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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE NUMODA CORPORATION	No. 121, 2015 Court below: Court of Chancery, Consolidated C.A. No. 9163-VCN

APPELLANTS' REPLY BRIEF

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The Answering Brief is larded with factual assertions that were contested below and were not contained in the Trial Court's findings of fact in the 205 Opinion. Certain of those contested factual assertions are addressed herein; however, the Borises do not concede the validity of any such factual assertions that are not expressly addressed herein.

I. THE TRIAL COURT ERRED BY VALIDATING "DEFECTIVE CORPORATE ACTS" THAT WERE NEVER ATTEMPTED.

As noted in the Opening Brief, the Trial Court erred by validating "defective corporate acts" – as the term is used in Section 205 – that were never attempted, let alone extant. OB 15-24. Consistent with how Mary's Group framed the issue below, the Trial Court analyzed only whether the disputed authorizations and issuances were "defective corporate acts" – *i.e.*, it did not analyze the disputed issuances as "putative stock" under Section 205.

The Answering Brief argues that Mary's Group should be permitted to pursue an argument on appeal that the disputed issuances constituted "putative stock," as that term is used in Section 205, despite the fact that those arguments were not timely raised by Mary's Group below. AB 19, OB 15. But their

[1] Capitalized terms not otherwise defined herein have the meanings ascribed to them in the Appellants' Opening Brief (the "Opening Brief" or "OB"). Citations to "Answering Brief" or "AB" refer to Appellees' Answering Brief. Emphasis is added unless otherwise indicated.

argument is of no moment because: (i) Mary's Group did not argue (or even mention the phrase) "putative stock" in post-trial oral argument; (ii) the Borises expressly noted during post-trial oral argument that Mary's Group only argued "defective corporate acts" in their opening post-trial brief, AR54; (iii) the 205 Opinion did not analyze the disputed issuances as "putative stock" under Section 205; and (iv) the Answering Brief simply claims that the disputed issuances constitute "putative stock," without engaging in any statutory analysis. As such, the Borises do not address whether the Trial Court had the power under Section 205 to remedy the disputed issuances as "putative stock." As for the arguments concerning the purported "defective corporate acts," they are addressed below.

A. The Trial Court Erred By Finding The Numoda Corp. Board Attempted To Authorize The Disputed Issuances

In their Opening Brief, the Borises argued that Mary's Group failed to adequately demonstrate that the Numoda Corp. Board ever attempted to act in any way cognizable under the DGCL – *i.e.*, they failed to demonstrate the occurrence of an "act or transaction purportedly taken by or on behalf of the corporation," as set forth in the definition of "defective corporate act" in Section 204(h)(1). OB 17-20. Rather than addressing the argument squarely, the Answering Brief responded:

> If the General Assembly intended Section 205 to apply *only* [to] acts that were formally approved by a written resolution or written consent, it would have said so and not defined 'defective corporate acts' as it has.

AB 20 (emphasis in original). But that argument mischaracterizes the issue, and ignores the fact that Section 205 does not define "corporate act."

In the Trial Court, Mary's Group essentially argued that any informal discussion (or shared belief) between two directors that pertained to Numoda Corp. could result in a "corporate act," whether or not there was any cognizable attempt by any person to effect corporate action. The Borises disagreed and argued that it was necessary to demonstrate some minimum attempt to comply with the DGCL before an informal discussion among directors (*e.g.*, a "water cooler" conversation) would rise to the level of an attempted "corporate act" under Section 205. AR52-55. As the 205 Opinion stated:

> Legislatively overturning [*STAAR Surgical* and *Blades*] would seem to allow equity to act even in situations where corporate formalities are barely recognizable…. [But, the Court] does not read the legislation as a license to cure just any defect. To do so could create greater uncertainty…. The Court cannot determine the validity of a defective corporate act without an underlying corporate act to analyze…. Even an *ultra vires* act can be a corporate act. ***However, there must be a difference between corporate acts and informal intentions or discussions***. Our law would fall into disarray if it recognized, for example, every conversational agreement of two of three directors as a corporate act. Corporate acts are driven by board meetings, at which directors make formal decisions.

OB Ex. A at 22-24 (footnote omitted).

