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IN THE SUPREME COURT OF THE STATE OF DELAWARE

OPTIMISCORP, a Delaware corporation, ALAN MORELLI, and ANALOG VENTURES, LLC,	)	
Plaintiffs Below-Appellants,	)	
v.	)	No. 523,2015
JOHN WAITE, WILLIAM ATKINS, GREGORY SMITH, and WILLIAM HORNE,	)	On Appeal from the Court of Chancery, C.A. No. 8773-VCP
Defendants Below-Appellees,	)	

APPELLEES JOHN WAITE, WILLIAM ATKINS, AND GREGORY SMITH'S ANSWERING BRIEF ON APPEAL AND CROSS-APPELLANTS' OPENING BRIEF ON CROSS-APPEAL

Dated: December 10, 2015

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NATURE OF THE PROCEEDINGS

On August 5, 2013, Plaintiffs-below, Appellants Optimis*Corp* ("Optimis" or the "Company"), Alan Morelli ("Morelli"), and Analog Ventures, LLC ("Analog," and together, "Plaintiffs") filed the Verified Complaint (the "Complaint"). (A1; A693-718.) On August 8, 2014, Defendants separately moved for summary judgment. (A35-40.) After summary judgment, Plaintiffs moved to amend the Complaint (the "Motion for Leave"), which introduced entirely new theories based on facts Plaintiffs never disclosed during discovery. (A53-61.) On January 28, 2015, the Court denied the Motion for Leave and granted in part Defendants' Joint Motion *in Limine* to Exclude Untimely Evidence and Previously Undisclosed Causes of Action at Trial. (A64; B1140.) The Court of Chancery held a six-day trial from February 6-13, 2015. On August 26, 2015, the trial court issued the Memorandum Opinion (the "Opinion") and entered the Final Order and Judgment (the "Order").[1] (A 68, A73; Exs. A-B.)

Plaintiffs filed their Notice of Appeal on September 24, 2015. (D.I. 1.) Horne and the Director Defendants timely filed separate Notices of Cross-Appeals on October 8, 2015. (D.I. 6, 8.) Plaintiffs filed their Opening Brief on Appeal on November 9, 2015. (D.I. 14.) This is the Director Defendants' Answering Brief on Appeal and Opening Brief on Cross-Appeal.

[1] The Memorandum Opinion is cited herein as "Op. at []" and attached hereto as Exhibit A. The Order is cited herein as "Order at []" and attached hereto as Exhibit B.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery properly found that Plaintiffs' conduct compromised the proceedings through improper settlement tactics and other misconduct.

2. Denied. The Court of Chancery correctly held that the Director Defendants did not breach the duty of loyalty by not giving Morelli advanced notice of his potential removal.

3. Denied. The Court of Chancery properly held that the Director Defendants did not breach the duty of loyalty in connection with Morelli's removal and the amendment of the Stockholders Agreement.

4. Denied. The Court of Chancery properly held that the Director Defendants did not breach the Stockholders Agreement when they refused to execute Morelli's written consents at the October Meeting.

5. Denied. The Court of Chancery properly held that Plaintiffs did not prove that they suffered any damages.

6. The Court of Chancery erred when it held that the Director Defendants breached their duty of candor by not earlier advising the Optimis Board of Directors of Rancho's flawed corporate structure.

7. The Court of Chancery erred in failing to award the Director Defendants their attorneys' fees and expenses.

COUNTERSTATEMENT OF FACTS[2]

Plaintiffs contend that this case is about corporate control. The voluminous record below, including Vice Chancellor Parsons's Memorandum Opinion (the "Opinion"), demonstrates that it is not control, but rather Morelli's narcissism and insatiable need for revenge that drives this litigation. Any corporate control contest, to the extent one ever occurred, ended years ago with the settlement of the Section 225 Action (defined below) and Morelli's subsequent firing of Defendants-below John Waite ("Waite"), William Atkins ("Atkins"), and Gregory Smith ("Smith," and with Waite and Atkins, the "Director Defendants") in 2013.

Following a six day trial, scores of depositions, thousands of exhibits, and extensive briefing, the trial court rightly observed that Morelli "is the locomotive propelling this litigation." (Op. at 4; *see also id.* at 67-75.) The record shows how Morelli used his financial sophistication, legal acumen, fear, and aggressive attorneys to punish his adversaries (real and perceived), all of whom tied their reputations and financial security to Optimis. After Morelli's own misconduct led to his termination, he retaliated. This case is but one stop along Morelli's retaliatory journey.[3] For the Director Defendants, the ride should end here.

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[2] Citations to B1-B1139 refer to the Appendix to William Horne's Answering Brief on Appeal and Opening Brief on Cross Appeal. Citations to B1140-2949 refer to the Appendix to this brief, which is filed contemporaneously herewith.

[3] As of February 2015, Optimis was involved in several lawsuits against at least nine former employees or consultants. (*See, e.g.*, B1596-1613; B1230-1244; B1614-38A693.)

A. The Director Defendants Build Rancho

Atkins founded Rancho Physical Therapy ("Rancho") in 1984, and, along with Waite and Smith, built it into an award-winning business with 19 locations. (A601-602, 1457:19-61:17 (Atkins) (describing Rancho's success and reasons for it); Op. at 57-58.) Over the years, the Director Defendants received numerous offers to sell Rancho. (A416, 1015:7-12 (Waite); A513, 1254-55 (Smith); Op. at 58-59.) The Director Defendants declined these previous offers because they were waiting for the right opportunity for Rancho. An opportunity where their friends, family, and employees who helped build Rancho could "shar[e in] the upside in the company and the growth of the company." (A513, 1255 (Smith); A416, 1015:13-1017:6 (Waite); A602-603, 1462:11-1463:15 (Atkins); Op. at 59.) In 2007, Morelli convinced the Director Defendants that Optimis was that opportunity.

B. The Optimis Transaction

Like the many Optimis acquisitions that would follow, Morelli proposed to acquire Rancho with Optimis stock. (Op. at 59.) The Director Defendants initially were skeptical. (A602-03, 1461:22-1462:10 (Atkins); Op. at 58.) After discussing their options and consulting with their families, however, they decided that the Optimis transaction would present the greatest upside potential for Rancho and its many employees. (A165, 274:8-17 (Morelli); A416, 1015:6-1018:22 (Waite).) In June 2007, the Director Defendants sold Rancho to Optimis. (A743; Op. at 59.)

The upside potential in which the Director Defendants invested came from Morelli's expertise in and promise to provide "liquidity opportunities." (A1391; A416, 1015:23-1017:6 (Waite); A513, 1255, A515, 1261-62 (Smith); Op. at 59.) The promised liquidity event was to occur "maybe three, four years [out] at the most," and was especially important to the Director Defendants because that was the mechanism by which the Rancho employees would share in the benefits from the deal. (A605, 1471:5-1472:2 (Atkins); Op. at 59.)

In connection with the transaction, the parties executed the Stock Purchase Agreement ("SPA") and the Stockholders Agreement. (A743; A1337; A1408; Op. at 59, 61.) After the transaction, Morelli remained a director and shareholder of Optimis and became a director of Rancho. (A169, 292:22-293:6; A171, 300:4-19 (Morelli); Op. at 60-61.) He (along with Analog) also obtained the right, through the Stockholders Agreement, to designate five (5) of the nine (9) Optimis directors for seven (7) years.[4] (A743; A1408 at §§ 3.3, 9; Op. at 61.) The Director Defendants became Optimis directors and shareholders, and remained directors and employees of Rancho.[5] (A1337; A743; Op. at 59-61.) The Director Defendants continued operating Rancho as they had prior to the transaction, and,

[4] Morelli's contractual control expired in February 2015, but through a combination of unlawful bylaws, preferential stock issuances and other defensive measures that are the subject of other litigation, Morelli has effectively retained control over the Company.

[5] In 2009, Morelli asked Waite to serve as Optimis' Chief Operating Officer. (A418, 1023:10-21 Waite).)

recognizing Optimis' potential, each agreed to reduce his base salary to $100,000 per year, after previously earning approximately $500,000-700,000 per year. (A417, 1019:5-1020:15 (Waite); Op. at 59-60.)

In connection with the SPA, the Director Defendants secured Employment Agreements, held at the Rancho subsidiary, which gave them limited but important protection in light of the all-stock deal with Optimis. (A1472; A1494; A1515; A744; A416, 1019:5-1021:3 (Waite); A513, 1256 (Smith); Op. at 59-60.) Once the initial term of the Employment Agreements expired, Rancho (which the Directors Defendants controlled) and the Director Defendants could extend them "for successive one-year terms by mutual written agreement." (A1473, A1495, A1516 at § 2.1; A417, 1019:5-1021:3 (Waite); Op. at 59-60.) Rancho and the Director Defendants could extend the Employment Agreements without Optimis' approval if (i) no liquidity event occurred, (ii) Optimis' common stock was less than or equal to $5.00 per share, and (iii) the Director Defendants did not breach the Employment Agreements. (A1473, A1495, A1516 at § 2.2; Op. at 59-60.) None of these events occurred. (A693; B1338-1486; A275, 574:7-24 (Morelli).)

C. Early Stages of Optimis

1. Optimis Structure

Rancho was the first and largest of several physical therapy businesses acquired by the Company. (A743; Op. at 61-62.) After the Rancho acquisition,

Optimis acquired eight (8) additional physical therapy practices. (A166, 281:21-282:17 (Morelli); Op. at 61-62.) In addition to the Director Defendants, Morelli sought other highly qualified and regarded individuals to join the Company at its early stages.[6] Like the Director Defendants, most, if not all, of these consultants and employees took substantial pay cuts to join Optimis.[7] (*See*, *e.g.*, A79-80, 18:5-23:1 (Owens) (explaining how he and his wife, Joan Lynch, received only options for their consulting work); A318, 748:5-10 (Fearon) (Fearon's annual salary dropped from $180,000 to $65,000).)

Morelli divided the Company into two divisions: the Software Services Division ("SSD") he administered, and the Clinical Services Division ("CSD") Waite managed. (A418, 1023:12-1024:3 (Waite); A166, 278:22-279:5 (Morelli); Op. at 62.) The SSD developed two primary products, OptimisPT (proprietary electronic medical record software) and OptimisSport (a series of modules to complement OptimisPT that, if ever finished, would provide a fully integrated physical therapy experience and keep patients engaged with the provider acute

[6] Among others, Morelli recruited: (i) Joe Godges, a former Optimis director and an "icon" in the physical therapy field (A603, 1465:7-8 (Atkins)); (ii) Helene Fearon and Steve Levine, "key employees in the Company's consulting subsidiary," recognized regulation and compliance experts (A167, 283:18-20 (Morelli); (iii) Will Horne, former Optimis Chief Financial Officer, with a wealth of financial experience (A174, 310:7-23 (Morelli); (iv) George Rohlinger, the former Chief Business Development Officer and a Harvard-trained investment banker (A185, 356:1-16 (Morelli); (iv) Kevin Owens, a former Optimis consultant with experience in high-level medical technology sales (A76-77, 7:1-10:4 (Owens); and (v) Joan Lynch, a former Optimis consultant who was an executive vice president at ESPN (A80, 21:19-22:4 (Owens).

[7] Notably, Fearon and Levine were the only two "key" employees who remained with the Company following 2013.

treatment as necessary). (A80-81, 24:21-28:18 (Owens); A165, 274:20-277:9 (Morelli); Op. at 62-64.) The CSD, comprised of the Company's physical therapy clinics, was the largest user of OptimisPT. (A515, 1262-64 (Smith); Op. at 64-65.) As such, the Director Defendants were incentivized to support the SSD as Rancho's revenues depended on the functionality of OptimisPT. (A515, 1262-64 (Smith); B1687, 191:9-192:4 (Gunn Dep.); Op. at 65.)

2. The Director Defendants Support Morelli's Vision

Consistent with Morelli's "vision,"[8] and immediately following the transaction, the Director Defendants worked hard to maintain Rancho's success, which continued to flourish even after the Optimis transaction. (A514, 1256-57 (Smith) ("We ran it the same as we always did; we continued to grow. We really just kept gaining momentum and it was -- it was an exciting time. It was -- it was very exciting. We had a great time doing it. You know, we had great employees and everyone worked very hard.").) The Director Defendants also encouraged the development of the SSD and the integration of the two divisions. For example, Atkins traveled to Morelli's house to learn more about OptimisSport, represented

[8] As the Vice Chancellor noted, everyone agreed that Morelli's strengths were as a "visionary" and "ideas-man" with "big goals for the future of the physical therapy industry." (Op. at 68-69; *see also* A629, 1568:3-7 (Atkins) ("Alan is . . . visionary . . . his talent is not in operations. It's not in daily operations. But he is a great visionary.") Unfortunately, Morelli's management style, sexual misconduct, and refusal to acknowledge financial constraints on the Company prevented him from realizing his "vision."

