IN THE SUPREME COURT OF THE STATE OF DELAWARE

CDX HOLDINGS, INC.
(f/k/a CARIS LIFE SCIENCES, INC.),

Defendant-Below,
Appellant/Cross-Appellee,

v.

KURT FOX,

Plaintiff-Below,
Appellee/Cross-Appellant.

No. 526, 2015
Court Below: Court of Chancery
of the State of Delaware
C.A. No. 8031-VCL

APPELLANT'S REPLY BRIEF ON APPEAL AND CROSS-APPELLEE'S ANSWERING BRIEF ON CROSS-APPEAL

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Dated: January 11, 2016

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SUMMARY OF REPLY

Plaintiff never meets the fundamental error at the heart of the trial court's Opinion: there is an absolute disconnect between the contractual term at issue in this contract case and the conduct the trial court wishes to punish. Delaware has settled law for what constitutes breach of a contractual duty to perform in good faith. Here, the Board was required to determine FMV in good faith. The Board relied on PwC for that valuation, received PwC's representation that it was providing a value for "the whole of the TN Business" and a "final value for the Carisome Business," A1163, and adopted resolutions effecting the transaction based on PwC's valuation. That is not bad faith and it is not arbitrary and capricious. Yet finding no bad conduct by the Board, the trial court took a novel approach, asking: *if there is no bad faith by the party relevant to the contractual term, did someone else, irrelevant to that term, breach it?* That is fundamental legal error and dangerous precedent.[1]

Plaintiff fails to rebut Caris' four appellate points, including:

1. Plaintiff tries to recast the trial court's legal disconnect on breach and damages as factual. But Plaintiff misses the key point that *taking the court's facts as given,* there is neither breach nor damages as a matter of law, because the trial court analyzed conduct that is irrelevant under the contract.

[1] Capitalized, undefined terms shall have the meaning in Caris' Opening Brief ("OB").

2. Trying to save the court's substitution of an objective reasonableness standard for the parties' bargained-for subjective rationality standard, Plaintiff runs afoul of this Court's holdings in *DV Realty*, *Encore*, and *Enbridge.* Plaintiff's defense for failing to raise an "arbitrary and capricious" standard in his pre-trial order is claiming there was no prejudice, but this is not only irrelevant but patently false when the whole trial was premised on a different standard.

3. Not surprisingly, Plaintiff offers no justification for the legal error of a trial court, as lay fact-finder, using "the psychological literature" on hindsight bias to disregard testimony it found truthful. Instead, Plaintiff tries to write off this holding as dicta. But that fails on the face of the Opinion. And Plaintiff does not even respond on the substantive points of the trial court's error, nor can he. Discrediting a director for later being proven right is bad law and bad policy.

4. While these legal issues are dispositive, Plaintiff's factual claims show that the findings below cannot be sustained as logical or orderly. Indeed, Plaintiff's brief omits that Carisome's only product failed in April 2011, that no one has bought TargetNow at any price despite aspirational projections, and that the Board never saw the report Plaintiff wishes to rely on to prove the Board's subjective views. Moreover, Plaintiff fails to address SpinCo's lack of goodwill and, as a result, ignores that he suffered no damages even if his shares had been cashed out based on a tax valuation.

SUMMARY OF CROSS-APPEAL ARGUMENT

1. DENIED. Plaintiff waived his cross-appeal argument by failing to present the issue to the trial court through a motion to alter or amend the judgment under Chancery Court Rule 59(e). Moreover, Plaintiff repeatedly adopted the trial court's damages figure through his proposed form of order and judgment and in his motions for fees, expenses, and lead plaintiff compensation. As a matter of law, he is not now permitted to argue on appeal that the trial court made a $5,000,000 typographical error in its damages calculation.

Moreover, the trial court's damages conclusion cannot be explained away as a typographical error because the calculation was not the product of a logical and orderly deductive process. Instead, the trial court's calculation was premised on the trial court's objective appraisal, rather than the Board's subjective beliefs. The trial court utilized a draft valuation that had been neither received nor reviewed by the Board and then compounded its error by rejecting and modifying the very valuation it had just adopted. The trial court also ignored the unimpeached expert report of Professor Paul Gompers that supports the Board's FMV determination of $65 million for SpinCo. These substantive errors are not ministerial, and Plaintiff's cross-appeal argument highlights how the trial court erroneously failed to apply the subjective good faith standard in favor of an objective *ad hoc* approach.

ARGUMENT

I. PLAINTIFF CANNOT RECAST LAW AS FACTS: ANALYZING THE WRONG CONDUCT IS LEGAL ERROR.

A. The appropriate standard of review is *de novo.*

Plaintiff is wrong that the trial court's legal conclusions—that Caris breached the Plan and that Plaintiff suffered damages—are factual findings to be reviewed for clear error. *See* Ans. Br. ("AB") 17-18. Whether a party has breached a contractual duty is a legal conclusion, and "[a]ppellate courts review a trial court's legal conclusions *de novo*." *Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp.*, 29 A.3d 225, 236 (Del. 2011). "Findings of historical fact" are "subject to the . . . 'clearly erroneous' standard of appellate review;" however, "[o]nce the historical facts are established . . . the ultimate determination of the legal issue presented is reviewed by appellate courts *de novo*." *Scharf v. Edgcomb Corp.*, 864 A.2d 909, 916 (Del. 2004). For the avoidance of any doubt, in arguing that the trial court's legal conclusions are erroneous, Caris accepts the trial court's findings of historical fact[2] and contests only the legal conclusions that Caris breached the Plan and that Plaintiff suffered damage as a result of that breach. Therefore, this Court should review Caris' challenges to the trial court's legal conclusions *de novo*. *Liberty Media*, 29 A.3d at 236.

[2] Caris separately argues that the trial court's findings of fact are erroneous. *See infra* § IV.

