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IN THE SUPREME COURT OF THE STATE OF DELAWARE

ISN SOFTWARE CORPORATION, Respondent-Below, Appellant, v. AD-VENTURE CAPITAL PARTNERS, L.P., POLARIS VENTURE PARTNERS FOUNDERS' FUND VI, L.P. and POLARIS VENTURE PARTNERS VI, L.P., Petitioners-Below, Appellees.	No. 43, 2017 On Appeal from the Court of Chancery of the State of Delaware, Consolidated C.A. No. 8388-VCG PUBLIC VERSION FILED APRIL 20, 2017

POLARIS VENTURE PARTNERS FOUNDERS' FUND VI, L.P. and POLARIS VENTURE PARTNERS VI, L.P., Petitioners-Below, Appellees/ Cross Appellants, v. ISN SOFTWARE CORPORATION, Respondent-Below, Appellant/ Cross Appellee.	

POLARIS PETITIONERS CORRECTED ANSWERING BRIEF AND OPENING BRIEF ON CROSS-APPEAL

OF COUNSEL:

Anthony S. Fiotto
William B. Brady
GOODWIN PROCTER LLP
100 Northern Avenue
Boston, MA 02210
(617) 570-1000

Dated: April 19, 2017

John M. Seaman (#3868)
Matthew L. Miller (#5837)
ABRAMS & BAYLISS LLP
20 Montchanin Road, Suite 200
Wilmington, Delaware 19807
(302) 778-1000

Attorneys for Petitioners-Below, Appellees and Cross-Appellants Polaris Venture Partners VI, L.P. and Polaris Venture Partners Founders' Fund VI, L.P.

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NATURE OF PROCEEDINGS

This is an appeal from the Court of Chancery's (the "Trial Court") determination of the fair value of Respondent-below, Appellant ISN Software Corporation ("ISN" or the "Company"), in this consolidated appraisal action pursuant to 8 *Del. C.* § 262. Petitioners Polaris Venture Partners VI, L.P. and Polaris Venture Partners Founders' Fund VI, L.P. (together "Polaris") join in the Answering Brief on Appeal and Opening Brief on Cross-Appeal filed today by Petitioner-below, Appellee Ad-Venture Capital Partners, L.P. ("Ad-Venture;" with Polaris, "Petitioners"), and incorporate by reference all of the points and arguments set forth therein, with the exception of Section IV thereof (which applies solely to Ad-Venture).

Polaris now submits this Answering Brief on Appeal and Opening Brief on Cross-Appeal seeking review on cross-appeal of one additional issue: the Trial Court's denial of Polaris's request to shift attorneys' fees and expenses to ISN.

Delaware follows the "American Rule," which provides that each party is generally expected to pay its own attorneys' fees regardless of the outcome of the litigation. This Court has, however, recognized exceptions to this rule, including the exception for "bad faith" conduct during appraisal litigation. *See Montgomery Cellular Holding Co. v. Dobler*, 880 A.2d 206, 227 (Del. 2005). This exception is "applied in extraordinary circumstances as a tool to deter abusive litigation and to

protect the integrity of the judicial process." *Id.* (internal quotation marks omitted).

Such circumstances exist here. This appraisal litigation arises from a January 9, 2013 cash-out merger (the "Merger") that removed Polaris as a 6% shareholder of ISN three months after Polaris had acquired its shares. Following the Trial Court's valuation opinion, which concluded that the fair value of ISN was nearly three times the price offered to Polaris in the Merger, Polaris moved to shift attorneys' fees to ISN under the bad faith exception to the American Rule.

In ruling on Polaris's motion, the Trial Court found that the method used by ISN and its controlling shareholder, William "Bill" Addy, to set the Merger price "was clearly improper . . . the kind of back-of-the-envelope valuation that cannot satisfy a duty of care for a fiduciary." OB, Ex. B at 30 ("Rearg. Tr."). The Trial Court acknowledged that ISN's controlling shareholder had interfered with and attempted to discourage Polaris' decision to seek appraisal. The Trial Court found that ISN committed numerous discovery violations and spoliation, which the Trial Court described as "violations of the norms under which we must function . . . to achieve justice." *Id*. at 29. The Trial Court also found that ISN's controlling shareholder "engaged in spin, exaggeration and partisanship" in his trial testimony. *Id*. Despite these findings, the Trial Court denied Polaris's motion to shift

attorneys' fees. The Trial Court gave four reasons for its decision; each reason was an error of law or an abuse of discretion.