OptimisSport at conferences[9] and attempted to implement certain components, such as the weight management program, into his clinics. (A605, 1472:6-1413:12 (Atkins); B1290-91.) When Atkins asked Morelli how he could support OptimisSport, Morelli responded, "[j]ust support the swim challenge," a non-revenue producing event sponsored by the SSD. (A606, 1475:2-1476:10 (Atkins).) Atkins did just that by recruiting the CFO of an HMO and potential client of the Company to swim in the Distance Swim Challenge ("DSC"). (*Id.*) Waite trained for and swam in every DSC held by the Company. (A419-20, 1030:15-1032:5 (Waite); A296, 658:14-24 (Morelli).) Waite also recruited volunteers from Rancho to assist with the DSC. (*Id.*)

Morelli's vision proved exceedingly expensive, and the Director Defendants repeatedly responded to calls for financial support. In 2009, the Company sought to raise equity capital to fund its operations and software development. (A294, 653:1-14 (Morelli); Op. at 76.) Optimis raised $3 million. (A295, 655:16-20 (Morelli); A531, 1328 (Horne).) The Director Defendants raised "a lot" of the

[9] Notwithstanding the Director Defendants' efforts, promoting OptimisSport proved challenging:

> Well, I had a lot of discomfort because we could not define OptimisSport. It was a lot of ideas but there was nothing concrete. And yet it appeared they were trying to get us to represent it as if it was a concrete program. We were literally trying to represent that this was a good program. We had four boxes. . . there was nothing behind the boxes. Nothing was done on it. It was disingenuous, in my mind. Yet I'm putting my reputation here.

(A606, 1473:15-1475:1 (Atkins).)

money from their friends, family and business associates.[10] (A295, 656:3-9 (Morelli); A418, 1025:14-1026:16 (Waite); A514, 1257-58 (Smith) ("I was really excited about the product, the things that it could do for our profession. And so, you know, with that, I asked some of my family, friends, and some of my physician friends if they would be interested in investing in the company . . . . My mom invested, I think, $80,000. My younger brother invested, I think, $200,000. . . [and some other good friends] invested $50,000."); A604, 1467 (Atkins); Op. at 76.) In 2011, the Company again needed capital to fund Morelli's unprofitable SSD. Waite and Atkins raised another $860,000. (A530, 1322-23; A533, 1335-36 (Horne) ("It came –the majority came from a very good friend of Mr. Waite . . . and the remaining portion came from Mr. Atkins' brother-in-law, Mark O'Connor."); Op. at 86.) Thus, the Director Defendants' commitment to Optimis was evident from the outset, and the Director Defendants remained incentivized to ensure Optimis' success.[11]

[10] The Company issued Private Placement Memoranda (each a "PPM") in 2009, 2011, and 2012. (Op. 76, 86, 105.) Morelli did not disclose the Stockholders Agreement in the 2009 or 2011 PPMs. (*Compare* A1556 (2009 PPM) *and* A1699 (2011 PPM), *with* B1338-1486 (2012 PPM); A295, 654:8-656:14 (Morelli); *see also* Op. at 95.) After learning this, Rohlinger discussed his concerns about the failure to disclose the Stockholders Agreement in the PPM with Horne. (A533-34, 1334:24-1338:12 (Horne); Op. at 94-95.)

[11] Thus, the Court of Chancery properly rejected Plaintiffs theory that a 2010 email from Smith to Waite expressing frustration with Morelli's "poor financial budgeting and lack of fiduciary responsibility as it relates to expenses Optimis is incurring" evidenced a takeover conspiracy. (D.I. 14 at 13; Op. at 79-83.) Plaintiffs' continued reliance on this "smoking gun" email only evidences the complete lack of support for Plaintiffs' conspiracy theory. Thus, the Court of Chancery properly rejected Plaintiffs' conspiracy theory beginning in 2010. (*Id.*)

At the close of trial, Vice Chancellor Parsons questioned Plaintiffs' theory in light of their failure to identify any credible motive on the part of the Defendants to take the actions Plaintiffs allege. (A658, 1682:19-83:1.) Vice Chancellor Parsons' bewilderment is well founded – the Director Defendants invested their extremely successful Rancho business, which took decades to build, in Optimis. They recruited their family and friends to invest substantial amounts of money into the Company. They substantially-reduced, performance-based compensation depended heavily on Rancho's success. Rancho, the SSD's largest and primary customer, relied upon OptimisPT to efficiently operate its business. The Director Defendants invested time learning about and promoting OptimisSport. There was **no** incentive for the Director Defendants to take any action that would harm Optimis – financially, structurally, or reputationally – and Plaintiffs have never pointed to a single shred of evidence showing otherwise.

D. Morelli's Management Causes Internal Turmoil[12]

As the Company grew, so too did its problems. Morelli created an uncomfortable work environment for Optimis employees. Optimis' corporate offices were housed in two personal residences – the Lower and Upper Bubbles –

[12] The Court of Chancery accurately assessed Morelli and his management style, which provide important context for the parties' actions. (Op. at 67-75.) Plaintiffs' complaint that the Court of Chancery "accepted the defense's invitation to wade into the weeds and determine who was 'good,' and who was 'bad,' and who had the better business judgment about how to run the business of Optimis" is without merit and unhelpful. (D.I. 14 at 10.) While Plaintiffs continue to blame everyone *but* Morelli, the voluminous record and trial court's findings show otherwise. (*See, e.g.*, Op. at 53, 92, 152, 175.)

that Morelli owned in Pacific Palisades. (A85, 43:3-11 (Owens); Op. at 65-66.) Morelli lived in the Upper Bubble, and used his bedroom as his office, where it was not unusual to see Morelli in various states of undress. (A537, 1349 (Horne); B2290, 28:11-29:1 (Eastman Dep.); B2199, 32:25-33:4 (Brys Dep.); B1840, 14:4-24 (Lynch Dep.) (describing Morelli's usual attire of bike shorts or a towel); B120; B7 ("the naked stuff only happened at night. He just walks around with his shirt off during the day which I know makes everyone feel uncomfortable."); Op. at 65-66.)

Morelli's leadership style also isolated Board members, officers, and key employees, and created tension among executives. (A305, 695:21-697:14 (Fearon) (describing Morelli's poor communication and lack of support of OptimisPT team); A318, 749:17-750:11 (Fearon); A628, 1564:5-20 (Levine) ("[Morelli's management style], to me, was exceedingly frustrating. Communication was poor or nonexistent, from that perspective, and it was just, for me, a sense that we were -- that I had -- I had come to this company, and sort of we were moving in a direction that was not what I had signed up for."); A106, 125:6-126:11 (Owens) (stating that one of the reasons he left Optimis was because of Morelli's cruel treatment of people); A501, 1206 (Olsen) (explaining that Morelli consistently failed to respond to inquiries); B1645, 23:1-5 (Gunn Dep.) (describing confusion resulting from a lack of "written – or an organizational chart" that explained proper reporting structure, and stating that "It just always appeared to be a revolving door,

and the individuals that left specifically in verbal conversations because of the poor work environment and because of Alan's lack of leadership abilities."); B1839, 12:23-13:7 (Lynch Dep.) (discussing Morelli's high expectations and the "unusual" and "difficult" environment he created); Op. at 69-75.)

Morelli humiliated, threatened, or punished those who disagreed with or challenged his "vision." (A106, 125:10-13 (Owens) (agreeing that Morelli was "almost cruel at times in the way he treated people" and describing one instance where Morelli yelled at Geller so badly that Owens stepped in and Morelli became angry at Owens); A89, 58:3-22; A92, 71:1-72:7 (Owens) (describing instance of Morelli belittling him); A514, 1259-60 (Smith) ("I was taken back by how rude and how condescending and how mean he was to Mr. Godges. I was just blown away . . . he humiliated him in front of us."); A604, 1466:1-1467:1 (Atkins) (describing Morelli's patronizing reaction when Atkins expressed skepticism of OptimisSport); A616, 1516:13-22 (Robinson) ("I had to be careful of everything I said, and had to agree with him . . . or I was afraid that I would lose my job or my husband would lose his job."); B2202, 44:16-19 (Brys Dep.) ("I also received complaints because of Mr. Morelli's temper . . . Nearly all of the employees at the upper bubble at that time expressed concern about Mr. Morelli's temper."); *see also* B2-68, B1284-88; Op. at 69-75.)

E. Morelli Drives Optimis into Financial Distress

By early 2012, the CSD continued to prosper, but the SSD struggled. (A273-74, 569:1-20 (Morelli).) Rather than devote resources to OptimisPT, the Company's only viable software, Morelli focused on OptimisSport, even though it had no structure, limited functionality, and could not generate revenue for years. Devoting resources to OptimisSport diverted resources from OptimisPT, an established product used by *paying* clients – *including the CSD*, which remained underdeveloped, unstable, and unable to meet its users' needs. (A303-04, 686:22-690:14, A321, 760:4-16 (Fearon); A636, 1596:23-1598:1 (Levine); A515, 1262-63 (Smith); B1687, 190:2-192:4 (Gunn Dep.); Op. at 78-84.) Morelli's unwillingness to focus on OptimisPT frustrated employees and left the Company cash-strapped. (A303-04, 686:22-690:14; A306-07, 701:7-702:18 (Fearon) ("The feeling that there was frustration and change wasn't happening with the product that we had our face on was what was causing the frustration. Court: But who is responsible for that? . . . For the fact that the product is not developing in a way that you think it should be developing, things of that nature . . . A: Alan[.]").); A630, 1571:4-1573:4 (Levine) ("And while OptimisSport was certainly part of the vision, it was not something that we – that I felt, that I believed, that we were ready to move into without making sure that we were credible in the industry for OptimisPT."); A486-87, 1148:18-1149:5 (Waite); B1319-37.)

The only "strategic disagreement at the highest management levels" was with Morelli. (D.I. 14 at 14; Op. at 95.) There is no evidence, and Plaintiffs do not cite any, that the Director Defendants recruited anyone to support their views.[13] Rather, the evidence shows, and the Vice Chancellor properly found, that Morelli's poor management style and reckless spending isolated Morelli from the rest of the management team. (Op. at 83-84.) For example, Morelli "directed the software developers to work on both OptimisSport and OptimisPT," when the Company could not afford to fund to develop both products. (D.I. 14 at 15; *see also supra* pp. 15-16.) Since Optimis could no longer raise equity capital, the CSD continued to fund the SSD. (A528, 1314 (Horne) (describing agreement for upstream payments from Rancho to support Optimis); A501 (Olsen) (explaining that from April to October 2012, Optimis's subsidiaries made upstream payments in the amount of $2 million); B1506-07; A515, 1262-63 (Smith).) Because the CSD – the only revenue producing division – heavily relied upon the OptimisPT product to effectively manage and bill its clients, the non-Morelli management believed that the SSD should focus on developing OptimisPT. (A515, 1262-64.)

[13] In fact, others sought them out. (A427, 1061:2-16 (Waite).) Plaintiffs claim, without citation, that Waite was "most heavily involved in day-to-day effort to effectuate their [unproven] strategy to undermine and remove Morelli." (D.I. 14 at 15.) Notwithstanding that Plaintiffs offer no support for this allegation, it was no secret that Waite too was frustrated with Morelli. Waite was running the CSD, which provided nearly all of Optimis' revenue, while attempting to manage frustration among senior management. (*See, e.g.*, A427, 1060:17-1062:14 (Waite).)

Despite these troubles, the Director Defendants continued to work hard to ensure Rancho's success, especially in light of Optimis' financial constraints. Notwithstanding Rancho's continued success, the Director Defendants agreed to extend their employment agreements at the *same* salary as the previous two years, but with enhanced bonus targets *that were harder to reach* (the "2012 Extension").[14] (*Compare* A1473-74 *with* A1485-86; *see also* B1313-14; B1315-16; B1317-18; A277, 584:1-23 (Morelli); A425-27, 1052:8-1060:8 (Waite); A516-17, 1268-1271 (Smith); Op. at 97-98.) The 2012 Extension followed a dispute between the Director Defendants that arose when Morelli objected to an extension of the Employment Agreements, claiming that they expired in 2011. (B1292-95; A425-427, 1052:8-1060:8 (Waite); Op. at 97-98.) Though the Director Defendants were outraged by Morelli's efforts to threaten their only downside protection, the Director Defendants, in the spirt of compromise, agreed to the 2012 Extension. (B1296-1308, B1310-12; Op. at 97-98.)