In support of their position, Mary's Group contends that *STAAR Surgical* and *Blades* provide "examples of defective corporate acts that can be remedied under the statute" and, in those cases, "there were no written resolutions or written consents approved by the board." AB 20-21. That is not correct. In *STAAR Surgical*, this Court had minutes and resolutions from a formal Board meeting at which the acts were attempted. *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1132 (Del. 1991) (noting the board "formally convened"); *id.* (relying upon minutes, resolutions and a certificate of designation). The same is true for *Blades*, where the Court of Chancery reviewed a written resolution and charter amendment. *See Blades v. Wisehart*, 2010 WL 4638603, at *3 (Del. Ch. Nov. 17, 2010). In those cases, there was concrete evidence that there was an attempt to act in a manner cognizable by the DGCL, and that an act (albeit a defectively authorized act) had occurred.

Here, however, there was no contemporaneous evidence that the Numoda Corp. Board ever attempted to act (*e.g.*, no meeting notices, no agendas, no minutes, no meeting notes, no resolutions, no evidence of votes, no unanimous written consents, and no internal records that purport to list or summarize board decisions). Instead, the Trial Court relied primarily upon Mary's conflicting memory of discussions with Ann that allegedly occurred a decade ago. At best,

Mary's Group demonstrated that Mary and others may have formed a belief that stock had been authorized. But beliefs are not corporate actions and they cannot be ratified.

The Court of Chancery's decision in *Kalageorgi v. Victor Kamkin, Inc.*, 750 A.2d 531 (Del. Ch. 1999) does not address the issue of whether there needs to be evidence of an attempt to act before the Trial Court can validate a defective corporate act. As in *STAAR* and *Blades*, the Court of Chancery reviewed and considered a unanimous written consent and draft resolutions. *Kalageorgi*, 750 A.2d at 533-34. In *Kalageorgi*, the Court of Chancery assumed without deciding that the stock at issue was not validly authorized. *Id.* at 539. The Court, however, determined that the board validly ratified the stock issuances. *Id.* at 540. Here, however, there is no claim of board ratification. *Kalageorgi* is inapposite.

Because no corporate act susceptible of validation had occurred, the Trial Court's conclusion that the Numoda Corp. Board attempted to authorize the disputed stock issuances (and would have done so but for a failure of authorization) is error and should be reversed.

B. The Trial Court Erred By Assuming That Numoda Corp. Attempted To Issue The Disputed Issuances

The Trial Court did not conclude that the disputed stock issuances were, in fact, attempted by Numoda Corp. Instead, the 205 Opinion improperly assumed that the issuances occurred as a result of the purported approvals. OB 21; OB Ex.

A at 6 n. 22. Instead of addressing the content of the 205 Opinion, Mary's Group argues that other evidence existed in the record to support a conclusion that issuances occurred. AB 25. Yet, they do not cite the 205 Opinion or otherwise provide a basis from which the Court can conclude that the Trial Court did not make the assumption expressly identified in footnote 22 of the 205 Opinion. The Trial Court's assumption is an error that should be reversed.

C. The Trial Court Erred By Relying Upon Inadmissible Hearsay To Establish Issuance Dates

At trial, the Numoda Corp. Parties objected to the Dill spreadsheets and argued that they are inadmissible hearsay. A2325. In their post-trial briefs, Mary's Group did not cite DRE 801(d)(2)(A)-(D) or otherwise argue that the spreadsheets were not hearsay. They cannot raise that evidentiary argument for the first time on appeal. AB 25-26; Supr. Ct. R. 8. The Dill spreadsheets were inadmissible hearsay and it was reversible error for the 205 Opinion to rely on them. OB 22-24.

D. The Trial Court Erred By Finding That The Disputed Issuances Were "Defective Corporate Acts"

If the disputed issuances were validly authorized as the 205 Opinion concluded, then they do not fall within the definition of a "defective corporate act" because they were not "void or voidable due to a failure of authorization." OB 24. The Answering Brief argues that the disputed issuances were found to be defective in the 225 Opinion; yet it wholly ignores the fact that the 205 Opinion *validated*

the authorizations. AB 26. As a result of that validation, the subsequent purported issuances fall outside the definition of a "defective corporate act." Section 205 provides for the validation of corporate acts; it does not address the validation of a failed authorization.

II. THE TRIAL COURT ERRED BY REFUSING TO SUBJECT SELF-INTERESTED TRANSACTIONS TO THE ENTIRE FAIRNESS STANDARD OF REVIEW

The Trial Court erred by applying the wrong equitable standard of judicial review to Mary's disputed retroactive stock compensation. The disputed issuance, if valid (which it was not), was not approved by a majority of disinterested directors; as such, the decision to authorize the issuance would be subject to the entire fairness standard.