First, the Trial Court held that its previous shifting of limited fees to ISN in connection with specific discovery motions precluded any further fee shifting. That is incorrect as a matter of law. Polaris did not seek a double recovery for fees that had already been shifted. Rather, Polaris sought shifting of other fees incurred based on ISN's overall pattern of bad faith, of which ISN's discovery misconduct is just one example.

Second, the Trial Court held that the "spin, exaggeration and partisanship" in the trial testimony of ISN's controlling shareholder did not justify fee shifting. But ISN's controlling shareholder did not innocently shade his testimony; he offered misleading testimony on important subjects, which is precisely the sort of abusive tactic that should be sanctioned and deterred.

Third, the Trial Court held that ISN's efforts to cloud Polaris's appraisal decision were not "a significant impediment to Polaris valuing its stock;" and that those efforts were "unsuccessful" in discouraging an appraisal action in any event. But a controlling shareholder's bad faith interference with the appraisal decision of a minority shareholder is not excused simply because that minority shareholder has the means and stamina to plow ahead with an appraisal action.

Fourth, the Trial Court suggested that ISN's misconduct in setting the Merger price could have been remedied by a separate breach of fiduciary claim, and that Polaris somehow waived its right to seek fee shifting by failing to bring such a claim. But that is incorrect: fiduciary duty claims and fee shifting are separate, independent remedies that protect distinct interests, and the Trial Court erred by conflating the two.

For these reasons, as further set forth below, the Trial Court's denial of fee shifting to ISN should be reversed.

SUMMARY OF ARGUMENT

1. Denied. Polaris adopts and incorporates by reference Ad-Venture's Summary of Argument with respect to ISN's argument 1. *See* Appellee's/Cross-Appellant's Answering Brief on Appeal and Opening Brief on Cross-Appeal ("Ad-Venture Br.") at 4, 25-39. The Trial Court properly removed ISN's annual "cash flow adjustment for incremental working capital" from its fair value calculation. ISN's argument that the court's valuation would render ISN insolvent is a myth based solely upon ISN's insistence that its post-merger accounting change would introduce a massive working capital requirement that would consume all of the excess cash stockpiled for years on its balance sheet to offset a newly-created deferred revenue liability. The controlling stockholder made the change to GAAP accounting under the bogus claim that it would "reduce the DCF value of ISN…."

2. Denied. Polaris adopts and incorporates by reference Ad-Venture's Summary of Argument with respect to ISN's argument 2. *See id.* at 4, 40-44. The Trial Court applied the capital asset pricing model ("CAPM") to calculate ISN's cost of equity using the beta calculated by ISN's expert, just as ISN's expert had done. In applying CAPM, the Trial Court did not abuse its discretion in selecting a size premium that reflected ISN's risk profile, which was well-supported by the trial record.

3. Denied. Polaris adopts and incorporates by reference Ad-Venture's Summary of Argument with respect to ISN's argument 3. *See id.* at 4, 45-48. The Trial Court construed Section 262 precisely as this Court has instructed: it considered prior transactions in ISN stock and determined, based on the record, that those sales were not reliable indicators of the fair value of ISN.

SUMMARY OF CROSS-APPEAL ARGUMENT

1. Polaris adopts and incorporates by reference Ad-Venture's Summary of Argument on Cross-Appeal with respect to Ad-Venture's argument 5. *See id.* at 5, 53-63. The Trial Court abused its discretion by adopting the revenue and expense projections proffered by ISN's valuation expert because those projections were not supported by the record. Specifically, ISN's DCF model flattened the Company's projected revenue growth based solely on self-serving speculation regarding increased competition that was contrary to the evidence. Further, ISN's expert admitted that he did not analyze ISN's actual expenses: instead, he "backed into" his expense projections based on hypothetical margins from public companies. He then arbitrarily reversed the growth trend of ISN's profit margins based on the controlling stockholder's theory that ISN's margins would fade over the course of the projection period, without ever identifying any actual expense that was expected to grow faster than the Company's historic trends. Neither of those theories to depress ISN's DCF value was supported by evidence in the trial record.