Plaintiffs attempt to tie the dispute surrounding the 2012 Extension to Morelli's removal from the Rancho Board, but the facts do not support this effort. The Rancho bylaws allowed only licensed physical therapists to serve on the Rancho Board. (B1245-62.) When the Director Defendants reviewed this

[14] In 2011, Rancho and the Director Defendants extended the Employment Agreements for one year, on the same terms (the "2011 Extension"). (A1483-84; A1505-06, A1528-29; A517, 1269 (Smith).)

provision, they removed Morelli from the board of Rancho to comply with the relevant bylaw provision.[15] (Op. at 98; A1836.) Morelli's removal had no impact on his control over Rancho or Optimis – Morelli still controlled Optimis; the Director Defendants still controlled Rancho.[16]

F. The Geller Investigation

On or about September 21, 2012, Geller told Waite that Morelli had sexually harassed her on several previous occasions. (A428, 1066:5-1067:18 (Waite); A2535, 60:13-61:23 (Robinson Dep.); A1905; Op. at 107.) Waite immediately reported Geller's claims to Nancy Kreile, Rancho's Director of Human Resources,[17] who reported the claims to Optimis's insurance carrier. (A747; A429, 1069:7-12 (Waite); B2359, 58:18-60:11 (Kreile Dep.); A1907; Op. at 107, 112.) The insurance carrier engaged Zilberman to represent the Company. (A747; A429-30, 1070:14-1071:4 (Waite); B2360-61,65:5-66:5 (Kreile Dep.); Op. at 112-

[15] The Director Defendants later discovered, after 2012 and through this litigation, that the bylaws also required Rancho directors to be stockholders of the company. (B1245-62.) As a result, no individual lawfully could serve on the Rancho board, since Optimis was the only stockholder of Rancho.

[16] Though Plaintiffs provide this factual background in the Opening Brief, they do not appear to contend that the Court of Chancery committed any legal error in connection with these facts. (*See generally* D.I. 14.) To the extent Plaintiff seeks to resurrect such an argument in its reply brief, the Court should deem such argument as waived. *Williams v. White Oak Builders, Inc.*, 2006 WL 1668348, at *9, n. 95 (Del. Ch.) (finding party waived argument by failing to include it in opening brief); *Emerald Partners v. Berlin*, 2003 WL 21003437, at *43 (Del. Ch.) (recognizing that parties may waive arguments by not including them in briefing).

[17] Optimis did not have its own human resources department; Kreile provided these services from Rancho for the Company. (B1921, 29:2-20 (Horne Dep.).)

113.) Optimis also engaged independent counsel, Thomas Kaufman, a partner at Sheppard Mullin Richter & Hampton LLP, to advise the Company regarding Geller's claim. (A738; B2205, 54:1-9, B2207, 65:18-66:3, B2216-17, 101:23-103:18 (Brys Dep.); Op. at 123.)

Given the seriousness of Geller's allegations,[18] Zilberman acted swiftly and started an independent investigation of Geller's claims.[19] (*See* B2780, 24:16-25:10 (Zilberman Dep.).) At his deposition, Zilberman explained:

> If there are allegations against senior management, especially the CEO, which is the top person at the organization, and allegations of harassment, and an investigation needs to be conducted, the three things that are the most important are that the investigation be done promptly, that the investigation be thorough and that the investigation be impartial.

(*Id.*; Op. at 113.) Waite asked Zilberman if he should notify the Board of Directors of Optimis (the "Board") of Geller's claims, but Zilberman said no; Zilberman repeated his advice at the October 20, 2012 meeting (the "October Meeting").[20] (A430, 1074:7-15 (Waite); A370, 833:12-834:1 (Sussman).)

[18] Less than a week after her initial report, Geller emailed Waite fearful that Morelli would go "completely crazy" if he learned of her claim. (B1487.)

[19] Zilberman also advised Brys about corrective measures the Company should take to minimize its exposure. (*See* B2195, 15:20-17:23 (Brys Dep.) (describing Zilberman's advice).)

[20] Reporting Geller's complaint and the Investigation to the Board also would have threatened the Investigation, as Morelli could unilaterally remove a majority of the Board. (A1540; A433, 1083:20-1085:4 (Waite); A538-539, 1357-58 (Horne); A608, 1482:3-1484:8 (Atkins).)

Recognizing that there was "no one at the company that could have conducted this investigation that didn't have a bias one way or the other," Zilberman recommended and subsequently engaged Solomon to investigate Geller's claims (the "Investigation"). (B73-74, B1488-91; B2780, 25:2-10 (Zilberman Dep.); Op. at 113.) Following her Investigation, Solomon issued a report.[21] (B92-125; Op. at 113.) Solomon found that "even assuming that initially Geller consented to sexual activity with Morelli, and [Solomon] did not find sufficient evidence to make that finding, the evidence supports a finding that at some point the conduct became nonconsensual, and Morelli continued with unwanted sexual touching using threats of retaliation and termination to coerce Geller to participate." (B117.) As the second highest ranking officer of the Company, Waite received periodic updates on the Investigation from Zilberman, Solomon, and Brys but otherwise played no role in the Investigation. (A430, 1072:11-18 (Waite); B2197, 24:13-25:18, B2200, 36:5-37:25, B2211, 79:25-82:9, B2213, 87:11-90:2 (Brys Dep.); Op. at 124.) Smith and Atkins were not involved in the Investigation at all. (A521, 1287-88 (Smith); A607, 1478:21-1479:14 (Atkins); B2502, 244:13-16 (Solomon Dep.); B2815, 164:1-18 (Zilberman Dep.); B2239, 191:12-19 (Brys Dep.).)

[21] Contrary to Morelli's assertions, Solomon was not rushed to complete her Report. (B126-29; B2447, 24:3-5 (Solomon Dep.).)

G. The October Meeting

1. Sussman Causes Faulty Notice of the October Meeting

Based on Solomon's Report, Zilberman recommended that Optimis hold a Board meeting "as soon as was reasonably possible" to terminate Morelli. (B2802-03, 112:20-116:20 (Zilberman Dep.) (explaining reasons for recommending termination); A430 (Waite); Op. at 124.) On that advice, Waite, Brys, and Sussman[22] noticed the October Meeting (the "Notice"). (B1174, B1503-05; B2198, 28:6-18 (Brys Dep.).) Sussman, Optimis's general counsel, assisted Brys and Waite in drafting the notice, notwithstanding his close friendship with Morelli, which he claimed prevented him from representing the Company in connection with Morelli's removal.[23] (B2220, 115:17-116:4 (Brys Dep.); B2692, 434:16-435:12, B2696, 449:5-21 (Waite Dep.); Op. at 125-128.) Although Sussman knew that the purpose of the October Meeting was to remove his friend, he did not advise Waite to state the purpose of the meeting in the Notice. (B1503-05; *see generally* A537-538, 1252-53 (Horne); *see also* A494, 1178:23-1180:4 (Waite); B2197, 22:25, (Brys Dep.); B2706, 489:17-20 (Waite Dep.); Op. at 128.)

[22] Sussman's failure properly to advise the Company forced a settlement of the 225 Action and allowed Morelli to return to power. (A1994.) Interestingly, Sussman appears properly to have advised Morelli about these notice requirements when Morelli noticed his own meeting a few days later. (*Compare* B1521-22, *with* B1523-24; A381, 878:17-879:21 (Sussman).)

[23] This friendship did not, however, compel him to resign as general counsel or corporate secretary; nor did he recuse himself from the October Meeting. (B2221, 118:17-119:4, 181:25-182:22 (Brys Dep.), B2688, 419:16-421:17 (Waite Dep.); Op. at 129.)

At trial, Sussman insisted that Waite and Brys knew of his conflict. (A366, 815:12-816:5 (Sussman); Op. at 126-127.) Waite understood that Sussman was unwilling to advise the Board on substance, but believed he was willing to (and did) advise Optimis about procedural issues for the October Meeting. (A431-32, 1075:7-1076:24 (Waite).) Sussman never explained this conflict or the scope of the representation he could provide in writing. (A376, 857:5-858:20 (Sussman); Op. at 126 n.425.) Had Sussman complied with his ethical obligations and advised Brys or Waite of his conflict in writing, he could have avoided their understandable confusion. (A376, 857:2-858:20 (Op. 126; Sussman); B2197, 23:12-15, B2198, 28:6-18, B2204, 52:19-53:25, B2220, 115:20-116:10, B2221, 118:16-119:4, B2236, 180:12-182:22, B2237-38, 185:22-186:17 (Brys Dep.), B1492-1505; B1508-14; A1908; CAL. R. OF PROF'L CONDUCT R. 3-310.)

2. The Board Forms the Geller Committee

The Board met on October 20, 2012. (Op. at 129.) On the advice of counsel, the Board appointed a committee to consider Geller's allegations, Solomon's Report, and Zilberman's advice (the "Geller Committee").[24] (A1910; A1917;

[24] Fahey's complaint "that the board should have been notified earlier and that an independent committee should have been handled the investigation" is ironic. (D.I. 14 at 18-19.) Days after the October Meeting, Morelli removed his designees who voted to remove him (including Fahey). Morelli then sued them in *Morelli, et al. v. Waite, et al.*, C.A. No. 8001-VCP (Del. Ch.) (the "Section 225 Action"). Notifying the Board or attempting to form an "independent" committee to consider the allegations against Morelli was an exercise in futility. In any event, Zilberman advised Waite *not* to inform the Board, and to proceed as he did. (A430, 1074:8-15 (Waite).) Waite relied upon and followed that sound advice.

A432, 1080:14-21 (Waite); Op. at 129-133.) The Geller Committee retained David Robbins, a partner at Bingham McCutchen LLP in Los Angeles, California, to represent them. (B75-77; Op. at 134.) Robbins advised the Company on the meeting's "corporate formalities." (B2221, 118:19-119:4 (Brys Dep.); B655-56, 287:23-288:10 (Waite Dep.); Op. at 133-134.)

Zilberman presented the Solomon Report, detailed Solomon's findings, and recommended that the Company terminate Morelli. (A370-71, 834:2-23 (Sussman); A432, 1081:10-1082:13 (Waite); A608, 1481:11-1482:16 (Atkins); Op. at 132-133.) After considering the allegations, Solomon's Report, Zilberman's advice, and Kaufman's second opinion, the Geller Committee recommended Morelli's termination to the Board. (A1910; A1917; A432, 1082:2-8 (Waite); A520, 1282:83 (Smith); A608, 1482:17-1484:8 (Atkins); Op. at 133-134.)

3. The Board Removes Morelli and Approves Amendment No. 2

The Board then reconvened and, on the advice of counsel and the Geller Committee's recommendation, Waite, Smith, Atkins, Abdelhamid, Godges, O'Keefe and Fahey voted to remove Morelli. (A1910; A1917; Op. at 134-135.) Morelli did not participate in the vote and his friend Brian Wing abstained. (841:15-842:9 (Sussman); Op. at 134.) Next, Sussman confirmed that the Board had a quorum and Robbins provided "certain amendments and things," to the Board, which included Amendment No. 2. (A433, 1083:3-1085:23 (Waite); A520,

1284 (Smith).) The Board approved Amendment No. 2 on Zilberman's advice to prevent Morelli from reversing his termination. (B1267-74; A433, 1083:3-1085:23 (Waite); A520-21, 1284-85 (Smith); A608, 1483:11-1484:8 (Atkins); B2230, 155:15-157:12 (Brys Dep.); Op. at 134.) Robbins, not Waite, lead the Board discussion; Waite did nothing to mislead or influence the Board. (B2712, 514:9-15 (Waite Dep.); A372, 839:7-840:18 (Sussman); A433, 1084:15-1085:4 (Waite).) Morelli returned to the Board meeting and attempted to replace the Board by written consent, which Sussman advised he could not do. (A433, 1085:24:1086:14 (Waite); A521, 1287 (Smith); A608, 1484:16-24 (Atkins); Op. at 135.)

H. Morelli Seeks Revenge

In the spring of 2012, the Company issued the 2012 PPM. The 2012 PPM failed to attract any investors, despite many presentations by Morelli and Horne. (A530, 1323 (Horne) ("We went to a lot of meetings in both August and September, and we were unsuccessful raising capital."); *see also* A211, 459:8-461:24 (Morelli); B1175-1229). In October 2012, Horne and Olsen obtained a $2.5 million secured line of credit, in addition to a $1 million unsecured line of credit from Wells Fargo Bank, N.A. ("Wells Fargo").[25] (A501-02, 1207-1209

[25] At the end of 2012, the Company only needed $500,000 for operations; the remainder of the loan would be used to fund Morelli's "investigations." (A207, 442:11-443:11 (Morelli) (purpose of financing was "working capital but also to pursue the investigation"), A293-94, 648:4-18, 649:20-650:16 (Morelli).) As part of the settlement of the 225 Action, the Board formed a special committee of Abdelhamid and Wing to investigate actions by Board members in connection with Morelli's removal (the "Special Committee"). (A2004; A1994-2003; A735; A739; A151,

(Olsen); A293, 648:4-649:19 (Morelli); B1525-26.) Morelli was back in power after the settlement of the Delaware litigation and terminated discussions with Wells Fargo in favor of financing from BofI on substantially worse terms. (A501-02, 1207-1209 (Olsen); B1559-60.)