B. Caris did not breach the Plan.

The Plan obligated the Board, as Administrator, to determine FMV in good faith. A811 § 2.2; A814 § 2.25. As Plaintiff concedes, *Allen v. Encore Energy Partners, L.P.*, 72 A.3d 93 (Del. 2013) provides the appropriate legal standard for breach of a contractual duty of subjective good faith. *See* AB 21-22. Under *Encore*, there are two ways to prove such a breach: either (1) bad faith—prove that a majority of the Board "subjectively believe[d] that the action [was] *against* [the option holders'] best interests," or (2) conscious disregard—prove that a majority of the Board "intentionally fail[ed] to act in the face of a known duty to act." 72 A.3d at 105-06. Even accepting the trial court's factual findings, Plaintiff cannot establish that he fulfilled either of these tests.

1. The trial court held that the wrong parties acted in bad faith.

While the Plan implicates the Board's good faith, Plaintiff concedes that the trial court focused solely on Halbert's and Martino's supposed lack of good faith. AB 19 (conceding the trial court applied the good faith standard to "Martino and Halbert" and "analyze[d] whether [Martino] acted in subjective good faith" (emphasis omitted)). The trial court did not find the Board acted in bad faith (Op. 47-52), and neither the trial court nor Plaintiff ascribe the bad faith actions of Martino and Halbert to the Board.[3] In fact, the trial court acknowledges that it

[3] Plaintiff argues the Board was aware PwC was providing a tax transfer valuation instead of FMV, AB 20, but the trial found to the contrary. A795-96, A806. Moreover, Board

only analyzed whether Martino and Halbert acted in subjective good faith. *Id*. at 55.

Plaintiff attempts to excuse this error by arguing that "[because] no such Board determination was attempted or made," the subjective good faith standard "applie[s] to the actual decision-makers (Martino and Halbert)…." AB 19. And while the Board plainly did act, reviewing PwC's valuation report and effecting the final transaction based on that number, *even if it had not*, what Plaintiff proposes is not the law. Contrary to Plaintiff's contention that "non-action itself breached the Plan," *id*. at 25, once the trial court determined that the Board did not act, its analysis should have proceeded under *Allen's* "conscious disregard" test rather than applying the subjective good faith standard to other actors. By failing to do so, the trial court erred.

2. The Board did not fail to act, let alone consciously disregard a known duty to act.

a. Even accepting the trial court's findings, the Board did "determine" FMV.

The trial court erroneously found that the Board did not "determine" FMV

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testimony reveals they believed PwC was providing FMV—an idea supported by documents PwC provided to the Board. *See* A430; A554; A768; A1162-63. At any rate, there is no evidence a tax transfer valuation and FMV would have differed because the only distinction is goodwill, and Plaintiff did not, and cannot, introduce evidence that SpinCo had any goodwill. *See infra* § IV.C.

based on supposed inadequacies with the Board's authorizing resolutions. Op. 51-52. Plaintiff incorrectly argues that the trial court "based its determination of Board non-action on the extensive evidence…not on Board resolutions." AB 20.

First, the court's legal conclusion that "Caris breached the Plan" was premised directly on its findings that the Board's October 5 and November 22 "resolution[s] did not make an adjustment or determine Fair Market Value" of the options, and that therefore "the Board did not act as the Administrator to set the value that holders of options would receive…." Op. 44, 51-52. Caris' $5.07 option price was driven by the $725 million merger price and PwC's $65 million valuation of SpinCo. At the October 5 meeting, PwC reviewed its valuation with the Board, and the Board authorized a final transaction based on those figures. A1191; A1399; A764-72. The only daylight between what the Board did and what the trial court complains of is that the Board did not *state* the equation it adopted in its authorizing resolutions. That is the only "breach" ascribed to the Board itself.

Second, Plaintiff's argument raises the question: how, if the Board did not determine FMV, were the options cashed out at the $65 million SpinCo value? A "determination" is the "act of deciding something officially." *Black's Law Dictionary* 544 (10th ed. 2014). Nothing Martino or Halbert did decided anything officially; Board action did. If the Board had not adopted the October 5 and November 22 resolutions (which effected the Transaction) the options would not have been cancelled, adjusted, and paid based on a $65 million valuation. *See* A1399; B570. Following the mandate of the Board's resolutions, Caris' officers and advisors later prepared a spreadsheet calculating the consideration that each option holder would receive after adjusting the Options and factoring in Caris' complicated equity structure. A789; AR410-35. Only the Board's resolutions "determined" FMV under the Plan. That is not "fictional" Board action (AB 19), and the court erred in holding the Board did not "determine" FMV.

b. Even if the Board did not "determine" FMV, Plaintiff fails to establish it consciously disregarded a known contractual duty.

To establish breach of a contractual duty of good faith under a "non-action" theory, Plaintiff must prove that a majority of the board "consciously disregard[ed] [their] contractual duty to form a subjective belief," *i.e.*, "intentionally fail[ed] to act in the face of a known duty to act." *Encore*, 72 A.3d at 105-06. But the trial court did not make any findings on this issue. Plaintiff presented no evidence as to two directors, and he presented no conscious disregard evidence as to any director. In fact, the trial court found that one director, Knowles, "did not know that . . . the Plan required the Board" to set FMV, which rules out a conclusion that he consciously disregarded a known duty. Op. 50. Thus, even accepting the trial court's findings of fact, Plaintiff failed to establish that a majority of the six-person Board consciously disregarded a known duty to act.

C. Even accepting the trial court's factual findings, Plaintiff is entitled to no damages.

Plaintiff concedes that (a) damages must be based on what the "Board subjectively believed was SpinCo's FMV at [the] time [of the cash-out]" and (b) only damages *caused by* breaching conduct can be awarded. AB 23 (emphasis omitted). These concessions are fatal to his damages claim for three reasons.

First, contrary to Plaintiff's argument that the trial court's "damage findings . . . properly focused on Caris' Board's subjective beliefs," *id.*, the trial court determined damages through its own hypothetical objective appraisal process. *See* OB 15-16. Had the trial court properly focused on the Board, the uncontroverted evidence establishes the Board would have accepted PwC's valuation. *See id.* 7-8.

Second, the Board's "breach" was permitting the shares to be cashed out at PwC's valuation without specifying (in a resolution) how the PwC number affected the Option Price and explaining the adjustments. Op. 51-52. Correcting that breach would not change the valuation or lead to any damages.