2. Polaris adopts and incorporates by reference Ad-Venture's Summary of Argument on Cross-Appeal with respect to Ad-Venture's argument 6. *See id.* at 5, 64-66. The Trial Court erred as a matter of law in determining the number of outstanding shares eligible for appraisal by adding employee and former employee

stock options to ISN's fully-diluted share count, despite the fact that those shares did not have voting rights and were contractually restricted from dissenting from the merger and seeking appraisal.

3. The Trial Court erred by denying Polaris's post-trial request to shift attorneys' fees and expenses to ISN. The Trial Court's findings that (i) ISN engaged in repeated discovery violations, including spoliation; (ii) the testimony of ISN's controlling shareholder engaged in "spin, exaggeration and partisanship;" (iii) the method used by ISN's controlling shareholder to set the Merger price was "clearly improper;" and (iv) there was evidence that ISN's controlling shareholder intentionally interfered with Polaris's appraisal decision; collectively and individually rise to the level of bad faith that justifies fee shifting. None of the reasons set forth by the Trial Court supports its denial of fee shifting here.

STATEMENT OF FACTS

A. ISN Background

Formed in 2000, ISN is a privately-held Delaware corporation that provides a subscription-based online contractor database to contractors and the companies that hire them, to help them meet internal and governmental record keeping and compliance requirements. OB, Ex. A at 3 ("Op."). Since its founding, ISN has been controlled by Bill Addy, who held approximately two-thirds of ISN's stock prior to the Merger.

Ad-Venture, a limited partnership controlled by Brian Addy, Bill Addy's brother, was an early investor in ISN, and held an approximately one-third minority stake in the Company. Brian Addy was on ISN's board of directors (the "Board") until December 2007, when he and Bill Addy had a falling out and Brian was removed from the Board. Op. at 4; A218. This marked the start of an extremely contentious period in the relationship between the brothers, leading to multiple lawsuits between them. Bill Addy cut off Brian Addy from ISN dividends while increasing his own compensation and that of ISN's President (and only other Board member) Joseph Eastin. Bill Addy also refused to provide any current financial information to Brian Addy about ISN.

Bill Addy understood that he would ultimately have to deal with Brian Addy's position as a minority shareholder, and thus embarked on a strategy to buy him out at the lowest price possible. Bill Addy familiarized himself with appraisal

cases and proceedings, A294-95, set up a "Litigation and Buy-Out Reserve" account, and made numerous attempts to buy his brother out—none of which were successful, A286; B3062; B3120; A236.

B. Polaris's Investment in ISN

In 2008, Bryce Youngren, Managing Partner at Polaris, a private equity fund, met with Bill Addy to discuss Polaris's interest in ISN. A99. At the time, Polaris did not "have enough information to propose a specific investment," but in 2010, Youngren met with Bill Addy a second time in continued pursuit of a deal. A99-100. Eventually, after multiple discussions, Bill Addy directed Polaris to Brian Addy to discuss a purchase of Brian Addy's stock in ISN.

The deal, as originally envisioned, would involve ISN, Polaris, and Ad-Venture, with Polaris and ISN jointly financing ISN's purchase of Ad-Venture's ISN stock, based on a $90-100 million valuation of the Company that had been provided to Polaris by Bill Addy.[1] When that structure failed, Polaris and Ad-Venture began to discuss a direct purchase by Polaris of a portion of Ad-Venture's ISN stock. Frozen out from dividends, reliable financial statements, and other information since 2008, Brian Addy was desperate to bring in an institutional investor to act as a "grown up in the room" to temper Bill Addy's oppressive

[1] The valuation for Polaris' investment in ISN came directly from Bill Addy in April 2010: Bill Addy told Youngren that he had made an offer to purchase his brother's stock at a valuation of $90-100 million. *See* Op. at 11 n.41; A100; A103-04.

conduct and help improve minority shareholder access to information. A219-20. The discussions between Polaris and Ad-Venture ultimately led to a term sheet in December 2010. Pursuant to the term sheet, Polaris agreed to purchase a portion of Ad-Venture's ISN stock amounting to approximately 8% of ISN's stock for $7.75 million (with 6% to be purchased up front and an option to later purchase an additional 2%), based on the valuation that Bill Addy had previously provided to Polaris.

