judgment is nothing more than the "creat[ion] of a rule of law" in "opinions in the case," and is "not a substantial, identifiable economic benefit upon which to base an award of attorneys' fees." *Thorpe v. CERBCO*, 1997 Del. Ch. LEXIS 18 at *13-*14 (Feb. 6, 1997), attached as Exhibit I. The Chancery Court attempted to distinguish *Thorpe* on the ground that "the [c]ourt in *Thorpe* reasoned that extracting a 'rule of law' from its previous

decisions would be a 'highly speculative endeavor,'" and by contrast "[t]he same cannot be said in this case because the issue involved was quite narrow and the ruling called for entry of a very specific declaratory judgment." Ex. A at 25 (quoting *Thorpe*). But the *Thorpe* court actually stated that "predict[ing] the *value* of such a rule of law...is a highly speculative endeavor, not a substantial, identifiable economic benefit upon which to base an award of attorneys' fees." *Thorpe*, 1997 Del. Ch. LEXIS 18, at *14. Here too, predicting the *value* of the Chancery Court's declaratory judgment — as specific as that (unentered) declaratory judgment may be — is just as speculative.

Fourth, when "look[ing] at the net benefits to the corporation produced by the litigation (that is, net of the corporation's own necessary expenses in . . . indemnifying its officers) . . . there would apparently be no benefit to the corporation by reason of the prosecution of this case." *Thorpe,* 1997 Del. Ch. LEXIS 18 at *6 n.1. The only practical result of t lawsuit is that Adhezion was forced to divert time and resources to more than two years of wasted litigation in the Chancery Court. That benefited no one, not even the common unitholders.

In sum, Williford's efforts did not confer a benefit on Adhezion or its unitholders that could entitle him to an award of attorneys' fees.

III. THE AMOUNT OF ATTORNEYS' FEES AWARDED BEARS NO RELATIONSHIP TO THE MINIMAL TIME AND EFFORT WILLIFORD SPENT ON THE SOLE ISSUE ON WHICH HE WAS SUCCESSFUL.

A. QUESTION PRESENTED

Whether the Chancery Court abused its discretion in the amount of attorneys' fees it awarded to Williford because that amount bears no relationship to the time and effort Williford spent on the sole claim on which he was successful. A.659-A.660, A.668-669, A. 671-672.

B. STANDARD AND SCOPE OF REVIEW

The Chancery Court's fee award is reviewed for abuse of discretion. *In re Infinity Broadcasting Corp. S'holders Litig.,* 802 A.2d 285, 293 (2002). The court abuses its discretion where, as here, the amount awarded is "not the product of an orderly and logical deductive process." *EMAK Worldwide, Inc.*, 50 A.3d 429. In addition, "plaintiffs' counsel [is not] entitled to an award of fees or expenses for work" that was "devoted to non-meritorious claims." *In re Triarc Cos., Inc. S'holders Litig.,* 2006 Del. Ch. LEXIS 66, *8 (Mar. 29, 2006), attached as Exhibit J; *see also Bhole, Inc. v. Shore Invs.,* 67 A.3d 444, 454 (Del. 2013) (an award of attorneys' fees should be "tailored . . . to the bases . . . on which [the party] prevailed").

C. MERITS OF THE ARGUMENT

Even if this Court upholds some measure of attorneys' fees for Williford, it should reduce the amount of fees in light of the minimal time and effort Williford spent on the only aspect of the case on which he was successful, and in light of the fact that much if not all of the two years the parties spent litigating below created nothing more than a waste of resources.

Williford's own fee petition requested $200,000 based on a common fund theory of recovery, and $200,000 based on a corporate benefit theory of recovery. Ex. A at 29; A. 593. After considering the fee petition, the Chancery Court determined there was no basis to award fees under the common fund doctrine, but nevertheless awarded fees under the corporate benefit doctrine. Ex. A at 7-8, 13, 21, 26, 31. Although the Chancery Court *said* that it did not "attribut[e] any fees" to the common fund theory, Ex. A at 29, it nevertheless inexplicably awarded Williford $300,000 in attorneys' fees, solely on the corporate benefit theory. This is fifty percent (50%) *more* fees than Williford *himself* believed he was entitled to under that theory, which is the *only* theory that the court accepted.

Indeed, the Chancery Court even acknowledged that the $300,000 fee award was *higher* than the amount Williford himself attributed to his success on the breach of contract claim, but then offered as the sole justification for this anomaly that the fee award was (just barely) below Williford's purported lodestar. Ex. A at

31. But this lodestar takes into account the work on *all* the claims that Williford pursued, the vast majority of which were not successful and conferred no benefit on anyone. Therefore, the award makes no sense and is "not the product of an orderly and logical deductive process." *EMAK Worldwide, Inc.*, 50 A.3d at 429.

The most to which Williford could have been entitled would be compensation for his work actually attributable to achieving the supposed "benefit" associated with the court's interpretation of the Operating Agreement. According to him, this is at most $200,000. But even this is excessive, because so much of the effort Williford spent on the case was simply a waste. He succeeded on a single count of this amended complaint — a count that he did not even assert until six months into the case. He took no discovery on this claim, and offered no witnesses to support it at trial. He did not even cross-examine the witness called by defendants to testify about the meaning of the Operating Agreement.

Instead, he focused solely on his attempt to show that the financing transactions that had supplied Adhezion with desperately needed capital — capital his own former client was unwilling to provide — were unfair. There is no basis to compensate Williford almost the entirety of his lodestar amount when the "central element of [plaintiff's] claim...failed after a long litigation," and "the heavy investment of attorney's work proved largely unproductive." *Thorpe,* 1997 Del. Ch. LEXIS 18 at *5. The Chancery Court's award fails to acknowledge this fact.

CONCLUSION

For all these reasons, Appellants respectfully request that this Court reverse the Chancery Court's award of attorneys' fees to Williford and hold that there is no basis for any award of fees at all. In the alternative, Appellants ask that the Court remand the case to the Chancery Court for a reassessment of the fee award that properly takes into account the minimal amount of time and effort that Williford devoted to the sole claim on which he was successful at trial.

Respectfully submitted,

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