Third, the trial court's calculation was untethered to bad faith misconduct *by the Board*. The court based damages on an objective assessment of what it believed a reasonable Board could have done assuming away unrelated misconduct such as "Martino's intervention" in the valuation process and GT's supposed improprieties. Op. 78. But the trial court never held these actions constituted bad faith by the Board, so they should have been irrelevant to any damages calculus.

II. THE TRIAL COURT USED THE WRONG STANDARD.

A. The trial court turned "good faith" into a more burdensome inquiry than the standard established by this Court.

The trial court erred by turning the Plan's subjective good faith standard into an objective reasonableness test. Plaintiff concedes that—under this Court's authorities—the trial court's only mandate under Section 2.25 was to examine whether there was "any ground other than bad faith" (*i.e.*, "any rational" basis) for the Board's FMV determination. *DV Realty Advisors LLC v. Policemen's Annuity & Benefit Fund*, 75 A.3d 101, 110 (Del. 2013); *Brinckerhoff v. Enbridge Energy Co.*, 67 A.3d 369, 373 (Del. 2013); AB 28 (conceding that the Plan only required the Board to make "rational decisions").[4] The trial court did not do so. Instead, it examined whether the $65 million valuation was objectively reasonable. Plaintiff—like the trial court—justifies this heightened test by arguing that the trial court was relying on "objective facts" to assess "witness credibility." AB 25. This justification is flawed for several reasons.

First, witness credibility determinations must be made within the parameters of the governing substantive standard. Plaintiff does not, and cannot, contend that the trial court adhered to the *DV Realty*/*Enbridge* test. The court fails to *mention*

[4] Plaintiff criticizes Caris for invoking fiduciary duty principles (AB 32) but this Court has explained that the applicable contractual subjective good faith standard is based on the "traditional common law definition of the business judgment rule." *DV Realty*, 75 A.3d at 110. Further, *DV Realty*, *Enbridge*, *Encore*, and many other opinions cited by Caris are contract—not fiduciary duty—matters.

the witnesses' proffered bases for the FMV determination—*e.g.*, the abysmal failure of the Carisome test and unsustainable costs needed to increase TargetNow revenues—let alone assess whether the bases were rational. *See* OB 5-6.

Second, Plaintiff—like the trial court—overstates the *Encore* opinion's cautious recognition that objective facts have relevance under the subjective good faith standard. *Encore* emphasized the difference between "believe" (subjective) and "reasonably believe" (objective) in contract language, declared that objective facts are "no[t] sufficient" for a bad faith finding, and admonished courts not to commit the very errors the trial court committed here:

> It is essential to ensure, however, that the subjective good faith standard remains distinct from an objective, "reasonable person" standard. Therefore, the ultimate inquiry must focus on the subjective belief of the specific directors accused of wrongful conduct . . . . Trial judges should avoid replacing the actual directors with hypothetical reasonable people when making the inquiry.

Encore, 72 A.3d at 107. The facts of *Encore* and *Enbridge* further illustrate how Plaintiff and the trial court have transformed a subjective rationality standard into an objective reasonableness test. In both of these cases, plaintiffs presented stark objective facts in an effort to establish breaches of contractual good faith standards. For instance, in *Encore*, a partnership's board approved a merger even though it knew, *inter alia*, that the final consideration (a) was *lower* than the counterparty's initial offer and (b) would result in lower post-merger distributions to unitholders. *Id.* at 97-99; *see also Brinckerhoff v. Enbridge Energy Co.*, 2011 WL 4599654, at

*2 (Del. Ch. Sept. 30, 2011) (detailing objective facts indicating that a transaction was subpar). This Court held—as a matter of law on the pleadings—that such facts could not create an inference that the *Encore* and *Enbridge* boards violated their subjective good faith obligations.[5] *Encore*, 72 A.3d at 107-10; *Enbridge*, 67 A.3d at 373. Under the trial court's good faith test, the outcome of *Encore* and *Enbridge* would have been very different.

Third, the trial court was indisputably assessing the wrong witnesses' subjective beliefs. Despite reminding the Court six times that "[t]his is a breach of contract action," Plaintiff disregards the contract's standard of good faith action by the Board and instead focuses solely on Martino's, Halbert's, and GT's good faith. AB 1, 30, 31, 32. Regardless of the permissible extent of witness credibility determinations in subjective good faith cases, it was legal error to use witness credibility to focus on the wrong parties' subjective beliefs.

Finally, the notion that the trial court was simply assessing witness credibility is belied by its statement that "[s]ome of the most probative evidence" of Martino's and Halbert's credibility "comes from the files of JH Whitney," a Caris investor. Op. 58. There is nothing in the record to suggest that the documents were reviewed by Martino or Halbert—let alone the Board—and thus,

[5] Plaintiff attempts to distinguish *Encore* by arguing that the *Encore* agreement had a "presumption [of] good faith," AB 21, but the *Encore* Court explained that it was not basing its decision on any such presumption. 72 A.3d at 103-04 (explaining that "we need not reach" the presumption of good faith provisions).

these documents could not possibly have memorialized these witnesses' true subjective beliefs. To the extent these documents are "probative evidence," they are objective indications of a third party's belief regarding SpinCo's potential value, not Martino's or Halbert's credibility.

B. The trial court impermissibly applied the arbitrary and capricious standard.

1. The arbitrary and capricious standard does not apply.

Plaintiff fails in his attempts to substantiate the trial court's erroneous decision to apply the Plan's general arbitrary and capricious ("A&C") standard despite the specific standard for FMV determinations in Section 2.25.

Plaintiff has no answer for the "well-settled rule[] of construction" that "specific language in a contract controls over general language." *Katell v. Morgan Stanley Grp., Inc.*, 1993 WL 205033, at *4 (Del. Ch. June 8, 1993). Rather, Plaintiff concedes that the A&C standard does not apply to all decisions under the Plan, citing to Section 2.21 as an example of a specific standard that renders the general A&C standard inapplicable. *See* AB 28. However, Plaintiff cannot explain why the A&C standard would apply to Section 2.25 but not Section 2.21.