When Bill Addy learned that Polaris and Ad-Venture had cut their own deal, which would result in Polaris becoming a minority shareholder in ISN alongside Ad-Venture, Bill Addy turned to undermine the deal. Understanding that a firm like Polaris would prefer to invest in companies with GAAP accounting, he told Polaris that ISN had "no plans to adopt" GAAP—adding: "is the deal contingent upon GAAP financial statements?" A318; B1479. In response to Polaris's requests for due diligence from the Company, Bill Addy imposed unreasonable demands, insisting that Polaris provide no more than its "absolute minimum [due diligence] requirements list[,]" B1475, and then requiring that Polaris and its managing partners sign a non-disclosure agreement containing a $5 million liquidated damages provision, B1482; B1485.

In 2011, with the Polaris/Ad-Venture transaction effectively stalled due to ISN's refusal to provide any due diligence, including basic financial information,

Bill Addy hired Peter Phalon of Waterview Advisors to update a valuation of ISN prepared by Phalon in 2008. B1494. Bill Addy manipulated the valuation by, among other things, directing Phalon's team to revise the projections they had developed for ISN, leading to lower projected revenue and earnings. A303-04. Those projections assumed a 10% decline in gross new contractors each year—a phenomenon the company had never experienced. A304. Bill Addy also impressed upon Waterview that ISN's EBITDA margins were unsustainable, and would "fade" to a significantly lower level. A304-05. Phalon ultimately produced a valuation (the "2011 Waterview Valuation") reporting that ISN's fair value as of June 30, 2011 was $127 million. B1495.

Bill Addy's efforts to frustrate the Polaris/Ad-Venture transaction extended to the dissemination of false and misleading information about the Company to Ad-Venture (and, at least indirectly, to Polaris).[2] Indeed, the only information that ISN provided about the Company was a letter from Bill Addy to Ad-Venture dated October 31, 2011 (the "Halloween Letter") that painted a dire picture of ISN's prospects. The Halloween Letter claimed that "ISN's growth rate ha[d] slowed substantially," that ISN "expect[ed] slower contractor addition growth rates for the foreseeable future," and that "[i]n light of this forecast . . . the ISN board of

[2] At the time, Bill Addy was of course aware of Ad-Venture's term sheet with Polaris, and thus knew that any information that he provided to Ad-Venture would ultimately be shared with Polaris (or any other prospective investor in ISN for that matter).

directors has authorized management to pursue two new and complimentary strategic thrusts, namely, acquisitions of businesses and acquisitions of real estate." B1554.

These claims were false, as the evidence at trial would eventually show. ISN Board minutes from that same day noted that ISN was "on track to exceed" its 2011 budget, with "very good" margins. B1551. The very next day, ISN confidently announced a 20% price increase to its customers. A361. As for the Halloween Letter's statement that "the ISN board of directors has authorized management to pursue two new . . . strategic thrusts," this, too, was false. As the testimony at trial made clear, none of ISN's senior management were aware of any change to the Company's business strategy, much less a tectonic shift to investments in "hunting ranches, ski homes, beach properties and city central condominiums." A309-10; A360; B3143; B3086-87; B3147-49; B3154; B3068; B1554.[3] The Halloween Letter reflects ISN's attitude towards its minority shareholders, and fits within a pattern of conduct by ISN that carried over into this

[3] ISN attempted to explain ISN senior management's lack of awareness in its Answering Post-Trial Brief by arguing that the "ISN management referred to in the Halloween Letter is Bill Addy and Joseph Eastin," and that "Messrs. Addy and Eastin were well aware of the contents of the Halloween Letter, the declining growth rates and ISN's business strategies." A923. In other words, Bill Addy and Eastin claimed that they informed ***themselves*** of this fake strategy—and nobody else on ISN's senior management team, including Brian Callahan, the Company's Executive VP of Business Development, who testified that he would have been aware of any such strategies had they existed. A360.

litigation: ISN's controlling shareholder would manipulate and twist the information provided to the minority shareholders to interfere with their decision-making and get them to back down.

In the face of Bill Addy's obstruction to the Polaris/Ad-Venture transaction, Ad-Venture was forced to pursue a books and records action to obtain the confirmatory due diligence necessary to close the deal. A73. During his trial testimony in that action, Bill Addy offered his unvarnished view of Polaris, testifying that his "opinion of Polaris is dirt[.]" B1565. Nevertheless, Ad-Venture prevailed, and the Court of Chancery ordered that certain diligence materials, such as financial statements, be provided in April 2012. B1570-72. In October 2012, Polaris and Ad-Venture closed the transaction on terms substantially similar to those in the December 2010 term sheet. *See* B1589-1611; B1462-66; *see also* A113-16. Through this transaction, Polaris became a 6% shareholder of ISN. B1589-1611; B1462-66; A113-16; A221.