In June 2013, Morelli caused the Director Defendants to be removed from the Rancho board. (B1527-37; A434, 1087:4-1088:3 (Waite); A521, 1288:20-1289:4 (Smith); A610, 1491:6-22 (Atkins).) In response, the Director Defendants resigned from the Optimis Board because the "OptimisCorp, the board, had taken some action with Rancho Physical Therapy that at the time was inconsistent with the Business and Professions Code and put the license, including mine, the license of every physical therapist in the company in direct violation." (A434, 1087:9-1089:1 (Waite); A522, 1289:5-12 (Smith) ("Well, I had grave concerns about my license and our company and why we were on the board of Rancho from the very beginning. That was kind of our deal. I mean, that was the one guarantees, that we had to be on the Rancho board. And now that was taken away."); A610, 1491:6-22 (Atkins) ("And I was informed at that time that I was removed off of the Rancho board. I didn't think that was possible, but I guess it was. And so I was removed

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221:13-223:23 (Hwang); Op. 136, 139.) Since Abdelhamid served on the Special Committee, Morelli caused the Board to form an "independent" committee of Camp, O'Shea, and Wing and charged them with the nearly identical task of investigating the "coup" attempt that resulted in his removal. (A281-82, 598:11-602:11 (Morelli).) Despite spending millions of dollars "investigating," neither committee ever produced a report or made a recommendation.

off the Rancho board. And so at that point, I also realized that at that point, that we had become an illegal structure and that our licenses, physical therapy licenses and the licenses of our therapists, were potentially or probably at risk at that point, as the structure had become illegal. And so that's why [I resigned from the Optimis board].").) On June 26, 2013, the Director Defendants filed suit in California to rescind the sale of Rancho to Optimis (the "Rescission Action").[26] (B1547-58; Op. at 140); *see* CAL. CORP. C. §13406. Shortly after the filing of the Rescission Action, Morelli attempted to remedy the illegal structure by selling Rancho to a third party for $1000 and a lopsided management agreement. (B1561-89; A291-92, 640:10-644:5 (Morelli); A503-04, 1214:21-1217:15 (Olsen); Op. at 140.)

On July 5, 2013, Morelli caused Rancho to terminate the Director Defendants in retaliation for filing the Rescission Action. (A735; B1590-95; A434, 1088:4-1089:1 (Waite) ("And then that therapist -- I have to assume under the direction of Mr. Morelli – fired myself, Greg Smith, and William Atkins. . . . I've never met Mr. Tinoco."); A522, 1289:13-23 (Smith) ("And ... find out I'm fired from my company that I spent my entire life with, you know. Pretty bad. Had a meeting with my family and told them. And we rallied around together and said 'We're going to get through this and we'll find a way to make it work . . .'");

[26] Plaintiffs claim the Rescission Action "was a transparent attempt to seize Rancho, and the OptimisPT software, from Optimis and interfere with the BofI loan." (D.I. 14 at 22.) Again, the evidence at trial failed to support Plaintiffs' theory. (Op. at 187-189, 202-204.) Plaintiffs have waived these arguments on appeal.

A610, 1492:23-1493:19 (Atkins) ("So my wife had said, 'You've been terminated from your company.' And I literally was so stunned at that time, I literally fell to my knees and -- how is this even possible that this could even happen? You know, a company I spent 30 years building. You know, I've been in this very office that I was standing in for 25 years. I'm now terminated from my own company."); Op. at 141.)

ARGUMENT

I. THE COURT OF CHANCERY PROPERLY CONCLUDED THAT PLAINTIFFS' CONDUCT COMPROMISED THE PROCEEDINGS BELOW.

A. Question Presented

Whether the Court of Chancery properly held that Plaintiffs' conduct compromised the proceedings below.

B. Standard and Scope of Review

"In an appeal from a decision in the Court of Chancery, this Court reviews conclusions of law *de novo*." *Stegemeier v. Magness*, 728 A.2d 557, 561 (Del. 1999). However, factual findings are accepted "[i]f they are sufficiently supported by the record and are the product of an orderly and logical deductive process." *Id.* The Court gives substantial deference to the Court of Chancery "[w]hen reviewing decisions based on the live testimony of witnesses, determinations of credibility, and expert witness presentations." *Id.*

C. Merits of Argument

For the reasons set forth in Horne's Answering Brief on Appeal and Opening Brief on Cross-Appeal ("Horne's Appellate Brief"), which the Director Defendants incorporate by reference, the Court should affirm the Court of Chancery's holding that Plaintiffs' conduct compromised the proceedings below.

II. THE TRIAL COURT DID NOT ERR WHEN IT HELD THAT THE DIRECTOR DEFENDANTS DID NOT BREACH THEIR DUTY OF LOYALTY BY NOT GIVING MORELLI ADVANCED NOTICE OF HIS POTENTIAL REMOVAL AND BY EXECUTING AMENDMENT NO. 2.

A. Question Presented

Whether the Court of Chancery correctly held that the Director Defendants did not breach their duty of loyalty by not giving Morelli advanced formal notice of his potential removal. The Director Defendants have not previously addressed this issue as it was raised for the first time in the Opinion.[27]

B. Standard and Scope of Review

See Section I(B), *supra*.

C. Merits of Argument

The Court of Chancery did not err in refusing to apply *Koch v. Stern*, 1992 WL 181717 (Del. Ch.) *vacated as moot by* 628 A.2d 444 (Del. 1993), and its progeny as a result of their conflict with Section 141(a) of the General Corporation

[27] Plaintiffs observe that the Director Defendants "did not raise [S]ection 141(a) or *Klaassen v. Allegro Development Corp.*, 2014 WL 5967028 (Del. Ch.), *aff'd on other grounds,* 106 A.3d 1035 (Del. 2014), relied on by the trial court, and they provided no substantive discussion of the *Koch* line of cases." (D.I. 14 at 37, n.32.) This observation, even if true, is irrelevant. As Plaintiffs acknowledge, none of the parties previously addressed the Section 141(a) issue as the Court of Chancery raised it for the first time in the Opinion. (*Id.* at 37; Op. at 163-175). Further, Plaintiffs' statement is inaccurate as to *Klaassen* and the *Koch* lines of cases because counsel for the Director Defendants discussed *VGS*, *Adlerstein*, and *Klaassen* at length at the post-trial oral argument. (A1146-A1163.) Consequently, this issue was fairly presented to the trial court. SUPR. CT. R. 8 ("Only questions fairly presented to the trial court may be presented for review."). Regardless, the Director Defendants do not seek to appeal this aspect of the Opinion and are not presenting this issue for review. No rule prohibits the Director Defendants from responding to an issue Plaintiffs present on appeal and Plaintiffs identify none.

Law of the State of Delaware (the "DGCL"). Not only are these cases inapplicable to and distinguishable from this case, but also they embrace the concept of "a super-director whose powers trump the board's statutory authority under Section 141(a)" and conflict with Section 141(a). (Op. at 173 (internal quotations omitted).) Even if these cases are still good law, the Court of Chancery's factual findings, to which this Court must defer, show that the Director Defendants did not breach the duty of loyalty. This Court should affirm the Court of Chancery's ruling that the Director Defendants did not breach the duty of loyalty by not providing Morelli with notice of the October Meeting.

1. The Court of Chancery Properly Held that Koch Conflicts with Section 141(a).

The Court of Chancery properly determined that the *Koch* line of cases conflicts with Section 141(a) of the DGCL, and this Court should affirm. Section 141(a) requires that "[t]he business and affairs of every [Delaware] corporation . . . be managed by or under the direction of a board of directors." 8 *Del. C.* § 141(a). *Koch* and its progeny conflict with Section 141(a) because the "super-director theory" they purport to embrace – in which Morelli's contractual rights trump the Board's ability to exercise its fiduciary duties by removing him – impairs the Board's ability to manage the business and affairs of Optimis under Section 141(a). (Op. at 173 ("In a Delaware corporation, the directors of the corporation manage the corporation and that principal is enshrined in Section 141(a). A written

contract allowing board appointment rights cannot be used to thwart that precept of Delaware law.").) Allowing Morelli to exercise his contractual removal and replacement rights would have prevented Waite and the rest of the Board from following the advice of three separate sets of counsel to remove him for cause as a result of his sexual harassment of Geller.[28] (*Id.* at 174 ("By contrast, the cases upon which Plaintiffs rely suggest that, even if the directors in the exercise of their fiduciary duties conclude that the CEO must be fired, the directors first must give the CEO the chance to fire a majority of the directors and replace them with his own hand-picked group of more acquiescent directors—a Catch-22 for Optimis in this case.").)

Plaintiffs ignore the conflict between Morelli's contractual rights and Section 141(a) and instead argue that several irrelevant sections of the DGCL expressly authorize the actions Morelli sought to take. (D.I. 14 at 38-39.) None of these statutory provisions resolves the conflict with Section 141(a) or justifies the "super-director theory" the Court of Chancery properly rejected. The Director

[28] Plaintiffs complain that the Court of Chancery "speculated" by concluding that "Morelli would have exercised his rights under the Stockholders Agreement if given the opportunity, [and] also that the yet-unnamed, newly appointed directors immediately would breach their fiduciary duties to the stockholders and interfere with the board's management of the corporation. (D.I. 14 at 40.) But the Court of Chancery did no such thing. To the contrary, then-Vice Chancellor Parsons's statements regarding Morelli's behavior were based on his findings at trial: Morelli intended to remove the directors that voted against him, and did just that following the October Meeting. (Op. at 136, 175 ("Here, the first thing Morelli did after October 20, 2012, was fire all three of the Board members he had appointed who voted to terminate him as CEO. I have no doubt he would have terminated those directors in advance of the meeting if he had been given the opportunity.").) Indeed, the only purpose served through the exercise of Morelli's contractual rights was to appoint directors who would not remove him.

Defendants do not dispute that the Stockholders Agreement governed the election and removal of Optimis directors, that the Stockholders Agreement was valid under and authorized by Section 218 of the DGCL, or that Section 211 allowed Optimis stockholders to act by written consent. None of these statutory provisions, however, provides legal support for the argument Plaintiffs need this Court to embrace: that Morelli's contractual right to elect a majority of the Optimis board trumps the Board's obligation to protect Optimis and its stockholders by following the advice of its counsel to remove Morelli for cause. Even if Morelli's contractual rights supersede the Board's obligation to remove him for cause, depriving Morelli of that notice cannot rise to a breach of the duty of loyalty as a matter of law. The facts of this case and Delaware law, including *Koch* and its progeny, do not support such a finding and the Court should affirm.

Plaintiffs' brief similarly ignores Vice Chancellor Laster's views about the continuing vitality of the *Koch* line of cases. *Klaassen v. Allegro Dev. Corp.*, 2013 WL 5739680, at *14 & n.6 (Del. Ch.) ("Here, the affirmative defenses dispose of the case, so this decision need not grapple with these four opinions. I note only that Klaassen's interpretation would create substantial tension with the DGCL's director-centric system of corporate governance."). Plaintiffs' failure to address, let alone reconcile, how *Koch* and its progeny can exist harmoniously with Section 141(a), is telling. This case demonstrates the exact tension Vice Chancellor Laster

predicted, and Vice Chancellor Parsons properly resolved it under both Delaware law and the facts of this case. For these reasons, the Court of Chancery properly held that *Koch* and its progeny conflict with Section 141(a) of the DGCL, and this Court should affirm that decision.