Instead, Plaintiff retreats to the trial court's "surplusage" argument but fails to explain how the A&C standard is "surplusage" if it applies to all Administrator decisions except for those with their own specific standards, like FMV determinations. *Id.* at 27. Plaintiff also appeals to generic equitable considerations, arguing that the trial court's interpretation was necessary to avoid "absurd results" that would "exculpate the Board." *Id.* at 28. But Section 2.25 is not a "get out of jail free" card; it requires the Board to fulfill a good faith standard that is commonly used in contracts. *Encore*, 72 A.3d at 106; *DV Realty*, 75 A.3d at 101; *Enbridge*, 67 A.3d at 373. This Court has rejected similar appeals to equity in interpreting the contractual good faith standard. *Encore*, 72 A.3d at 109; *Norton v. K-Sea Transp. P'rs LP*, 67 A.3d 354, 368 (Del. 2013). Finally, the doctrine of *contra proferentem* is inapplicable because the Plan is unambiguous.

2. Plaintiff represented that he was only litigating under the good faith standard.

The trial court should not have applied the A&C standard because the pre-trial stipulation and order—which Plaintiff drafted and the court entered—represented that Plaintiff was only proceeding to trial on the good faith standard. The pre-trial order must set forth "[a] statement of the issues of fact and of law which any party contends remain to be litigated." Ct. Ch. R. 16(c)(3). Neither cursory mention of the term "arbitrary and capricious" in the complaint, nor post-trial briefing on the A&C standard (at the behest of the trial court, A802-04), can save Plaintiff because issues not raised in the pre-trial brief or pre-trial order are waived. *See Brown v. Rembert*, 2008 WL 5182307, *9 n.104 (Del. Ch. Dec. 18, 2008) (refusing to consider exhibit not disclosed in pre-trial order); *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *18 (Del. Ch. Aug. 18, 2006);

Emerald P'rs v. Berlin, 2003 WL 21003437, at *43 n.144 (Del. Ch. Apr. 28, 2003) ("[I]ssues not briefed are deemed waived"); *Frazer v. Worldwide Energy Corp.*, 1990 WL 61192, at *6 (Del. Ch. May 3, 1990) (pre-trial order "will narrow and clarify" the issues to be covered at trial); *see also Itron, Inc. v. Consert Inc*., 109 A.3d 583, 587 (Del. Ch. 2015) ("The pretrial conference should not be viewed as merely an informal meeting at which those involved can act without concern for future consequences . . . . Courts generally hold stipulations, agreements, or statements of counsel made at the pretrial conference binding for . . . trial.").

The pre-trial order made no mention of—and therefore waived—the A&C standard. Plaintiff identified the sole operative standard as follows:

> **V. ISSUES OF FACT AND LAW TO BE TRIED**
>
> **66. Plaintiff's Issues:**
>
> a. Whether Defendant's Board of Directors (as Administrator) exercised good faith in arriving at and paying Fair Market Value, as defined in the Plan, in connection with the Option Transaction.

A189 ¶ 66. Like the trial court, Plaintiff completely ignores the pre-trial order and argues that Caris was not "prejudiced" because "the Complaint" and "Defendant's pre-trial brief" discussed the A&C standard. AB 29 (emphasis omitted). This is a red herring: Rule 16 does not turn on whether a party was prejudiced or the issue was raised in earlier filings. *See Basista v. Weir*, 340 F.2d 74, 85 (3d Cir. 1965) ("It is, of course, established law that a [Rule 16] pretrial order when entered limits the issues for trial and in substance takes the place of pleadings covered by the pretrial order.").[6] Further, Caris was prejudiced. According to the trial court, "[t]he central fact issue" at trial "was what Halbert, Martino, and other Caris principals believed in fall 2011 about the value of TargetNow and Carisome." Op. 5. In other words, the "central fact issue" focused on subjective good faith, not the A&C standard. *Id.* As a result, for instance, Caris did not spend precious trial time on the GT report, given that "the Board never saw [it]." Op. 7. Yet this report became a focal point of the trial court's A&C analysis. *Id.* 70-71. Thus, the pre-trial order—as it is intended to do—set the issues to be tried.[7]

3. The trial court erred by selectively importing administrative law.

Even if A&C applies, the trial court misapplied it. Plaintiff argues that Caris is "estopped" from complaining about the court's use of administrative A&C law because Caris cited to Delaware administrative law precedents in prior briefs. AB 31. This mischaracterizes Caris' arguments. The trial court did not err simply by citing to administrative law. The trial court erred by (1) failing to interpret these precedents in light of the different context of this matter (*i.e.*, corporate board vs.

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[6] Delaware courts look to guidance from the analogous federal Rule 16. *See, e.g.*, *Itron*, 109 A.3d at 586-87 & n.2.

[7] Plaintiff's claim that Supreme Court Rule 8 bars Defendant from bringing its waiver argument is meritless. This argument was fairly presented below, and the trial court expressly (albeit incorrectly) rejected it. Op. 53 n.12; *see also* A1651, 1653-56, 1666-67, 1678-79, 1685-86.

government agencies) and (2) holding Caris to a higher standard than the standard it purported to apply (*i.e.*, rationality review vs. heightened scrutiny).

Both Plaintiff and the trial court acknowledge that the A&C standard only requires "a decision making process rationally designed for the issue to be decided." AB 32; Op. 66. Under well-settled law, a corporate board has "rationally designed" a process for determining FMV where it (1) hired one of the world's most well-respected accounting firms, PwC, (2) tasked its CFO with overseeing this advisor, and (3) evaluated the results of PwC's analysis. OB 7-8, 23; A769-72; *see also, e.g.*, 8 *Del. C.* § 141(e). Plaintiff criticizes Caris for citing to 8 *Del. C.* § 141 and business judgment rule precedents, but the Opinion declares that the A&C standard is "similar to that performed by the business judgment standard" and regularly cites to the Section 141, which applies to corporate affairs even outside the context of a fiduciary duty lawsuit. Op. 49, 50, 66-67. The trial court ignored these legal principles by blindly importing administrative law precedents without tailoring them to the corporate context. For instance, the trial court held the Board strictly liable for its advisor's mistakes, but this harsh result finds no support under corporate law. *Compare* Op. 70 (explaining that an "agency" has not "made a rational decision" where it "relied on incorrect information" from an expert), *with In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 673-74 (Del. Ch. 2013) (explaining that even under *Revlon*'s reasonableness test, a plaintiff must prove that a "board purposely relied on analyses that were inaccurate for some improper reason"); *In re Novell, Inc. S'holder Litig.*, 2013 WL 322560, at *12 (Del. Ch. Jan. 3, 2013) (requiring "that the Board had knowledge of [an advisor's] purported improprieties").