C. The Merger to Remove Polaris From ISN

Almost immediately, ISN set about removing Polaris as an ISN shareholder. On January 9, 2013, ISN completed the Merger, by which ISN merged with a wholly owned subsidiary pursuant to 8 *Del. C.* § 251, with ISN continuing as the surviving corporation. The Merger was approved by the written consent of Bill Addy and Eastin, who at the time owned 65.3% and 4% of the Company's stock,

respectively. Polaris and a second minority shareholder, Gallagher Industries, LLC ("Gallagher"), were cashed out of the Company in the Merger, with their ISN stock converted into a right to receive $38,317.00 per share (the "Merger Consideration"). A574; A576.

In setting the Merger Consideration, the ISN Board (consisting solely of Bill Addy and Eastin) did not prepare any projections, nor did they engage a financial advisor to prepare a valuation or a fairness opinion. A280; B3107-08. Indeed, overwhelming evidence showed that the Merger Consideration was determined by Bill Addy and Eastin without any fair process or protection for the minority. Bill Addy and Joe Eastin chose instead to "use what [they had] on the shelf and move forward." B3127; *see also* A300. That is, they took the 2011 Waterview Valuation and "adjusted" it by scribbling up and down arrows on a sheet of notebook paper. A299-300; B1648-49. Despite the Company's significant growth over the eighteen months since June 30, 2011—including 42% growth in the Company's cash collections in 2012 alone—Bill Addy and Eastin concluded that the Company's core equity value was essentially unchanged from the 2011 Waterview Valuation (which had been doctored by Bill Addy), and that the fair value of ISN was $138 million. A546-47.

D. ISN's Interference With Polaris's Appraisal Decision

On January 16, 2013, ISN sent a Notice of Stockholder Action (the "Notice") to Polaris and the other minority shareholders, along with a binder of "Supplemental Documentation." B1675-1708; B2523-2956. Notably, the Supplemental Documentation did not include any projections, any ISN Board meeting minutes, or any information even hinting at how the ISN Board determined the Merger Consideration. The binder did not include the 18 month-old 2011 Waterview Valuation or the notebook paper with the scribbled up and down arrows purporting to "adjust[]" this valuation. A299-300; B1648-49. The Supplemental Documentation did, however, include the Halloween Letter, with its false claims about ISN's growth and business plans and prospects. B2700.

ISN structured the Merger to leave Ad-Venture's stock unaffected and to freeze Ad-Venture into its minority position, specifically to avoid the risk of having to pay fair value for that stock in an appraisal proceeding. A298. Bill Addy was therefore shocked to learn—after the Merger but before sending notice to ISN shareholders on January 16, 2013—that Ad-Venture could seek appraisal under 8 *Del. C.* § 262 after all. A318-19.

On January 31, 2013, ISN received appraisal demands from both Ad-Venture and Polaris. *See* A318-19. Bill Addy was suddenly faced with the very risk he had maneuvered to avoid: an appraisal action where ISN would have to pay

fair value for nearly 25% of the Company's stock, including Ad-Venture's ISN stock, not just to Polaris and Gallagher. Bill Addy understood, however, that Petitioners could still withdraw their appraisal demands and accept the Merger Consideration. A319.

Thus, on February 21, 2013, Bill Addy sent another letter to Polaris and Ad-Venture, suddenly announcing that ISN had changed from cash basis to GAAP accounting (the "February 21, 2013 Letter"). The February 21, 2013 Letter stated that, consequently, the Merger Consideration "now looks to overestimate the value of one share of ISN stock." A319-20; B1721. Bill Addy wrote, "[w]hat appears to be significant excess cash . . . is an illusory result of Cash Basis Revenue accounting," adding, "[w]hen we next perform a third party valuation of ISN, we will use Deferred Revenue Basis accounting[, which] ***will reduce the DCF value of ISN***." B1721 (emphasis added). At trial, Bill Addy was forced to admit that this was false—GAAP accounting does not change the discounted cash flow ("DCF") value of ISN. A310-11. Bill Addy further admitted that he "hoped, when [he] sent that letter, that Polaris would change their mind and accept the merger consideration[.]" B1719-21; A319.