A. Entire Fairness Applies to Mary's Self-Interested Compensation Decisions

The 205 Opinion held that Mary and Ann, as the July 2006 Numoda Corp. Board, authorized the disputed stock compensation to Mary. At that time, both Mary and Ann were officers and directors. Because Mary was the primary beneficiary of any such issuance, that issuance was not approved by a majority of disinterested directors. Note that Dill's December 2007 spreadsheets also contemplated Ann receiving retroactive stock compensation for 2002, 2003 and 2004. *See* A2329.

As such, at trial, the Borises identified *Valeant Pharmaceuticals International v. Jerney*, 921 A.2d 732 (Del. Ch. 2007), and *Telxon Corp. v. Meyerson*, 802 A.2d 257 (Del. 2002), to support their contention that Mary's Group bore the burden of establishing that the disputed stock compensation for Mary was entirely fair. *See, e.g.*, A2372. As explained in *Valeant*:

> Before the 1967 enactment of 8 *Del. C.* § 144, a corporation's stockholders had the right to nullify an interested transaction. To ameliorate this potentially harsh result, section 144 … provides three safe harbors to prevent nullification of potentially beneficial transactions simply because of director self-interest. First, section 144 allows a committee of disinterested directors to approve a transaction and, at least potentially, bring it within the scope of the business judgment rule. Second, the transaction may be ratified by a fully informed majority vote of the disinterested stockholders. Finally, the challenged transaction can be subjected to post-hoc judicial review for entire fairness…..
>
> ***Self-interested compensation decisions made without independent protections are subject to the same entire fairness review as any other interested transaction***.

Valeant Pharm., 921 A.2d at 745 (footnotes omitted). Moreover, as explained in *Telxon*:

> Like any other interested transaction, ***directoral self-compensation decisions lie outside the business judgment rule's presumptive protection***, so that, where properly challenged, the receipt of self-determined benefits is subject to an affirmative showing that the compensation arrangements are fair to the corporation.

Telxon, 802 A.2d at 265. Here, the Trial Court did not find, and Mary's Group did not argue, that either of the first two safe-harbors in Section 144 applied. Therefore, to demonstrate compliance with Section 144, Mary's Group was obligated to affirmatively demonstrate entire fairness.

Despite the foregoing, the Answering Brief argues that the entire fairness standard of judicial review does not apply to Mary's disputed compensation

because the Borises did not assert a breach of fiduciary duty claim against Mary. AB 27; AR39-40. But that argument simply ignores the fact that Mary's Group bore the burden of proof at trial with respect to their affirmative request for relief under Section 205 concerning Mary's disputed compensation. That burden necessarily required Mary's Group to demonstrate that the "defective corporate act" otherwise complied with applicable statutory law and equity. Moreover, the argument ignores the fact that the request for affirmative relief under Section 205, by definition, placed "the validity and effectiveness" of Mary's disputed compensation at issue.

As noted, there was no effort by Mary's Group at trial to demonstrate that the disputed compensation was fair (entirely or otherwise) to all other Numoda Corp. stockholders generally. As such, they failed to satisfy the burden of proof associated with their affirmative case. The Court need not engage in speculation concerning whether the Borises would be barred from pursuing fiduciary claims against Mary because that issue has no bearing on whether Mary's Group met its affirmative burden of proof. Moreover, even if such equitable doctrines applied to the Borises, they do not apply to Numoda Corp. or the other Numoda Corp. stockholders.

B. Although Mary's Group Bore The Burden, Mary's Disputed Compensation Was Not Entirely Fair

As argued in the Opening Brief, the record demonstrated the disputed compensation for Mary was not entirely fair. Mary's Group failed to address that argument and, as such, conceded it. *See, e.g.*, *Boulden v. Albiorix, Inc.*, 2013 WL 396254, at *5 & n.45 (Del. Ch. Feb. 7, 2013) (holding that a party conceded certain arguments by failing to respond in his answering brief); *id.* at *10 (observing that plaintiff "failed to respond to [an argument] in his answering brief, and therefore concedes"); *In re Dow Chem. Co. Deriv. Litig.*, 2010 WL 66769, at *7 (Del. Ch. Jan. 11, 2010) (noting that plaintiff abandons his claim when he fails to address or respond to defendants' arguments in their motion to dismiss).