By analogizing to a "penal law" definition and emphasizing that this "is a breach of contract case, not an administrative law case," Plaintiff proves Caris' point: standards for liability must reflect the severity of the punishment. AB 32. Because punishments are severe in criminal law, there is often a higher threshold for liability (when compared to analogous civil liability). *See, e.g.*, 15 U.S.C. § 78ff. By contrast, the punishment under administrative law is meager (*i.e.*, the agency gets a do-over), so the threshold for liability is lower (*i.e.*, strict liability for an advisor's errors). OB 22-23. Here, the trial court erroneously paired the lower threshold for liability with a higher severity of punishment (*i.e.*, damages).[8]

Subjecting the Board's rationally-designed FMV determination to an objective reasonableness review finds no support in the Plan. The trial court impermissibly created a heightened standard for subjective good faith in violation of this Court's precedent. Accordingly, this Court should reverse and enter judgment for Caris.

[8] Even if the A&C standard applies—to be clear, Caris argues it does not—the Board's action was neither arbitrary nor capricious; the valuation would be no different, so Plaintiff suffered no damage, and the proper remedy is remand. *See* OB 22; *supra* § I(B)(2); *infra* § IV.

III. PLAINTIFF DODGES THE TRIAL COURT'S CENTRAL "PSYCHOLOGY" ERROR

Not surprisingly, Plaintiff offers no justification for the trial court, as a lay fact-finder, using "psychology literature" on hindsight bias to disregard testimony it found truthful. Plaintiff never meets Caris' argument that this is beyond the proper scope of lay fact-finding. Or that the trial court misapplied the articles it cites. Or that the so-called "contemporaneous" evidence supporting the court's theory was neither contemporaneous nor probative of five of the six directors' subjective views. Or that discrediting a director for later being proven right is bad policy. Or that reversing on this point is case-dispositive for Caris.

Instead, Plaintiff simply denies that the court relied on psychology literature, claiming that the court invoked it as "mere dicta" or (even more strangely) as "mere courtesy." AB 7; *see also id.* at 33. The problem with this view is that it fails on the face of the Opinion. Far from dicta, the court's psychology theory was the centerpiece of its rejection of the directors' honest testimony about their subjective view of FMV in late 2011. Not only was this testimony consistent *across* the directors (who were sequestered during trial), but the trial court adjudged it to be *individually* truthful, finding that three directors testified on point "with conviction" and "honestly." Op. 5-6. Then, in the very next sentence of the Opinion, the trial court made plain its reliance on the psychology theory to reject this testimony, stating: "In my view, this [testimony] was a product of of [sic] hindsight bias…." Op. 5-6. The court then proceeded to discuss at length two articles describing "the psychological literature" on hindsight bias and what "[s]tudies have demonstrated." *Id*. at 6. The court then referenced "the years *after* the Miraca Transaction" to show that the directors' testimony about FMV proved true (to discredit them). *Id.* (emphasis added). Only *then* did the court reach the "contemporaneous" evidence supporting its theory.[9] To claim, as Plaintiff does, that "The Basis For All Of The Trial Court's Fact Determinations Was The Extensive Evidence, Not References In Dicta To Psychology" is not defensible.

Nor does Plaintiff's "courtesy" theory hold up. Plaintiff's implication is that the court invoked "hindsight bias" to avoid calling the directors' testimony untruthful. *See* AB 37 (claiming court made "brief reference to applicable [psychology] literature" "[r]ather than call such testimony perjury."). But Plaintiff's view faces a problem: not only did the court find these directors generally credible (as Plaintiff concedes at AB 34), but it credited this *specific* testimony as truthful, finding that these directors "seemed honestly to believe when testifying that they thought TargetNow and Carisome had very little value in fall 2011" and that they "testified with conviction that they believed these things in fall

[9] Further, the trial court never explains what "contemporaneous evidence" of the Board's beliefs it is referring to. For instance, it claims that undefined "defense witnesses…believed TargetNow was crossing into profitability and would continue on its promising trajectory" in fall 2011. Op. 6. But the Opinion never provides a single citation supporting this statement as to any defense witness, let alone the Board. To the contrary, as of September 2011, SpinCo had *lost* \$36 million for the year, which was worse than 2010 results and did not count \$18 million in free overhead Caris provided to these companies. *See* A269; A379-82; A1004.

2011." Op. 5-6; *cf.* AB 34; *Black's Law Dictionary* 408 (10th ed. 2014) (defining "conviction" as "a strong belief or opinion"). Nor did the court have any problem using strong language when it disbelieved other witnesses. *See, e.g.*, Op. 7, 64. The idea that the court's lengthy discussion of psychology literature was "mere courtesy" to spare the feelings of mendacious witnesses (when in reality the court found those witnesses "very, very" credible) (A794) is again unsupportable.

Echoing the trial court's fundamental disconnect, Plaintiff muddies the waters in its psychology section with reference to Martino's and Halbert's alleged *scienter* (AB 34-36), but of course that has no relevance at all to the psychology theory, which by definition the court only used for the testifying directors who were adjudged **not** to have *scienter* (*i.e.*, all but Halbert).

Likewise, the so-called extensive contemporaneous evidence referenced by Plaintiffs, including documents the directors never even saw, in no way pertains to the subjective beliefs of the *directors*. Plaintiff cites the Opinion's findings of (1) "'corroborated evidence' that [Martino] provided falsely low numbers to PwC and Grant Thornton"; (2) "'[o]verwhelming evidence' in the record [that] makes clear that in rendering its decision, PwC did not determine the fair market value of TargetNow and Carisome"; (3) "probative evidence" and "powerful evidence" that Martino and Halbert did not believe TargetNow was worth only $47 million; (4) "Evidence of Scienter" as to Martino and Halbert's actual beliefs; and (5) "'persuasive evidence' that Martino manipulated the valuation process." AB 37 (quoting Op. 7, 27, 58, 59, 60). None of this "evidence" supports the trial court's conclusion that contemporaneous evidence showed that the *directors* (apart from Halbert) held subjective beliefs in fall 2011 different than what they testified to at trial. Once again, the Board cannot be impugned with non-Board conduct or beliefs. That is a decoy.