All of this shows ISN's clear intention to interfere with Polaris's appraisal decision-making—to make the prospect of litigation to obtain fair value for its ISN stock more expensive, more time-consuming, and all-around riskier. ISN and Bill

Addy understood what this would mean for Polaris, a private equity fund focused like a laser on any factor that might impact its rate of return.

E. ISN's Discovery Violations and Misleading Testimony at Trial

After Polaris filed suit in April 2013, ISN shifted to the next battleground: discovery. Petitioners were forced to bring five motions to compel over the course of this litigation—all of them granted—which extended what should have been a straightforward appraisal proceeding for three years. B0431-0545; B0546-1015; B1016-1113; B1114-1302; B1303-15. These motions stemmed from a series of unreasonable positons staked out by ISN in discovery—*e.g.*, ISN's initial stance that Bill Addy would be the only custodian for email collection in a company of approximately 300 employees—not accounting, not finance, not business development, not sales. Indeed, it was readily apparent that broad discovery across ISN's business would be essential in this case precisely because Bill Addy had so carefully limited and manipulated the record around the Merger.

Moreover, by summer 2014, it emerged that ISN had engaged in a number of serious discovery abuses, as ISN had: (i) not issued a written document hold; (ii) not suspended its document destruction policy following the appraisal demands;[4] (iii) permitted Bill Addy to personally conduct ISN's electronic document

[4] For example, Bill Addy testified that he would occasionally clean out the ISN shared drive "like a dirty fridge"—a practice that was not suspended following receipt of Petitioners' appraisal demands. A317.

collection; (iv) never interviewed ISN custodians about their documents; and (v) failed to timely search or preserve various laptops and other electronic devices used by key ISN custodians at the time of the Merger. B1022-23; B1036. Discovery also revealed that Eastin had emailed senior management in the run-up to the Merger to instruct them to delete emails related to expressions of interest in ISN by third parties, and ISN's Texas counsel had thanked him for doing so. B2452-54. This delayed the appraisal proceeding by a year as it required a virtual "redo" of ISN's electronic discovery production.

By the fifth motion to compel, the Trial Court found that there had been spoliation of evidence by ISN, due to the destruction of electronic devices used by key ISN custodians at or around the time of the Merger. B1320; B1347-49. Although certain limited fees were shifted in connection with the last three of Petitioners' motions to compel, Polaris has never been compensated for the injury caused by the broader pattern of ISN's conduct in the litigation, and the delay and additional expense it has placed on Polaris.

At trial, Bill Addy dissembled about ISN's conduct in discovery. On redirect, when asked about the aftermath of Petitioner's fourth motion to compel, Bill Addy testified that ISN had "every single computer we had . . . forensically examined." A321. Just minutes later, he was forced to recant that claim, as ISN

"had a whole closet full of computers that nobody went through for purposes of this litigation." *See* A322-23.

Bill Addy's trial testimony was misleading in other respects. For instance, Bill Addy testified that the reason why the ISN Board did not obtain a fairness opinion for the Merger was because they were aware of the prices used in Ad-Venture's sales of ISN stock to Polaris and Gallagher. A280. But that was plainly false: there is no evidence that Bill Addy or Eastin knew those prices, which are not mentioned anywhere in the ISN Board meeting minutes where the Merger was discussed. A538-50; *see* B3105 (Eastin testifying that Youngren declined to share the Polaris Transaction price with Bill Addy and Eastin). Moreover, despite repeatedly testifying that ISN did ***not*** prepare long-term projections, Bill Addy admitted at trial that he had "[p]retty regularly" prepared what he characterized as "personal little valuation scenarios" on his "own little spreadsheet[.]" A316. Those "valuation scenarios" were never produced in this litigation.

F. The Rulings Below

On August 11, 2016, the Trial Court issued its post-trial Letter Opinion ("8/11/16 Opinion") in which it concluded that the fair value of ISN as of the Merger was $357 million, or $98,783 per share—that is, nearly three times the Merger Consideration of $38,317. Op. at 18. Relying exclusively on the DCF valuation method, the Trial Court squarely rejected ISN's claim, as first set forth in

Bill Addy's February 21, 2013 Letter, that the Company's post-Merger switch to GAAP accounting reduced the fair value of ISN, *see* Op. at 14 n.48, and further rejected ISN's attempt to exclude from the valuation approximately $34 million in excess cash sitting on the Company's balance sheet in a "Buyout and Litigation Reserve," *see id.* at 15.