III. THE TRIAL COURT ERRED BY FINDING THAT THE NUMODA CORP. BOARD AUTHORIZED THE ISSUANCE OF 5.1 MILLION SHARES OF VOTING COMMON TO JACK

The Trial Court erred by finding that the Numoda Corp. Board authorized the issuance of 5.1 million Voting Common shares to Jack. The testimony relied upon is contradicted by the documents and mathematics (*i.e.*, 15% of the fully diluted equity is not 5.1 million shares, and never has been). Moreover, the Trial Court erred by relying upon inadmissible hearsay to establish an issuance date. Finally, there is no evidence to support the Trial Court's conclusion that Non-Voting Shares were issued as the result of an error.

A. Mary's Group's Testimony Is Contrary To The Documents

As noted in the Opening Brief, Mary's testimony that the Numoda Corp. Board authorized Jack to receive 15% of the outstanding stock on a fully-diluted basis, and no more, does not support the Trial Court's conclusion because 5.1 million shares is not (and never has been) 15% of the outstanding stock on a fully-diluted basis. OB 28-29. The Answering Brief responds to the foregoing argument in a footnote and, as such, that argument should be ignored. *See, e.g.*, *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1264 & n.141 (Del. 2012) ("Arguments in footnotes do not constitute raising an issue in the 'body' of the opening brief.") (citing Supr. Ct. R. 14(d) ("Footnotes shall not be used for argument ordinarily included in the body of a brief….")); *see also Lum v. State*,

101 A.3d 970, 972 & n.8 (Del. 2014) (same); Supr. Ct. R. 14(d). Therefore, Mary's Group failed to address the argument and, as such, conceded it. *Lum*, 101 A.3d at 972 (holding that an appellant waived his argument by not addressing it in the body of his opening brief).

B. The Trial Court Relied Upon Inadmissible Hearsay

Mary's Group failed to address the Borises' argument that the Trial Court improperly relied on hearsay (the Dill spreadsheets) in deciding that Jack was entitled to Voting Common shares. *See* OB 29 (citing OB Ex. A at 31). Accordingly, Mary's Group has waived any argument in opposition to the Borises' claim that the Trial Court abused its discretion.

Instead of addressing the Trial Court's articulated analysis, Mary's Group argues that other evidence exists to support the Trial Court's conclusion. But, the Trial Court did not purport to rely upon that other "evidence" in the 205 Opinion. Rather, page 31 of the 205 Opinion clearly states:

> [A]n informal stock ledger from December 11, 2007, suggests that Houriet's 5,100,000 shares were approved by at least that date, and Numoda Corp. was not able to issue non-voting stock until it filed a charter amendment on December 27, 2007.

OB Ex. A at 31. The referenced "informal stock ledger" is inadmissible hearsay and it was used, in part, to establish that the issuance occurred prior to the filing of the charter amendment on December 27, 2007.

C. The Trial Court Erred By Finding Jack's Non-Voting Shares Were Issued As The Result Of An Error

The Trial Court concluded that Jack was issued a non-voting stock certificate as the result of a "ministerial error." OB Ex. A at 31. As noted in the Opening Brief, there was no basis for the Trial Court to conclude that a ministerial error had occurred because, at best, the record establishes that Jack and Patrick assumed that Jack would be issued Voting Common, but neither could testify that they were told – at any time – that Jack's shares would be Voting Common. *See* OB 29-30.

Instead of addressing the Trial Court's articulated analysis, Mary's Group argues that other evidence exists to support the Trial Court's conclusion. AB 29-30. But, the Trial Court did not purport to rely upon that "other evidence" to support its conclusion in the 205 Opinion that an error occurred in connection with Jack's 5.1 million shares.

Jack's stock certificate is for Non-Voting Common shares, A1263-64, and there is no record of Jack ever attempting to vote those shares:

> THE COURT: Did Numoda Corporation, between 2006 and 2012, have stockholder meetings?
>
> THE WITNESS: I don't know that they were formally titled as such. We did meet as a group and discuss company issues.
>
> THE COURT: Did you ever vote during that period of time as a stockholder at a Numoda Corporation meeting?

> THE WITNESS: I don't know that we held votes. I don't recall doing that.

A848-49. The Trial Court's conclusion that Jack was issued a non-voting stock certificate as the result of a "ministerial error" should be reversed.