Plaintiff does not (and cannot) contest that the trial court's error is case dispositive. The hindsight theory is bad fact-finding, bad law, and bad policy. It cannot be the case that a director in Delaware may be deemed less credible in testifying about his business judgments because those business judgments later prove right. OB 27. And if a director in Delaware cannot use later validation to defend his earlier judgments (as the court below has held), then trial courts should not be permitted to use that same later validation to discredit the director's testimony about those earlier judgments. *Id.* For these reasons, as well as the reasons set forth in Caris' Opening Brief, this Court should reverse and enter judgment for Caris.

IV. WHILE LEGAL POINTS RESOLVE THE MATTER, THE TRIAL COURT'S FACTUAL FINDINGS ARE ALSO ERRONEOUS.

A. Both Plaintiff and the trial court ignore the relevant contemporaneous evidence.

Plaintiff's timeline "concerning the Board's information and beliefs regarding SpinCo's value" is fundamentally flawed for two primary reasons. AB 39. First, Plaintiff cannot deny the contemporaneous evidence showing the decline of SpinCo, so his timeline simply ignores, *inter alia*, the failed assay, abruptly halted trials, downgraded forecasts, declining revenues, and accelerating losses. *E.g.*, A1004-05; A1009; A1030-33; A1076; A1165; A1288-89; B399; AR318; AR336; AR374. These facts are grounded in documentary evidence and not just *post hoc* testimony, as Plaintiff claims. *See* AB 38-39. However, the testimony also provides support for the collapsing events of 2011 and offers probative insight into the impact of these events on the Board's subjective belief concerning SpinCo's FMV.[10] *See* A427-28; A532-33; A662-65; A675; A699-705; A769-72.

Second, Plaintiff's purported "evidence" provides no basis for the trial court's findings concerning the Board's subjective belief of FMV in fall 2011:

<u>Outdated Grant Thornton Valuations</u>: Plaintiff's timeline cites to four GT valuations. Three state that they are analyses performed as of various dates in

[10] Plaintiff has no support for his assertion that this testimony was "discredited." AB 39. To the contrary, the trial court found that the directors "testified with conviction" and "seemed honestly to believe when testifying that they thought TargetNow and Carisome had very little value in fall 2011." Op. 5-6.

2010.[11] *See* B2; B143; B213; B289. And all of the reports pre-date the value-plummeting events described in the Opening Brief. Plaintiff also misleadingly represents that the last routine draft valuation prepared by GT was an approved internal Caris financial projection. *See* B373; AR272. But there is simply no evidence the Board or the Company's executive management saw or approved this draft valuation. A257-61.

Efforts to sell TargetNow: The timeline also consists of evidence from Caris' failed efforts to sell TargetNow, including (1) a number of rosy sell-side comments and projections and (2) third parties' informal expressions of interest in acquiring TargetNow. The fact that Caris was consistently unable to sell TargetNow belies the relevance of this evidence—if anything, the inability to sell TargetNow proves that such evidence was not indicative of its market value. *See* A81-82; A87-88; A203; A541-42; A710; A723-24; A747; A759-60 (expressions of interest never progressed or materialized into formal offers). Further, as the court recognized, this evidence "fits the typical scenario in which a seller gives stretch projections to bidders to induce a higher bid, but has more realistic internal projections that it uses in the ordinary course of business." Op. 24.

Necessary Financial Investment: Plaintiff also points to Halbert's and JH

[11] Plaintiff misleadingly lists these documents as of the dates they were signed in 2011. The date of signature has no relationship to the actual valuation date or to the date associated with the underlying data.

Whitney's post-spin investments in SpinCo. *See* AB 40. Plaintiff ignores that SpinCo was so bereft of value that it would have gone bankrupt after the spinoff without a fresh infusion of capital. *See* A396. Thus, this investment was necessary to see whether the SpinCo "lottery ticket" may pay off. *See* A711-13; A437. Further, directors perceived the investment as a charitable contribution, not an indication of current market value. *See* A543; A704; A770-71.

Third-Party Opinions: Comments from JH Whitney on the operations or potential value of SpinCo are not relevant to the *Board's* view of SpinCo's value in late 2011. *See* B209; B480-83; B484-90; B731; B734-35; A714-15; A725-28; A787-88; B595; B597. There is no indication the Board saw the documents prior to this litigation or agreed with these views on SpinCo's value. A706, 709-10.

TargetNow Revenues: In an attempt to direct this Court's attention away from TargetNow's indisputable failings, Plaintiff—like the trial court—emphasizes TargetNow's increasing revenue. But revenue stopped increasing in mid-2011 and had only increased because Caris poured an unsustainable amount of money into TargetNow. OB 6; A468; A744. Indeed, the increased revenue actually occasioned greater losses. For 2010, TargetNow had $27.3 million in revenue, but ($7.4 million) in negative EBITDA. AR159. For 2011, TargetNow generated revenue of only $45.7 million with ($11.3 million) in negative EBITDA. A1524. So earning $20 million more revenue in 2011 caused $4 million more in losses.

And TargetNow and Carisome's losses would have been even worse but for Caris providing $18 million annually in free overhead to these companies. A242; A269.

<u>The potential market for Carisome</u>: Finally, Plaintiff points to motivational e-mails by Board members and two presentations merely showing a large *potential market* for Carisome and details on sales staff. *See* A762-63; B491; B567; B470-71; B476-79; B571; A533. These do not suggest a viable Carisome product was forthcoming (or even a possibility) and have no relation to the Board's view of SpinCo's value. Instead, the e-mails and presentations support the uncontested position that Carisome was perceived as a "lottery ticket" that could someday result in a viable product and that SpinCo would continue operating despite the long odds of achieving that goal.[12] *See* Op. 80. Even if a $1 lottery ticket *might* have a million-dollar payoff, the market value of such a ticket is still (at most) $1.