In its post-trial briefing, Polaris had requested that attorneys' fees and expenses be shifted to ISN. In the 8/11/16 Opinion, the Trial Court found that "[i]n the course of preparing this matter for trial, the Petitioners had difficulty securing discovery that should have been forthcoming with minimal effort; ultimately, they were forced to resort to motion practice, and I shifted some fees in this regard to [ISN][.]" Op. at 17. Noting that "the parties here were ultimately able to develop a record sufficient to permit me to determine fair value[,]" the Trial Court directed the parties to confer and inform the Trial Court "whether and to what extent the Petitioners' request to shift fees remains at issue[.]" *Id*. at 17-18.

Polaris and ISN conferred on the issue, but were unable to reach an agreement. Polaris moved for an award of its attorneys' fees, and oral argument on the motion was heard by the Trial Court on December 6, 2016.[5] The Trial Court issued its ruling on the record following the argument. Rearg. Tr. at 27-32.

[5] While Ad-Venture had also requested fee shifting to ISN in its post-trial briefing, it did not join in Polaris's subsequent motion for fee shifting. Ad-Venture was differently situated than Polaris, including that Ad-Venture was not forcibly cashed

The Trial Court held that "[w]here there's bad faith in the conduct of the litigation, it is within the sound discretion of the trial court to shift fees to account for at least two circumstances. One is for harm that that bad faith has caused to the movant, and the other is in recognition of its deterrent effect." *Id.* at 28.

The Trial Court found that Polaris had raised "three categories" here: "One are the pre-suit actions of Mr. [Bill] Addy. The other are the discovery problems. And the third . . . was the trial testimony." *Id.* at 29.

With respect to the trial testimony, the Trial Court found: "The argument is that Mr. Bill Addy's trial testimony engaged in spin, exaggeration and partisanship. I think that it did, but if that were the standard for shifting fees, we would simply have the English rule under which the loser pays." *Id.*

With respect to the "second category" of "discovery violations and spoliation," the Trial Court found: "There was spoliation here. There were violations of the norms under which we must function. Otherwise, we would not be able to achieve justice." *Id.* But, the Trial Court held, "I have already shifted fees with respect to those . . . But I think having already shifted fees for those, I don't need to further address them here." *Id.*

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out in the Merger and the proportionate cost of this appraisal proceeding for Ad-Venture, as the larger shareholder, is dramatically lower than for Polaris. In any event, this was not a basis cited by the Trial Court in its ruling on Polaris's motion.

With respect to the third "category"—"the behavior of [Bill] Addy concerning the potential suit for appraisal"—the Trial Court found that the method of setting the Merger Consideration was "clearly improper." Rearg. Tr. at 29-30. "It didn't make any sense. It was the kind of back-of-the-envelope valuation that cannot satisfy a duty of care for a fiduciary." *Id.* The Trial Court held that "[i]n another case, [the method used to set the price] might be quite telling to me in consideration of a request to shift fees, but I note here that as the case went forward, that Polaris' own expert valuation was two and a half times the ultimate valuation I determined." *Id.* at 31. The Trial Court thus held that "it seems unlikely to me that with the best will in the world, we could have avoided an appraisal action here[.]" *Id.*

The Trial Court noted "other actions taken [by ISN]: The Halloween letter, the change to GAAP, the letter alleging that the change to GAAP would result in a lower DCF to try to discourage allegedly the appraisal action." *Id.* at 30. However, the Trial Court held that, first, ISN's efforts were not "a significant impediment to Polaris valuing its stock because it had just bought it, so I'm sure it had some idea of what it thought that valuation was." *Id.* The Trial Court added:

> Second, even if I accept that those letters and actions were meant to discourage the legitimate pursuit of appraisal, they were unsuccessful. There was an appraisal case. Despite the discovery problems, it did result in a valuation, and it resulted in a valuation that I think returned about 800 percent on the investment made

> shortly before the merger by Polaris.[6] That's not determinative of anything, the amount. . . . But I note that simply there is no direct harm that arose from those letters to Polaris.