IV. THE TRIAL COURT ERRED BY DECLARING THAT ANN GAVE BACK 2,000,000 SHARES

The Trial Court relied upon circumstantial evidence to declare that Ann, as a stockholder, surrendered 2 million shares to Numoda Corp. OB Ex. A at 34-35. Once again, Mary's Group could not point to any document or agreement, other than a one-page email, demonstrating that Ann gave back 2 million shares of stock to Numoda Corp. Under Numoda Corp.'s bylaws (A1050-62), Ann was required to tender the certificate representing her shares to Numoda Corp. for the transfer to be registered. *See* A1060. She did not do so. Indeed, the bylaws provide that "[t]he shares of stock of the corporation shall be transferable *only* upon its books by the holders thereof in person." *Id.* Thus, under the bylaws, there is only one way to transfer shares. There was no evidence presented below that Ann complied with the bylaws (or ever intended or attempted to) in purportedly surrendering 2 million shares to Numoda Corp. There is also no evidence that anyone asked the secretary to make an entry on the stock ledger, or that any such entry was ever attempted. Instead, Mary's Group relies on hearsay in the Dill spreadsheets and the testimony of its own witnesses, Patrick and Jack, as support for the purported surrender of shares. AB 31-32. Here, given the lack of concrete evidence, the Trial Court's decision to issue a declaratory judgment was an abuse of discretion.

V. THE TRIAL COURT ERRED BY DECLINING TO VALIDATE THE 2005 NUMODA TECH. SPIN-OFF

The Trial court erred by declining to validate the Numoda Corp. spin-off of Numoda Tech, effective January 1, 2005. It is undisputed that the Numoda Corp. Board, and all interested parties, intended the foregoing spin-off and believed that it had been validly accomplished. Moreover, the spin-off was reported to the IRS, and the record establishes a basis to determine the Corporations' capitalizations as of that time. No contrary evidence was presented.

As described in the 205 Opinion, the Numoda Corp. parties sought the following affirmative relief at trial:

> *With respect to their affirmative case*, the Numoda Corp. Parties ask the Court to "order Numoda Tech. to issue shares to Numoda Corp., *with instructions that Numoda Corp. effect the [2005] spin-off as originally intended*."
>
> * * *
>
> The Numoda Corp. Parties … ask for an order requiring Numoda Tech. to distribute its stock to Numoda Corp. *for subsequent distribution to shareholders in accordance with records of Numoda Corp.'s ownership as of January 1, 2005*.

OB Ex. A at 14, 37-38. That relief was denied by the Trial Court and, therefore, the Numoda Corp. parties have the right to appeal that decision – and did so in the Opening Brief. OB 33-34.

The Answering Brief argues that the Borises cannot challenge the above-

noted denial of relief by the Trial Court because "Numoda *Tech*. did not appeal that ruling." AB 34. Yet, that argument is a non-sequitur because the appeal issue relates to the denial of a request for relief at trial *by the Numoda Corp. Parties*. Moreover, Mary's Group ignores their prior representation that "no argument will be made on appeal that Ann and John's arguments fail simply because Numoda Corp. did not file a notice of appeal." A5 (Response to Motion to Stay Pending Appeal). Accordingly, whether the Trial Court erred by declining to validate the Numoda Corp. spin-off of Numoda Tech, effective January 1, 2005, is properly before this Court.

With regard to the merits, the Trial Court concluded that "[t]here is little doubt that the Numoda Corp. Board intended a spin-off of Numoda Tech. on January 1, 2005" and the Trial Court further found "some evidence of corporate acts—an alleged issuance of Numoda Tech. stock to Numoda Corp., as well as purported agreements reached by the Numoda Corp. board to effectuate a spin-off and by the Numoda Tech. board to issue Numoda Tech. stock post-spin-off." *See* OB Ex. A at 31, 32. Given the evidence, and in light of the fact that the Trial Court relied upon weaker evidence to validate the Numoda Corp. issuances, the Trial Court should have validated the 2005 Numoda Tech. Spin-Off by ordering Numoda Tech. to issue shares to Numoda Corp. with instructions to effectuate the 2005 Numoda Tech. Spin-Off in accordance with records of Numoda Corp.'s

ownership as of January 1, 2005. The Trial Court's decision is against the weight of the evidence, conflicts with the Trial Court's other factual findings, and should be reversed.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in the Opening Brief, John and Ann respectfully request that this Court reverse the 205 Opinion and the 205 Final Order.

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