* * *

Finally, the operative contractual standard asks whether there is *any basis* supporting the Board's subjective belief, not whether alternative bases could conceivably support alternative beliefs. *See infra* § II. Plaintiff cannot prove a breach simply by pointing to his own preferred evidence of value.

[12] Plaintiff and the trial court both ignored that to value a speculative proposition like SpinCo, the potential payout of the asset must be discounted by the unlikelihood of the payout actually occurring. *See Matthew v. Laudamiel*, 2015 WL 5723985, at *19 (Del. Ch. Sept. 28, 2015).

B. The record does not support a goal of "zero tax."

Plaintiff is unable to support the trial court's foundational findings that "the zero tax outcome . . . was critical if the Miraca transaction was going to close," (Op. 7), and that "Martino suppressed the valuation of SpinCo to achieve zero tax," (*id*. 65). These findings are clearly wrong and illogical. To accept the zero-tax theory, the Court must ignore the following undisputed facts: (1) Miraca's insistence that SpinCo be valued *high enough* to avoid subsequent tax liability, (2) the scrutiny Deloitte and Skadden Arps (Miraca's advisors) applied to ensure the SpinCo valuation was appropriate, and (3) Caris' need to appease Miraca in order to close the deal and take advantage of the high yen value while avoiding looming debt covenants. *See e.g.*, A185 ¶ 46; A262; A375; A385; A547; A1039-40. This set of facts did indeed mean that "Caris and Miraca were 'focused' on the tax aspect of the Spinoff." AB 43. But their collective focus was on closing the Transaction and assuaging Miraca's tax concerns by not ***undervaluing*** SpinCo. *See* Op. 21; A373-75; A382-83; A1028-29; A1034-38; A1039-40.

Perhaps realizing that the trial court's reasoning on this point cannot be logically reconciled with the facts, Plaintiff makes no attempt to argue that zero-tax was necessary for the Transaction to close and does not mention Miraca at all. Instead, Plaintiff argues that Caris alone insisted on a "zero-tax" valuation to save money on taxes. *See* AB 41-44. However, Plaintiff runs into the same problem as the trial court—the facts simply do not support this theory.

Plaintiff attempts to paint a picture that Martino and PwC conspired to cook the numbers in order to arrive at a valuation that resulted in zero taxes for the benefit of Caris' owners. *Id.* However, there is no evidence of their motivations for doing so—or that one of the world's most well-respected accounting firms would put its reputation on the line by accepting a "bogey to hit" when valuing SpinCo. Op. 25-26; *see, e.g.*, *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 1005 (Del. Ch. 2005) (rejecting as "implausible" the notion that "a very large investment bank with serious reputational interests at stake" would "taint[] its advice to its client"). Further, Plaintiff offers no evidence establishing that Caris would have jeopardized the $725 million sale of the AP Business—which was $200 million more than expected due to favorable yen-to-dollar exchange rates—to save some unknown amount in tax liability. A385. As Martino testified:

> Any tax that we may or may not have to pay on some value for this spin-off entity is -- is so small compared to getting $725 million from the only bidder in town, at . . . a price . . . $200 million more than they should have paid, okay? At a time when I had debt covenants ready to bust in two months.

Id. Plaintiff's evidence only establishes the uncontroversial proposition that no one "wants to pay more taxes than they have to." B724; *see also* B737; B210. Furthermore, Plaintiff has no answer for the fact that Skadden Arps and Deloitte, who were motivated to ensure the valuation was high enough to satisfy Miraca, performed full due diligence on Caris and signed off on the SpinCo valuation. *See* AR208-71; B401-05; A185; A262; A375; A1039-40.

The trial court's findings of a "suppressed valuation" through "falsely low" projections are also clearly wrong. The very e-mail in which Martino transmitted the September projections to PwC contains actuals showing TargetNow and Carisome **lost** $35.9 million through August (instead of **making** $14.7 million as projected in Caris' original Board approved budget for 2011—a $50.6 million swing). A1004; A1445; AR7; A267; A379. The actuals reveal that TargetNow generated only $35.2 million in revenue through August, missing the 2011 original budget by over 30%. A1004; AR7. In response to this significant revenue shortfall, Caris revised its forecast downward, but in September when Martino sent the revised projections to PwC, TargetNow was not even on track to meet the supposedly "falsely low" $55 million in those projections. A1011; A1450.

C. There is no evidence a tax valuation and FMV would be different.

To demonstrate monetary harm, it was necessary for Plaintiff to show that the PwC valuation relied on by the Board was lower than the FMV the Board was obligated to determine under § 2.25. The difference between tax transfer value and market value is that a tax valuation omits goodwill. Op. 68-69.

Plaintiff does not address goodwill even once in his Answering Brief. Perhaps this is because Plaintiff failed to elicit testimony, provide expert analysis, or introduce documentary evidence at trial establishing that SpinCo had *any* goodwill at the time of the Transaction. To the contrary, the record indicates that SpinCo had no goodwill during the relevant time. SpinCo had little, if any, name recognition and no historical success to rely on. *See* OB 5-6, 35. PwC came to the same conclusion when it decided SpinCo had no goodwill because it is "without a proven track record." B380.

Yet Plaintiff's argument requires the trial court to assume that SpinCo had "hundreds of millions of dollars" in goodwill in late 2011. AB 44. By way of comparison, the internationally recognizable Toys "R" Us, Inc.—with more than 850 domestic storefronts and over $12 billion in sales for fiscal year 2014—reported only $64 million in goodwill. *See* Toys "R" Us, Annual Report (Form 10-K) (March 26, 2015) at 7-8, 52, 54. Without evidence of SpinCo's goodwill, there is no evidence that a tax valuation and a fair market valuation would have differed at all. Therefore, Plaintiff cannot prove damages from the use of PwC's valuation.

Plaintiff and the trial court make three flawed attempts to sidestep the lack of goodwill. First, they cite an email from PwC stating that the valuation "**may** not equate to the definition of fair market value under Revenue Ruling 59-60, or to the concept of fair value in a financial reporting context." AB 11; Op. 27, 68; B414 at No.10. "May" is not "will," and there is no evidence of difference here. Nor is there any requirement under § 2.25 that FMV comport with any regulatory standard. A814 § 2.25. Thus, this email merely says that PwC's valuation ***may*** not equate to two irrelevant valuation standards.