To the extent this Court is inclined to consider the super-director theory that Plaintiffs assert, the Court should review Vice Chancellor Laster's analysis in *Klaassen v. Allegro Development Corporation*, 2013 WL 5967028, at *1 (Del. Ch.). The plaintiff in *Klaassen* put forward arguments very similar to Plaintiffs, and the Court there suggested that this theory is not viable after analyzing the *Koch* line of cases. *Klaassen*, 2013 WL 5967028, at *3-16. Then-Vice Chancellor Parsons used the dicta in *Klaassen* to support his holding that Defendants did not breach the duty of loyalty in connection with the lack of notice to Morelli. (Op. at 172-175.) This Court should hold likewise.[29]

[29] In footnote 40 of their Opening Brief, Plaintiffs appear to make a new argument that was not addressed by the Court of Chancery that Defendants "also violated their duty of loyalty by substituting their own judgment for those who held the right to elect a majority of the board." (D.I. 14 at 46 n.40 (citing *Johnston v. Pedersen*, 28 A.3d 1079, 1091 (Del. Ch. 2010)).) It is unclear whether Plaintiffs are actually making this new argument, but to the extent it is considered by this Court, the Court should nonetheless affirm the Court of Chancery's decision relating to the breach of duty of loyalty. This argument is duplicative of their breach of the Stockholders Agreement below, and should not be countenanced for that reason alone. (*See* Section III, *infra*); *Grayson v. Imagination Station, Inc.*, 2010 WL 3221951, at *7 (Del. Ch.) ("The breach of fiduciary duty claim will consequently only be allowed where it may be maintained independently of the breach of contract claim." (internal quotations omitted)); *Nemec v. Shrader*, 991 A.2d 1120, 1129 (Del. 2010) ("It is a well-settled principle that where a dispute arises from obligations that are expressly addressed by contract, that dispute will be treated as a breach of contract claim. In that specific context, any fiduciary claims arising out of the same facts that underlie the contract obligations would be foreclosed as superfluous."). Further,

2. The Court of Chancery Properly Held that the Director Defendants Did Not Breach Their Duty of Loyalty in Connection with Notice of the October Meeting.

Even if *Koch* and its progeny are good law, the circumstances under which they were brought, the relief sought, and other important factors distinguish them from the present action. Procedurally, these cases were summary proceedings seeking declaratory or injunctive relief, not breach of fiduciary actions seeking monetary damages. *Koch v. Stearn*, 1992 WL 18177, at *4-7 (Del. Ch.) (brought pursuant to 8 *Del. C.* § 225 to determine board of directors);[30] *Adlerstein v. Wertheimer*, 2002 WL 205684, at *7-8 (Del. Ch.) (brought pursuant to 8 *Del. C.* § 225 to determine board of directors); *Fogel v. U.S. Energy Systems, Inc.*, 2007 WL

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although the Initial Stockholders had the right to choose the majority of the board, the shareholders and directors retained the right to amend the Stockholders Agreement. (A1543-1544 at § 3.3; A1548 at § 6.) Thus, Defendants' actions were entirely permissible and cannot be liable for a breach for exercising their contractual rights. *Fisk Ventures, LLC v. Segal*, 2008 WL 1961156, at *10 (Del. Ch.) *aff'd*, 984 A.2d 124 (Del. 2009) *and aff'd*, 984 A.2d 124 (Del. 2009) ("Like Segal's claim about the Class B members' refusal to abdicate their Put Right, the Board's decision to replace Segal with Pugh was not a breach of some duty; it was merely the exercise of a contractual right.").

[30] *Koch* has no precedential value because it was vacated by the Supreme Court. (Op. at 167 ("The Delaware Supreme Court vacated *Koch*…").) Plaintiffs state in a footnote that "the result of the vacatur was that the trial court's decision in *Koch* would not have any precedential or preclusive *res judicata* effect against the parties." (D.I. 14 at 42 n.36.) They are wrong and ignore this Court's decision in *Pauley ex rel Pauley v. Reinoehl*, which held that appellants' reliance on a vacated decision was misplaced because "[a] vacated decision has no force and effect." 848 A.2d 561, 566 (Del. 2003) *opinion vacated on reargument sub nom. Pauley v. Reinoehl*, 848 A.2d 569 (Del. 2004). As Vice Chancellor Laster observed in *Klaassen*, "[s]ubsequent trial court decisions have followed *Koch* as precedential without discussing its departures from prior cases or the Supreme Court's decision to vacate it." 2013 WL 5967028, at *11. *Koch* has no precedential value and the Court should not use it, or the cases that depend on it, to reverse the Court of Chancery's well-reasoned decision.

4438978, at *1 (Del. Ch.) *overruled by Klaassen v. Allegro Dev. Corp.*, 106 A.3d 1035 (Del. 2014) (brought pursuant to 8 *Del. C.* § 211 to compel stockholders meeting). None of these cases justified an award of money damages to remedy the invalid corporate action. *See generally id*. In contrast, the parties here resolved by agreement the validity of the Morelli's removal and Amendment No. 2 long before Morelli filed this suit.[31] (A1994-2003; *see also* A2004-2006.) Plaintiffs have not cited a single case that supports a monetary award where a fiduciary acts disloyally to prevent someone from exercising his contractual control rights. (*See generally* D.I. 14.) Thus, the *Koch* line of cases does not apply here.

Koch, *Adlerstein*, *VGS*, and *Fogel* contain numerous other distinguishable facts (an inconvenient truth Plaintiffs ignore throughout their papers). For example, those cases each involved a calculated, deceitful plan to remove a controlling director, and that plan resulted in the director's removal. Here, Morelli failed to prove the existence of a clandestine conspiracy to remove him (notwithstanding everyone's concerns about his management). But even if there was such a conspiracy, that conspiracy did not cause Morelli's removal. Rather, Morelli's decision to engage in oral sex with an employee of the Company during the course of her employment in the bedroom that doubled as his office caused his termination.

[31] Pursuant to that agreement, the parties agreed to void Morelli's removal and the amendments to the Stockholders Agreement. (A1994-2003.)

a. Koch v. Stearn

Assuming *arguendo* that *Koch* has any precedential value, it is nonetheless distinguishable. In *Koch*, the President, CEO, and majority stockholder, Stearn, controlled two of the four board seats of Showcase Communications Network, Ltd. ("Showcase"). *Koch v. Stearn*, 1992 WL 181717, at *1-2 (Del. Ch.). Koch agreed to invest in Showcase, and as a result of his purchase of Showcase Series A Preferred Stock, he was entitled to elect two of the board seats, and an additional fifth director if Showcase took certain actions without the prior affirmative vote or written consent of the majority of the preferred. *Id.* at *1-2. "In December 1991, Koch was becoming concerned about the fact that Showcase had not yet begun generating revenues" and "[b]y February 1992, it was apparent to all the board members that Showcase was running out of funds." *Id.* at *2. Koch agreed to make an additional investment subject to certain conditions, including Stearn's resignation. *Id.* The other board members, including Stearn's designee to the board, "endorsed the Koch offer as being the most attractive proposal available to the company." *Id.* at *3. Thereafter, Koch's designee, Bunn, faxed a letter to Showcase's lawyer asking him and Stearn to attend special board meeting the next morning. *Id.* Prior to the special meeting, Koch, Bunn, and Ginsberg, Stearn's designee, circulated draft resolutions which included the removal of Stearn. *Id.* At the special meeting, Stearn was removed as President and CEO after he refused to

accept the Koch offer. *Id.* at *4. After the vote on his removal, Stearn attempted to remove Ginsberg as a director, and the Section 225 action ensued. *Id.*

The *Koch* Court found that "the outside directors had an agenda, which included removing Stearn from office if he did not cooperate and step down voluntarily" and "that Stearn was tricked into attending the April 7th meeting." *Id.* at *5. Unlike the directors in *Koch*, the Director Defendants had no agenda and Morelli was not ambushed at the October Meeting. (Op. at 184.) Other than Waite and Morelli, none of the directors (including Atkins and Smith) were aware of the Investigation or the Solomon Report. (A197-198, 405:17-407:22, A199, 412:6-13, A260, 515:9-13, A262, 522:5-523:5 (admitting he was aware that the results of the Investigation would be discussed at the board meeting) (Morelli); A430, 1073:17-1074:18 (Waite); A519, 1278:7-1280:5 (Smith); A606-607, 1477:16-1479:14 (Atkins).) Morelli was not tricked into attending the October Meeting: he spoke to Wing in advance and even asked Hwang to contact the board members on his behalf. (B130-31; A289-290, 633:16-634:9 (Morelli); B1519 ("John Waite has called a Board of Directors meeting for one hour from now, apparently with the goal of seeking my removal from the company I founded.").) Morelli even tried to delay the October Meeting, by alleging that Solomon was being rushed to complete her report. (A198-199, 409:24-410:10, A260, 516:18-515:18 (Morelli); B82-83.) Given his awareness of his potential removal, Morelli could have exercised his

control rights to protect himself, but did not. Morelli's strategic decision to wait until the October Meeting to attempt to exercise his control rights renders *Koch* inapplicable. Neither *Koch*, nor the facts as the Court of Chancery found them, justifies Plaintiffs' appeal.

b. VGS, Inc. v. Castiel

Plaintiffs also analogize to *VGS, Inc. v. Castiel*, which, as the Court of Chancery properly found, is similarly inapplicable. (*Id.* at 43.) The court in *VGS* found that "Sahagen and Quinn failed to discharge their duty of loyalty to Castiel in good faith by failing to give him advance notice of their merger plan *under the unique circumstances of this case and the structure of this LLC Agreement*." *VGS, Inc. v. Castiel*, 2000 WL 127737, at *5 (Del. Ch.) (emphasis added). Castiel formed Virtual Geosatellite LLC (the "LLC"), and the LLC initially had one member, Virtual Geosatellite Holdings, Inc. ("Holdings"). *Id.* at *1. Thereafter, Ellipso, Inc. ("Ellipso") and Sahagen Satellite Technology Group LLC ("Sahagen Satellite") became the second and third members of the LLC. *Id.* Castiel controls Holdings and Ellipso, and Sahagan, a venture capitalist, controls Sahagen Satellite. Castiel was the majority unitholder, and "had the power to appoint, remove, and replace two of the three members of the Board of Managers." *Id.* Sahagen, Castiel, and Quinn comprised the three members of the Board of Managers of the LLC. *Id.*

Castiel and Sahagen had differing opinions about how to best run the LLC, and Sahagen eventually convinced Quinn to oust Castiel. *Id.* at *2. Without notice to Castiel, Sahagen and Castiel merged the LLC into VGS, Inc. ("VGS"), and the LLC ceased to exist. *Id.* In connection with the merger, "Holdings and Ellipso went from having a 75% controlling combined ownership interest in the LLC to having only a 37.5% interest in VGS. *Id.* Castiel was not named to the Board of Directors of VGS. *Id.*

VGS is distinguishable for several reasons. First, there was no clandestine act here. Unlike *VGS*, Morelli chose not attend the portion of the October Meeting where the Shareholders Agreement was amended. (A1915 (showing that Morelli was asked to join the meeting at 6:20 p.m. and only arrived at 6:40 p.m.); A432-433, 1082:14-1083:18 (Waite); A520, 283:7-1284:6 (Smith); A608, 1484:9-24 (Atkins).) Second, Smith and Atkins did not conspire with Waite to remove Morelli; they were not aware of the Investigation and had no notice of Morelli's potential removal. (Op. at 148-153; A519, 1278:7-1280:5 (Smith); A606-607, 1477:16-1479:14 (Atkins).) To the contrary, Smith and Atkins tried to find alternative ways of keeping Morelli involved in the Company. (A521, 1285:11-1286:24 (Smith); A613, 1503:6-1504:7 (Atkins).) Third, the Defendants made no effort to restructure Optimis. Although Morelli was removed from the Board and lost his contractual control rights through Amendment No. 2, he kept the same

stock ownership percentages. (B1267-74 (showing that Morelli's ownership did not change as a result of Amendment No. 2).) Fourth, in *VGS*, Castiel had no notice and there was no meeting: Sahagen and Quinn acted by written consent to oust Castiel. *VGS, Inc. v. Castiel*, 2000 WL 1277372, at *2 (Del. Ch.) *aff'd*, 781 A.2d 696 (Del. 2001). In contrast, Morelli was present at the October Meeting, and had notice of his potential removal. (Op. at 129-131; A9110-1916; A262, 522:5-523:5 (Morelli); B84-5, B130-31, B1519-20.)

Fifth, and most importantly, *VGS* deals with a limited liability company, and the court's holdings depend on the specific language of the applicable LLC agreement. *VGS*, 2000 WL 1277372, at *5 ("But, I also find that Sahagen and Quinn failed to discharge their duty of loyalty to Castiel in good faith by failing to give him advance notice of their merger plans *under the unique circumstances of this case and the structure of this LLC Agreement*." (emphasis added)). Optimis is not a limited liability company, and the Director Defendants owed no fiduciary duties to Morelli. *CML V, LLC v. Bax*, 28 A.3d 1037, 1043 (Del. 2011), *as corrected* (Sept. 6, 2011). For these reasons, *VGS* is inapplicable and the Court should not reverse the Court of Chancery's holding.

c. Adlerstein v. Wertheimer

Plaintiffs rely most heavily upon the *Adlerstein* to support their argument that the Court erred in finding that Defendants did not breach their duty of loyalty

in connection with the October Meeting. (D.I. 14 at 43-46.) As with the cases above, *Adlerstein* is also distinguishable. In *Adlerstein*, a majority of the board of SpectruMedix Corporation ("SpectruMedix") "voted to issue to the I. Reich Family Limited Partnership ('Reich Partnership'), an entity affiliated with Reich, a sufficient number of shares of a new class of supervoting preferred stock to convey to the Reich Partnership a majority of the voting power of the Company's Stock." *Adlerstein v. Wertheimer*, 2002 WL 205684, at *1 (Del. Ch.). In addition, the board voted to remove Adlerstein as Chief Executive Officer and Chairman of the Board of SpectruMedix, and appointed Reich to serve in both capacities. *Id.* Finally, the Reich Partnership, acting by written consent, removed Adlerstein as a director. *Id.* "When the dust settled, the board consisted of Wertheimer, Mencher, and Reich; the Reich Partnership had replaced Adlerstein as holders of majority voting control; and Reich had replaced Adlerstein as Chairman and CEO." *Id.*

The October Meeting did not restructure Optimis, result in the issuance of new stock or strip Morelli of his voting power.[32] (*See generally* A1910-1916; B1267-74.) Rather the sole purpose of the October Meeting was to address Morelli's harassment of Geller and take appropriate action. The Optimis directors and shareholders exercised their contractual right to amend the Stockholders Agreement, on the advice of counsel, to prevent Morelli from reversing the actions

[32] Amendment No. 2 also stripped the Director Defendants of their right to designate various Optimis directors. (B1267-74; A433, 1085:12-19 (Waite).)

they took at the October Meeting. (B1267-74; A1584 at § 6.) Unlike *Adlerstein*, the Director Defendants did not use trickery or secrecy to deprive Morelli of his rights. *Id.* at *11. The Court of Chancery found that the Defendants did not engage in a conspiracy to remove Morelli and Smith and Atkins (along with the other directors) did not know the purpose of the October Meeting. (Op. at 146-153.) Plaintiffs do not challenge this holding on appeal. (D.I. 14 at 37-48.) Without evidence of an unlawful conspiracy, there is no evidence that Defendants acted in such a way to lure Morelli into attending the October Meeting. (Op. at 129-131.) Finally, and unlike in *Adlerstein*, Morelli "had an adequate opportunity to protect his interests." 2002 WL 205684, at *10. Morelli was aware of Investigation, tried to stall issuance of the Solomon Report, and even spoke to directors and employees in advance of the October Meeting regarding his potential removal. (*See, e.g.*, B82-83; B130-31, B1519-20.) *Adlerstein* does not apply and does not justify reversal of the Court of Chancery's Opinion.

d. Fogel v. U.S. Energy Systems, Inc.

Although neither party discussed *Fogel v. U.S. Energy Systems, Inc.*, 2007 WL 4438978 (Del. Ch.) *overruled by Klaassen v. Allegro Dev. Corp.*, 106 A.3d 1035 (Del. 2014), the Court of Chancery discussed it in analyzing the "super-director theory" since it flows from the *Koch* line of cases. (Op. at 171-172.) The

Court of Chancery declined to follow *Fogel*, and this Court should affirm that decision.

In *Fogel*, the directors determined that the board should terminate Fogel's employment as CEO and Chairman of the board. *Fogel*, 2007 WL 4438978, at *1-2. The Court held that "[w]here a director is tricked or deceived about the true purpose of a board meeting, and where that director subsequently does not participate in that meeting, any action purportedly taken there is invalid and void." *Id.* at *3. In addition, the *Fogel* Court found that "the independent directors' failure to inform Fogel about their plan was ***intentional***." *Id.* (emphasis added). No such trickery or deceit occurred here. The Court of Chancery found that Waite relied upon the advice of counsel in preparing the Notice. (Op. at 182; A431, 1075:7-1076:5 (Waite).) None of the directors of Optimis (other than Waite and Morelli) were aware of the Investigation and heard about the Solomon Report for the first time at the October Meeting. (Op. at 181 ("There is no evidence of any such manipulation by either Smith or Atkins."); A519, 1278:7-1280:5 (Smith); A606-607, 1477:16-1479:14 (Atkins).) To that end, Morelli had more knowledge than his fellow directors since he knew about the Investigation, participated in it, and knew about the Solomon Report. *Fogel* does not provide any basis for this Court to disturb the Court of Chancery's holding.

3. The Court of Chancery Properly Held that the Director Defendants Did Not Breach Their Duty of Loyalty By Executing Amendment No. 2.

Plaintiffs also maintain that the Court of Chancery erred by holding that Director Defendants did not breach their duty of loyalty by executing Amendment No. 2. (D.I. 14 at 46-48.) Their argument in this regard is twofold: (i) the Court of Chancery "acknowledged, but never analyzed, the breach committed by Waite in obtaining consents from Optimis stockholders by misrepresentations . . . and (ii) Waite misled the board about the significance of the amendment before it was approved." (*Id.* at 46.) Plaintiffs' arguments are factually inaccurate and fail as a matter of law, and this Court should affirm the decision of the Court of Chancery.

a. Waite did not obtain consents from stockholders by misrepresentations.

First, the Court of Chancery held that Plaintiffs lacked standing to assert "that other people, not parties to this litigation, fraudulently were induced into adopting Amendment No. 2." (Op. at 196.) The Court of Chancery properly stated Plaintiffs "do not have such standing because only parties to an agreement can assert a claim for breach of the implied covenant." (*Id.* (citing *Gerber v. Enter. Prods. Hldgs., LLC*, 67 A.3d 400, 421 n.53 (Del. 2013) ("We reject [the] argument that the implied covenant applies to nonparties to the contract."), *overruled in irrelevant part, Winshall v. Viacom Int'l Inc.*, 76 A.3d 808 (Del. 2013))); *see also Amirsaleh v. Bd. of Trade of City of New York, Inc.*, 2008 WL 4182998, at *4 (Del.

Ch.) ("only parties to a contract and intended third-party beneficiaries may enforce an agreement's provisions"). Plaintiffs do not appear to challenge this holding on appeal.

Second, the Court of Chancery never found that Waite "lied" to stockholders, mislead the Board about the significance of Amendment No. 2 or otherwise breached his fiduciary duties and the Court must respect the factual findings on which these conclusions rest. The Court evaluated Waite's "approach"[33] in procuring signatures for Amendment No. 2 from stockholders and found that the "Board understood that the purpose of the amendment," crediting the contemporaneous documents and the testimony of Atkins and Smith over the "murky" testimony of Abdelhamid. (Op. 183-184.) Plaintiffs offer no basis for this Court to reject the trial court's factual findings regarding Amendment No. 2.

Third, one cannot breach his fiduciary duty in connection with a "void" act. If, as Plaintiffs suggest, Amendment No. 2 is "a nullity, [that] never happened" (D.I. 14 at 47), it is unclear how the Court of Chancery could have found a breach of fiduciary duty in connection with something that never happened. *Robbins Hose Co. No. 1 v. Baker*, 2007 WL 3317598, at *8 (Del. Ch.) ("Because the

[33] The Court acknowledged that though Waite's procurement of signatures did not necessarily fully comply with Delaware law, "it is largely moot, because Amendment No. 2 was vacated on or about March 21, 2013, in connection with the 225 Action." (Op. at 125.)

Appeal Board's acts were *ultra vires*, and therefore void, it is as though those acts never happened.")

Fourth, Waite[34] cannot breach his fiduciary duty in connection with Amendment No. 2 because he obtained the written consents from shareholders in his capacity as a shareholder. "Under Delaware law a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation." *Ivanhoe Partners v. Newmont Min. Corp.*, 535 A.2d 1334, 1344 (Del. 1987). None of the Director Defendants is a majority stockholder and collectively they own approximately 30% of Optimis. (Op. at 5-6, 61, 164 n.532); *In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656 (Del. Ch. 2013) (holding 27.7% stockholder with two seats on an eight person board was not a controlling stockholder). "Nothing precludes [the Director Defendants], as a stockholder[s], from acting in [their] own self-interest." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985); *Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling*, A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders.").

[34] Plaintiffs' arguments all center on Waite's actions and there is no evidence that Smith or Atkins did anything regarding the written consents, other than executing them in their individual and director capacities. (D.I. 14 at 46-48; Op. at 181.) In any event, the argument above applies with equal force to Smith and Atkins.

The Director Defendants did not breach their duties in connection with Amendment No. 2 and the Court of Chancery's holding should be affirmed.

b. Waite did not mislead the Board about the significance of Amendment No. 2 before it was approved.

Plaintiffs' assertion that the Court of Chancery erred in finding a breach because Waite purportedly misled the Board is similarly flawed. Plaintiffs find error because "*Defendants* offered no testimony or evidence at trial from four members of the nine-director board . . . as to their understanding or lack thereof." (D.I. 14 at 48 (emphasis added).) Plaintiffs ignore that they bear the burden to prove that Defendants breached their fiduciary duty, and Defendants had no need to offer such testimony. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 756 (Del. Ch. 2005) *aff'd*, 906 A.2d 27 (Del. 2006) ("*[P]laintiffs* must prove by a preponderance of the evidence that the presumption of the business judgment rule does not apply either because the directors breached their fiduciary duties, acted in bad faith or that the directors made an unintelligent or unadvised judgment, by failing to inform themselves of all material information reasonably available to them before making a business decision." (emphasis added and internal citations omitted)). Tellingly, Plaintiffs do not offer evidence that any board member failed to appreciate the significance of Amendment No. 2. This makeweight argument ignores the Court of Chancery's well supported factual findings and the Court should reject this argument.

That the Court of Chancery credited the testimony of Atkins, Smith, and Waite over the "murky" testimony of Abdelhamid, presented by Plaintiffs, is not error. (Op. at 182-183; *see also* B2127-2190.) Further, the documentary evidence contradicts Abdelhamid's testimony: Abdelhamid and his lawyer reviewed Amendment No. 2 and exchanged several emails with Waite and Brys about the import of Amendment No. 2 and its impact on Abdelhamid's own board rights under the Stockholders' Agreement. (B1509-18.) Thus, there was no error here.

4. The Director Defendants' Actions Were Justified and Do Not Constitute a Breach Their Duty of Loyalty.

Even if this Court finds that the Court of Chancery erred, it should nonetheless affirm the Court of Chancery's decision because the Director Defendants' actions were justified under the circumstances. As the Court of Chancery properly noted, "in appropriate circumstances, the fiduciary duties of directors may enable a board to take action *against* a controlling stockholder." (Op. at 173-174 (emphasis in original).) There is no dispute that Morelli "had sexual contact with a subordinate in his bedroom-office while she was working" and that "at least one other female employee previously had seen Morelli naked in his bedroom-office." (*Id.* at 178.) The Court also found "numerous facts that support Defendants' explanation of the challenged event, the bona fides of the investigation, and the actions Defendants took." (*Id.*)

As this Court has noted, "a board of directors is not a passive instrumentality." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). Its "power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source." *Id.* (emphasis added). Thus, a board may take action in the face of "a controlling shareholder [that] is abusing its power and is exploiting or threatening to exploit the vulnerability of minority shareholders." *Mendel v. Carroll*, 651 A.2d 297, 304 (Del. Ch. 1994). The Board perceived Morelli and his actions to pose a risk to the Company and its stockholders. (Op. at 133; A432, 1081:2-1082:13 (Waite); A520, 1282:2-1283:6 (Smith); A607-608, 1481:9-1483:10 (Atkins).) The Board retained counsel who advised it to remove Morelli to protect the Company. (Op. at 180-184.) Under the circumstances, the Director Defendants, as members of the Board, acted reasonably in voting to remove Morelli and this Court should affirm the Court of Chancery's findings.

III. THE COURT OF CHANCERY DID NOT ERR IN FAILING TO FIND A BREACH OF THE STOCKHOLDERS AGREEMENT BY THE DIRECTOR DEFENDANTS IN REFUSING TO EXECUTE THE WRITTEN CONSENTS.

A. Question Presented

Whether the Court of Chancery properly held that the Director Defendants did not breach the Stockholders Agreement by failing to execute the written consents distributed by Morelli at the October Meeting.

B. Standard and Scope of Review

A question of contract interpretation is a "question of law that this Court reviews *de novo* for legal error." *AT&T Corp. v. Lillis*, 953 A.2d 241, 251 (Del. 2008). However, "[t]o the extent the trial court's interpretation of the contract rests upon findings of extrinsic evidence to the contract, or upon inferences drawn from those findings, our review requires us to defer 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." *Id.* at 252.