Second, for TargetNow, Plaintiff argues that (i) there must be goodwill *because* Plaintiff claims the Board subjectively believed FMV was higher than PwC's number and (ii) PwC "deducted" $40 million from its DCF. AB 44. The first argument is circular, declaring victory by starting with his conclusion. The second ignores that PwC used a "form of discounted cash flow" (AB 44; *compare* A1190 *with* A1321) which subtracts "routine returns" from EBIT, whereas GT calculated free cash flow traditionally (EBIT (1 - tax rate) + depreciation and amortization - changes in working capital - Cap Ex). Because GT's standard cash flow adjustments are overall negative, its free cash flows are slightly **lower** than the "EBIT less routine returns" cash flows used by PwC. PwC's method thus **increases** value slightly over a traditional DCF where, as here, both models use the same projections and there is no goodwill.

Third, for Carisome, Plaintiff compares outdated and unrelated GT and PwC valuations to speculate that variances among them must equate to a difference in a tax valuation and a FMV. This apples-to-oranges comparison ignores changes in SpinCo's value between 2010 and PwC's late-2011 valuations, most notably that Carisome no longer had a viable product and had to scrap the research that went into developing that failed product. *See* A657; A664; A697-98; A704; A760-61.

V. PLAINTIFF'S CROSS-APPEAL POINT IS WAIVED AND HIGHLIGHTS THAT THE TRIAL COURT'S DAMAGES ANALYSIS WAS FLAWED.

A. Question Presented.

Did Plaintiff waive his claim that the trial court made a typographical error as to damages, and is Plaintiff's claim further evidence that the trial court failed to base its damages conclusion upon a logical and orderly deductive process?

B. Scope of Review.

This Court cannot review a question that was not fairly presented to the trial court unless "the interests of justice so require," in which case, this Court's review is for plain error only. *Smith v. Del. State Univ.*, 47 A.3d 472, 479 (Del. 2012).

C. Merits Of Argument.

1. Plaintiff waived his cross appeal.

Plaintiff waived his cross-appeal argument because he failed to fairly present this issue to the trial court in his many post-opinion, prejudgment motions or through a post-judgment Rule 59(e) motion to alter or amend the judgment. Under Delaware Supreme Court Rule 8, "[o]nly questions fairly presented to the trial court may be presented for review." *Id*. Here, Plaintiff not only failed to raise any issue with the trial court's damages calculation below, but repeatedly adopted the damages calculation (which he now claims was based on a typographical error) in several filings before the trial court. *See* AR438; AR447; AR455; AR457-58; AR469.

Any issue with the calculation of damages due to the trial judge's inadvertence should be evaluated by the trial court itself. Allowing Plaintiff to raise this issue for the first time on appeal—asking appellate judges to reverse engineer the trial court's calculations or divine its intentions—is inefficient and contrary to Delaware waiver principles.

2. The trial court's damages calculation was not based on an orderly and logical deductive process.

Moreover, Plaintiff's argument highlights that the trial court's damages award was not "the product of an orderly and logical deductive process." *Schaefer v. Butzke*, 692 A.2d 415 (Del. 1996) (TABLE). The trial court found that a draft GT Q1 2011 report was the most reliable indicator of the Board's subjective belief as to SpinCo's FMV in fall 2011, Op. 78-79, even though the Board neither requested nor ever reviewed this report. *See* A297-98. It is illogical to assume that the Board's subjective belief as to value in fall 2011 would be based upon a Q1 2011 report that it neither requested nor reviewed. Rather, the trial court's Opinion reflects its conclusion that the Board *should have* relied upon the draft GT report, which provided (in the trial court's view) a good *objective* appraisal of FMV. This analysis highlights the trial court's application of an objective standard instead of the subjective standard set forth in the Plan.

The trial court then exacerbated this error through a series of illogical and unsupported departures from the GT report. Although it had just found that the GT report provided "a reasonable approximation of the Board's subjective belief" as to TargetNow's and Carisome's value, Op. 79, the trial court immediately rejected this finding and concluded that the Board would have determined a much higher value for TargetNow ($150 million vs. $47.5 million) and a much lower value for Carisome ($150 million vs. $226 million). *Id.* at 79-80. Equally troubling, the trial court's only support for this conclusion as to the "Board's subjective belief" were documents generated by Martino, Citi, and JH Whitney. *See id*. But because the combined value of the entities remained roughly the same in both scenarios,[13] the trial court expressed comfort with its analysis. This is obvious error. The trial court cannot rely on a combined valuation figure for two companies while simultaneously rejecting each of the underlying valuations that make up the combined figure. Instead, the trial court must apply a logical and orderly deductive process in determining damages.

Moreover, in calculating damages, the trial court wholly ignored the uncontroverted expert report of Professor Paul Gompers. A1471-1552. In his report, Professor Gompers analyzed the benchmark failure rates for young healthcare/biotech ventures and found failure rates of between 12.9% and 13.4%, for ventures at a similar stage as TargetNow, and failure rates of between 28.2%

[13] GT report scenario: $47.5 million (TargetNow) + $226 million (Carisome) = $273.5 million (combined SpinCo). Trial court's modified scenario: $150 million (TargetNow) + $150 million (Carisome) = $300 million (combined SpinCo). *See* Op. 79-80.

and 35.1%, for ventures at a similar stage as Carisome. *See* A1503-04. From this, Gompers concluded that PwC's and GT's valuation approaches were conservative and resulted in unduly high values because they did not sufficiently account for the significant failure rates of for similar stage ventures. *See* A1507. Professor Gompers' report therefore supports Caris' good faith reliance on PwC's value as reasonable (if not high) and directly contradicts any assertion that PwC's valuation was so low as to be evidence of manipulation or bad faith.

In sum, Plaintiff waived his cross-appeal argument, and this argument highlights that the trial court's damages analysis at least requires remand for a proper determination of the Board's subjective belief as to the FMV of SpinCo in November 2011.

CONCLUSION

For the foregoing reasons, Caris asks this Court to reverse the judgment of the trial court and render judgment in favor of Caris.

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Dated: January 11, 2016