C. Merits of Argument

The Court of Chancery properly held that the Director Defendants did not breach the Stockholders Agreement (Op. at 189-196), and this Court should affirm the Court of Chancery's decision. Plaintiffs argue that Defendants' refusal to execute the written consents is a breach of the Stockholders Agreement. (D.I. 14

at 49-51.) The Court of Chancery considered this argument and rejected it because Morelli did not have the contractual right (that he alleges was breached) at the time he demanded that the Director Defendants execute the written consents. (Op. at 189-192.) At trial, Morelli was the only person who recalled making a demand for the Director Defendants to execute written consents at the beginning of the October Meeting. (Op. at 184 n.544, 192 n.590; A201, 420:7-421:2 (Morelli).) The Director Defendants only recalled Morelli making his demand after the Board of directors had voted on Amendment No. 2. (A432-433, 1082:14-1086:19 (Waite); A521, 1287:1-9 (Smith); A608, 1484:9-24 (Atkins).) Indeed, Sussman's contemporaneous notes, support the Director Defendants' recollection. (A1910-1916.) There is no record of Morelli distributing the written consents in advance of the formation of the special committee of the Board; the notes show that Morelli handed out the written consents after Amendment No. 2 passed. (A1915.) The Board reconvened at 6:20 p.m., but only came back into the room at 6:40 p.m. (*Id.*) Thus, the evidence supports the Court of Chancery's finding.

This Court previously has held that "board action taken in violation of an equitable rule" is voidable, rather than void. *Klaassen v. Allegro Development Corp.*, 106 A.3d 1035, 1047 (Del. 2014). Plaintiffs do not suggest that Amendment No. 2 violated a statutory prohibition and is, therefore, void. Rather, they take issue with the Court of Chancery's characterization of the passage of

Amendment No. 2 as a voidable act based on the language of the settlement agreement in the Section 225 Action. (D.I. 14 at 50-51; Op. at 191 n.589.)

The settlement agreement in the Section 225 Action, dated March 7, 2013, provides that "[t]he parties agree that the notices for the purported meetings of the Company's board of directors on October 20 and 25, 2012 were not effective and, therefore, any actions of the board purportedly taken at those meetings were void." (A1997 at ¶ 5.) Thus, Amendment No. 2 became void as of that date. (*Id.*) Prior to March 7, 2013, Amendment No. 2 was simply voidable, and on October 20, 2012, when Morelli attempted to act by written consent, it was effective, albeit voidable. (Op. at 191 n.589 ("I assume that the actions taken at the October 20 Meeting were only voidable, as the holding in *Klaassen* suggests, and therefore remained in force until voided by the settlement agreement.").) The settlement agreement in the Section 225 Action, which Smith and Atkins did not sign, cannot cause the Director Defendants retroactively to breach the Stockholders Agreement, which was validly amended when they refused to sign Morelli's consents. Moreover, the Director Defendants relied on Sussman's statement that Morelli's consents were too late in refusing to sign them. (A433, 1085:24-1086:19 (Waite); A521, 1287:1-9 (Smith); A608, 1484:9-24 (Atkins).) For these reasons, the Court should not disrupt the Court of Chancery's findings.

IV. THE COURT OF CHANCERY DID NOT ERR IN HOLDING THAT PLAINTIFFS DID NOT PROVE DAMAGES.

A. Question Presented

Whether the Court of Chancery erred in holding that Plaintiffs are not entitled to damages for Defendants' alleged breaches of contract and the duty of loyalty.

B. Standard and Scope of Review

"When reviewing the formulation and application of legal precepts made by the Court of Chancery, the standard of appellate review is *de novo*." *Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 474 (Del. 1992). Damages awards are reviewed "for abuse of discretion." *Gatz Properties, LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1212 (Del. 2012).

C. Merits of Argument

"It is well-settled that "[p]laintiffs must prove their damages by a preponderance of the evidence." *Encite LLC v. Soni*, 2011 WL 5920896, at *24 (Del. Ch.). While mathematical certainty is not required, there must be some basis for the Court's estimate. *Id.* at *25. Thus, "[i]t is appropriate to decline an award of damages when there is no evidence thereof." *Cline v. Grelock*, 2010 WL 761142, at *2 (Del. Ch.). Despite this lenient standard, Plaintiffs failed to prove a wrong or injury (except as discussed below), and failed to provide the Court with a

reasonable estimate of its damages. The Court of Chancery properly determined that Plaintiffs did not prove damages, and this Court should affirm.

1. The Court of Chancery Properly Held that Plaintiffs' Did Not Prove Damages.

At trial, Plaintiffs sought "approximately $50 million in damages." (Op. at 206.) In this appeal, Plaintiffs argue that the Court of Chancery erred (i) in failing to find that Defendants breached their fiduciary duties and (ii) in denying an award of damages for the Director Defendants' breach of duty of candor. (D.I. 14 at 52-54.) As discussed above, this Court should affirm the Court of Chancery's holding with regard to the alleged breaches of loyalty and breaches of the Stockholders Agreement because Plaintiffs' claims fail legally and factually. (*See* Sections II-III, *supra*.)

With regard to the breach of duty of candor claim, the Director Defendants appeal that portion of the appeal for the reasons set forth below. (*See* Section V, *infra*.) Even if this Court rejects that portion of the Director Defendants' appeal, and upholds the Court of Chancery's finding of a breach, it should also affirm the finding that Plaintiffs did not prove damages. The Court of Chancery found that the Director Defendants' breach of the duty of candor did not warrant monetary or equitable relief because the Company quickly cured the structural issue following the filing of the Rescission Action. (Op. at 187.) Further, the Court of Chancery noted that even if it were inclined to award damages for this breach, "the evidence

of record makes it impossible to determine what amount of damages, if any was caused by that wrong." (*Id.* at 210.) Indeed, one of the major flaws of Bratic's analysis is that he failed to apportion the damages calculation by defendant or alleged wrong. (*Id.*; A400-401, 952:17-958:7 (Bratic).) Rather, he assumed as true Plaintiffs' allegations, and based his damages analysis on that assumption. (A400, 951:19-952:16 (Bratic).) Plaintiff therefore did not prove damages resulting from this particular wrongdoing and therefore the decision of the Court of Chancery should be affirmed. *Cline v. Grelock*, 2010 WL 761142, at *2 (Del. Ch.) (finding that, despite the fact that the defendant had breached his fiduciary duty, the plaintiff had not "provided any basis for a rational award of damages").

Plaintiffs' reliance on *Thorpe v. CERBCO, Inc.* does not affect this result. In *Thorpe*, this Court reversed the trial court and held that "Eriksons are liable to CERBCO for the amount of $75,000 received from INA in connection with the letter of intent" and remanded for "further determination of damages." *Thorpe by Castleman v. CERBCO, Inc.*, 676 A.2d 436, 445 (Del. 1996). The *Thorpe* Court found a breach, including damages as a result of that breach. *Id.* Plaintiffs' suggestion that they "are entitled to at least $10 million in incidental damages caused by Defendants' actions, including legal fees" is baseless. new request for damages lacks any factual support and the fees that Plaintiffs have incurred are a problem of their own making. There is no correlation between the $10 million

dollars and the breach of duty of candor, and an award of damages in that amount is unwarranted. *PharmAthene, Inc. v. SIGA Techs., Inc.*, 2014 WL 3974167, at *8 (Del. Ch.) ("Responsible estimates of damages that lack mathematical certainty are permissible so long as the court has a basis to make such a responsible estimate."). The award sought, $10 million, is approximately one-fifth of the damages sought at trial for all of their claims. (*Compare* D.I. 14 at 53, *with* Op. at 206.) It cannot be that this minor breach, that was promptly cured, by itself, caused $10 million worth of damages. Therefore, the Court should reject Plaintiffs' argument and affirm the Opinion.

2. The Court of Chancery Properly Held that Plaintiffs' Damages Calculations Were Speculative and Unreliable.

Plaintiffs assert that the Court of Chancery erred by finding that Plaintiffs' damages calculations were speculative and unreliable, arguing that (i) Defendants should not be permitted to disclaim the management projections upon which Bratic relied to formulate Plaintiffs' damages calculations; and (ii) the Court abused its discretion in finding that management's projections were speculative. (D.I. 14 at 54.) Both arguments must fail because Delaware law permits the Court of Chancery to find and (it has found) management's projections unreliable when the circumstances warrant such finding.

a. Management's Projections Are Unreliable.

While it is true that the Court of Chancery traditionally gives "great weight" to projections prepared by management, the Court is not required to do so if it finds that management's projections are speculative and unreliable. *Compare Delaware Open MRI Radiology Associates, P.A. v. Kessler*, 898 A.2d 290, 332 (Del. Ch. 2006) ("Traditionally, this court has given great weight to projections of this kind because they usually reflect the best judgment of management, unbiased by litigation incentives."), *with Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, at *11 (Del. Ch.) *judgment entered sub nom. Merion Capital, L.P v. 3M Cogent, Inc.* (Del. Ch. July 23, 2013) (rejecting projections prepared by management "where management had never prepared projections beyond the current fiscal year, the possibility of litigation, such as an appraisal proceeding, was likely, [] the projections were made outside of the ordinary course of business," and the preparers of the projections "risked losing their positions if the ... bid succeeded and were involved in trying to convince the Board to pursue a different strategic alternative in which [they] were involved." (internal quotations omitted)). Indeed, "Delaware courts have found projections to be too unreliable to support a credible discounted cash flow analysis where they are grossly inconsistent with the corporation's recent performance." *In re Nine Sys. Corporation Shareholders Litig.*, 2014 WL 4383127, at *41 (Del. Ch.); *see also*

Cooper v. Pabst Brewing Co., 1993 WL 208763, at *4 (Del. Ch.) (finding expert's discounted cash flow analysis was not reliable because it "assumed that the volume of sales would increase by 1.5% per year when, despite [the company's recent] acquisitions, its volume of sales had declined every year between 1977 and 1981 and had declined further during the first nine months of 1982"); *In re John Q. Hammons Hotels Inc. S'holder Litig.*, No. CIVA758-CC, 2011 WL 227634, at *4-5 (Del. Ch. Jan. 14, 2011) *judgment entered,* (Del. Ch. Jan. 14, 2011) (finding that "[m]anagement projections were, in fact, based on numerous overly optimistic assumptions" and expert's terminal value was equally flawed because he "created his own projections for 2011 by extrapolating from the overly-optimistic 2010 numbers").

Here, the projections upon which Bratic relied for his damages calculation had no basis in reality. Management's projections "estimate that the software revenue would be fifteen times larger by the end of 2014 than it was in 2011" and "the Company's income before taxes was expected to be roughly nine times larger in 2014 than in 2013." (Op. at 207.) These numbers were not justified, as OptimisPT was marginally developed, and OptimisSport was still just a vision in 2012. (*Id.* at 208 n.630 ("The revenue figures for OptimisSport border on fantasy.").) Likewise, "the assumed growth in acquired clinics, fifteen per year from 2012-2014 and then ten per year for 2015 and 2016, is entirely out of line

with the fact that the Company acquired, on average, only 4.25 clinics per year from 2009-2012." (*Id.* at 207-208.) In addition, Horne, the Company's CFO, admitted that the "company did not [ever] meet its forecasts." (*Id.* at 209.) Thus, management's projections are unreliable and Bratic's reliance on them renders his damages calculations speculative.

Uncertainties in the amount or proof of damages should not be resolved against Defendants, as Plaintiffs suggest. The Court of Chancery not only found Plaintiffs' damages calculation speculative and unreliable, but it also found that "any damages based on [the projections] would be mere conjecture." (*Id.* at 212.) While Delaware courts do show sympathy to plaintiffs who succeed on breach of fiduciary claims, "when acting as the fact finder, this Court may not set damages based on mere speculation or conjecture where a plaintiff fails adequately to prove damages." *In re Mobilactive Media, LLC*, 2013 WL 297950, at *24 (Del. Ch.) *reargument denied*, 2013 WL 1900997 (Del. Ch.) (internal quotations omitted); *see also Frontier Oil v. Holly Corp.*, 2005 WL 1039027, at *39 (Del. Ch.) *judgment entered sub nom. Frontier Oil Corp. v. Holly Corp.* (Del. Ch. May 23, 2005) ("Even though damages need not be proven with absolute precision, Holly failed to provide the Court with a reasonable basis for any such calculation."). Plaintiffs argue that the Court should resolve uncertainties in their favor by relying on cases that focus on the differences in stock price or trading price over period of time.

(D.I. 14 at 57 n.48.) These cases, however, are inapposite because they do not deal with a complete and total failure of proof or a complete and total failure to allocate among their various claims the damages where the evidence of damages was entirely within Plaintiffs' control. The Court of Chancery did not commit any error in finding that Plaintiffs did not prove damages.

b. Defendants' Reliance Upon Management's Projections Does Not Render Them Reliable.

Defendants' purported reliance upon management's projections in the past does alter this analysis. In *Delaware Open MRI Radiology Associates, P.A. v. Kessler*, the Court of Chancery stated that it regards "with rightful suspicion attempts by parties who produced such projections to later disclaim their reliability, when that denial serves their litigation objective." 898 A.2d 290, 332 (Del. Ch. 2006). Plaintiffs seize on this statement as the basis for their estoppel argument: namely, that management's projections must be reliable if Waite and Horne participated in preparing them and the Board, including the Director Defendants, voted in favor of the valuation of Optimis stock presented in the 2012 PPM. (D.I. 14 at 54-55.) In *Kessler*, the Court first found that the projections were not speculative, and the "assumption[s] struck [the Court] as reasonable and achievable ones." *Kessler*, 898 A.2d at 333. As discussed above, the Court of Chancery did not find management's projections reasonable or achievable: in fact,

the Company has never met its forecasts. (Op. at 207-209.) Thus, Waite and Horne's participation in management's projections are immaterial.

Further, Horne testified that while many individuals participated in preparing the projections used in the 2012 PPM, Morelli provided many of the numbers (especially for the SSD that he ran and from which the most speculative growth numbers originated) and insisted on a more aggressive approach. (A530-531, 1323:11-1328:12 (Horne).) In addition, although the projections were created to attract investors, no one invested in 2012. (Op. at 207; A404-405, 970:21-971:1 (Bratic).) Defendants' disclaimer of management's projections does not serve their litigation objective since it could have exposed them to criminal liability if anyone had invested in the 2012 PPM. *Kessler*, 898 A.2d 290, 332 n. 109 ("Again, it is a felony to knowingly obtain any finds from a financial institution by false or fraudulent pretenses or representations."). Thus, the Court should reject Plaintiffs' estoppel argument.

c. Plaintiffs' Failure to Apportion Harm Between Plaintiffs or Between Claims is Fatal.

Plaintiffs also allege that the Court of Chancery "erred by holding that Plaintiffs failed to prove damages, as a matter of law, because harm was not apportioned between Plaintiffs or between claims." (D.I. 14 at 57-58.) This finding is not contrary to Delaware law. In *Beard Research, Inc. v. Kates*, cited by Plaintiffs for this proposition, the Court of Chancery found that the expert's failure

to allocate damages among the different tort claims that plaintiffs pursued was not detrimental "[i]n the circumstances of *this* case," in part because the plaintiffs "succeeded in proving most of their claims and the damages from Defendants' various wrongs tend to overlap." 8 A.3d 573, 614 (Del. Ch.) *aff'd sub nom. ASDI, Inc. v. Beard Research, Inc.*, 11 A.3d 749 (Del. 2010) (emphasis added). Here, Plaintiffs did not succeed in proving any of their claims. (Op. at 201, 213.) Thus, Plaintiffs' reliance on *Beard Research* is misplaced.

In addition, Bratic's proposed solution (apportionment by share ownership) does not solve the problem about which the Court of Chancery complained. First, Bratic's solution does provide the Court with a means to apportion between claims or by defendant. (A401, 955:2-956:5 (Bratic).) As the Court of Chancery noted, "[e]ven though I have found liability on one fiduciary duty claim, the evidence of record makes it impossible to determine what amount of damages, if any, was caused by that one wrong." (Op. at 211.) Plaintiffs' sole victory in this matter was for a minor breach of the duty of candor by the Director Defendants; Horne did not participate. (*Id.* at 184-187.) With the failure of the conspiracy and aiding and abetting claims (which they have not appealed), Plaintiffs cannot tie Horne to this breach and provide no way to apportion the damages among the different defendants.

Finally, Bratic's solution ignores the fact that Optimis itself is a plaintiff in this matter, and any award of damages relating to the Company's claims should flow back to the Company, and in turn, its shareholders. (*See* A693-718.) *Cf. In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 817 (Del. Ch. 2005) *aff'd*, 906 A.2d 766 (Del. 2006) (stating that "a stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation" to succeed on a direct claim). Bratic provides only a means of apportioning specific damages to Morelli and Analog. (D.I. 14 at 58; A398, 943:11-944:6 (Bratic).) Apportionment among the Plaintiffs is necessary when part of the damages would flow back to the Company. *Cf. Boyer v. Wilmington Materials, Inc.*, 1999 WL 342326, at *3 (Del. Ch.) (agreeing with defendant's argument relating to apportionment because "it would not be appropriate to compensate plaintiff and his attorneys from the derivative fund for efforts expended on individual claims").

3. The Alleged Diminution in the Company's Equity Value Is Not a Viable Alternative Measure of Damages.

Plaintiffs also argue that the Court of Chancery erred by failing to consider the diminution of the Company's equity value as a viable alternative measure of damages. Even if the Court of Chancery erred in failing to consider this alternative, this Court should still reject Plaintiffs' argument because this alternative measure of damages suffers from the same maladies as the first measure

of damages based on the Company's valuation: there is no apportionment of the harm for each alleged wrong.

Though Plaintiffs downplay it, Bratic only reached $44 million in damages by applying a control premium to the difference in equity value. (A412, 1001:9-19 (Bratic); Op. at 4 n.10; A1174.) There is no basis to apply a control premium to derivative breach of fiduciary duty claims because those claims belong to the Company. *Kelly v. Blum*, 2010 WL 629850, at *9 n.60 (Del. Ch.) ("Though narrow, this distinction is important because of the ramifications of characterizing a claim as derivative, including additional standing and demand requirements and the fact that any recovery in a derivative suit inures to the benefit of the corporation or LLC."). Because this alternative damages calculation is also flawed, the Court of Chancery's decision to reject it is not reversible error.

V. THE COURT OF CHANCERY ERRED WHEN IT HELD THAT THE DIRECTOR DEFENDANTS BREACHED THEIR DUTY OF CANDOR BY FAILING TO ADVISE THE OPTIMIS BOARD OF DIRECTORS OF RANCHO'S FLAWED CORPORATE STRUCTURE.

A. Question Presented

Whether the trial court erred by holding that the Director Defendants breached their duty of candor by not alerting the Optimis Board of Directors as to the illegal ownership structure of Rancho prior to filing the Rescission Action. This issue was preserved for appeal. (Op. at 184-187; A1002-1004; A1168-1170, 70:24-72:10.)

B. Standard and Scope of Review

See Section I(B), *supra*.

C. Merits of Argument

In the Opinion, the Court of Chancery held that the "Director Defendants did not breach their duty of loyalty by filing the Rescission Action," but "breached their duty of candor by not alerting the Board to the issue." (Op. at 185, 187.) The Court of Chancery erred in finding that the Director Defendants breached their duty of candor because (i) the Director Defendants' were not obligated to inform the Board of Rancho's flawed corporate structure; and (ii) the Director Defendants actually disclosed the structural defect before they filed the Rescission Action.

In *Hoover Industries v. Chase*, the Court of Chancery held that "[t]he intentional failure or refusal of a director to disclose to the board a defalcation or

scheme to defraud the corporation of which he has learned, itself constitutes a wrong, unless a recognized privilege against disclosure pertains." 1988 WL 73758, at *2 (Del. Ch.). However, this duty of disclosure is limited: "director disclosure cases decided in Delaware courts have implicated circumstances in which the director is personally engaged in transactions harmful to the corporation, but beneficial to the director." *Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*, 922 A.2d 1169, 1184 (Del. Ch. 2006). Thus, in *Hollinger International v. Black*, the Court of Chancery found that the controlling shareholder and director breached his duty of loyalty by failing to disclose dealings that violated a contract to which he was subject, "circumstances in which full disclosure was obviously expected." *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1061 (Del. Ch. 2004) *judgment entered sub nom.* (Del. Ch. Mar. 4, 2004) *and aff'd*, 872 A.2d 559 (Del. 2005).

The concerns raised in *Hoover* and *Hollinger* are not present here. The Director Defendants did not defraud the Company, nor did they stand to benefit from the disclosure (or the lack thereof). The Director Defendants testified that they filed the Rescission Action defensively, and after Morelli removed them as directors of Rancho, which put their physical therapy licenses in danger. (A434, 1087:11-1088:22 (Waite); A522, 1289:5-12 (Smith); A610, 1491:6-22 (Atkins); B1538-46; B1558.) Further, the discovery of the flawed entity structure was just as harmful to them since they gave up their Rancho stock when they acquired stock

in Optimis, and the bylaws of Rancho require that "each Director [] be and continuously remain a shareholder *and* a licensed person as defined in section13401(c) of the California Corporations Code." (B1246 at § 2.02.) Thus, the Director Defendants did not gain anything by failing to disclose the flawed entity structure to the Board of Optimis.

In addition, Delaware case law "clearly establishes that a director owes no fiduciary duty to disclose matters that are already known to the company." *Summit Inv'rs II, L.P. v. Sechrist Indus., Inc.*, 2002 WL 31260989, at *6 (Del. Ch.); *Fisher v. United Techs. Corp*, No. 5847, 1981 WL 7615, at *3 (Del. Ch. May 12, 1981) ("there is no duty to disclose information to one who reasonably should already be aware of it"). Morelli is a Skadden trained-attorney who was involved in the drafting of the transaction documents. (A164, 272:16-273:4; A170, 294:2-9 (Morelli).) In addition, he served as a director of Rancho, with full access to review Rancho's bylaws. (B1263-65; *see also* B1275-79, B1280-83.) Likewise, the Board of Optimis was aware of Rancho's structure, and as the parent company, had access to the corporate documents. (B1263-65, A1337 at ¶ 2.2(d) ("Sellers shall afford Parent access to all corporate books and records and other property of the Company in any Seller's possession."); B1538-46.) Thus, knowledge of Rancho's bylaws can and should be imputed to the Company, and the Director

Defendants' had no obligation to point out that *no one* was meeting the requirements of Section 2.02 of Rancho's bylaws.

To the extent the Director Defendants had any duty to disclose this information to the Board of Optimis, they could not do so without waiving the attorney-client privilege, and therefore, their failure to disclose cannot constitute a breach. "The intentional failure or refusal of a director to disclose to the board . . . itself constitutes a wrong, *unless a recognized privilege against disclosure pertains*." *Hoover Industries v. Chase*, 1988 WL 73758, at *2 (Del. Ch.). In their individual capacities, the Director Defendants' retained attorneys, and upon legal advice, subsequently filed the Rescission Action. The Director Defendants only learned of the structural defect from their counsel and could not disclose it to the Board of Optimis without waiving the attorney-client privilege. *Khanna v. McMinn*, 2006 WL 1388744, at *36 (Del. Ch.) ("A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client ... between the client or the client's representative and the client's lawyer or the lawyer's representative." (citing DRE 502)). In any event, the Director Defendants *did* disclose the flawed structure to the Board in advance of filing the Rescission Action. In their resignation letter, the Director Defendants state that they are resigning because they "have reached the conclusion

that any ownership structure for Rancho Physical Therapy, Inc. ("Rancho") in which anyone other than licensed physical therapists own shares (and particularly corporate ownership of shares) is illegal under California law." (B1527-37.) The Director Defendants did not fail to disclose the structural defects in Rancho's ownership and did not breach their duty of candor. The Court should reverse the Court of Chancery's decision on this issue.

VI. THE COURT OF CHANCERY ERRED IN FAILING TO AWARD THE DIRECTOR DEFENDANTS THEIR ATTORNEYS' FEES AND EXPENSES.

A. Question Presented

Whether the Court of Chancery erred by denying the Director Defendants' their fees and expenses as a sanction for Plaintiffs' litigation misconduct. This issue was preserved for appeal. (Op. at 53, 212-213; Order at 2; A755-756; A1023-1024.)

B. Standard and Scope of Review

"[A]wards of attorneys' fees [are reviewed] for abuse of discretion." *William Penn P'ship v. Saliba*, 13 A.3d 749, 758 (Del. 2011). The Court "do[es] not substitute [its] own notions of what is right for those of the trial judge if that judgment was based upon conscience and reason, as opposed to capriciousness or arbitrariness." *Id.*

C. Merits of Argument

For the reasons set forth in Horne's Appellate Brief, incorporated by reference herein, the Court should sanction Plaintiffs and their counsel for their litigation misconduct, and require Morelli and his counsel to pay the Director Defendants' fees and costs incurred in defending this action.

CONCLUSION

The Director Defendants respectfully request that the Court (i) affirm the Court of Chancery's holdings in connection with the October Meeting, Amendment No. 2 and Stockholders Agreement, (ii) affirm the Court of Chancery's denial of damages to Plaintiffs; (iii) reverse the Court of Chancery's holding that the Director Defendants breached their duty of loyalty; and (iv) award the Director Defendants their attorneys' fees and expenses incurred in defending this action.

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Dated: December 10, 2015

BAYARD, P.A.

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