Rearg. Tr. at 30-31.

[6] Despite the Trial Court's reference to an "800 percent" return, its valuation actually represents a roughly three-times return on Polaris's initial investment in ISN. Op. at 5, 18.

ARGUMENT

I. THE TRIAL COURT ERRED BY REFUSING TO SHIFT FEES DESPITE FINDING EVIDENCE OF BAD FAITH BY ISN.

A. Question Presented

Did the Trial Court err by refusing to shift attorneys' fees despite its findings that ISN engaged in a pattern of discovery violations, including spoliation; ISN's controlling shareholder offered misleading testimony at trial; ISN's process for the Merger that gave rise to litigation was "clearly improper"; and ISN's controlling shareholder attempted to manipulate and discourage the appraisal decision of the minority shareholders? This issue was preserved in the Trial Court at B0162-65, B0312-13, B1371-90, and B1418-54.

B. Scope of Review

While the decisions of the Court of Chancery on requests for fee shifting are generally reviewed for abuse of discretion, errors in the formulation or application of legal principles by the Trial Court are nevertheless reviewed *de novo*. *See Montgomery Cellular*, 880 A.2d at 227 ("This Court reviews the award or denial of attorneys' fees under exceptions to the American Rule for abuse of discretion."); *Dover Historical Soc'y, Inc. v. City of Dover Planning Comm'n*, 902 A.2d 1084, 1089, 1092 (Del. 2006) (reversing and remanding, in part, denial of application for attorneys' fees under a *de novo* review of the legal principles applied); *see also Alaska Elec. Pension Fund v. Brown*, 988 A.2d 412, 417 (Del. 2010) (denial of

application for attorneys' fees and costs reviewed for abuse of discretion, but the legal principles applied in reaching that decision reviewed *de novo*).

C. Merits of Argument

1. The "Bad Faith" Standard For Fee Shifting.

Delaware follows the "American Rule," which provides that each party is generally expected to pay its own attorneys' fees regardless of the outcome of the litigation. *Shawe v. Elting*, 2017 WL 563180, at *5 (Del. Feb. 13, 2017) (citing *Montgomery Cellular*, 880 A.2d at 227). Delaware courts, however, have the power to shift attorneys' fees where a "losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *Dover Historical Soc'y*, 902 A.2d at 1093-94 (internal quotation marks and citation omitted); *see also Shawe*, 2017 WL 563180, at *5 (citing *Johnston v. Arbitrium (Cayman Islands) Handels AG*, 720 A.2d 542, 545 (Del. 1998)).

"Although there is no single definition of bad faith conduct, courts have found bad faith where parties have unnecessarily prolonged or delayed litigation, falsified records[,] or knowingly asserted frivolous claims." *Shawe*, 2017 WL 563180, at *5 (quoting *Johnston*, 720 A.2d at 546) (discussing the dishonest purpose behind appellant's misconduct in affirming sanctions against him). "Courts have also found bad faith where a party misled the court, altered testimony, or changed his position on an issue." *Id.* (citing *Beck v. Atl. Coast*

PLC, 868 A.2d 840, 851 (Del. Ch. 2005)). "Bad faith implies the conscious doing of wrong because of ***dishonest purpose***." *E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436, 438 (Del. 1996) (emphasis added); *see also In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 64 n.102 (Del. 2006) ("Bad faith . . . implies the conscious doing of a wrong because of dishonest purpose or moral obliquity.") (internal citation omitted).

Recently, in *RBC Capital Markets, LLC v. Jervis*, this Court reiterated that the bad faith "exception is premised on the theory that when a litigant imposes unjustifiable costs on its adversary by bringing baseless claims or by improperly increasing the costs of litigation through other bad faith conduct, shifting fees helps to deter future misconduct and compensates the victim of that misconduct." 129 A.3d 816, 877 (Del. 2015) (internal quotation marks and citation omitted).

This Court has applied the bad faith exception to shift fees in the appraisal context. In *Montgomery Cellular*, this Court reversed the Court of Chancery's denial of fee shifting where the respondent's CEO and controlling shareholder failed to reasonably ascertain fair value, instead setting the merger price unilaterally with no process or protections for the minority. 880 A.2d at 227-29. As this Court held, the controlling shareholder's pre-litigation conduct was relevant to the bad faith inquiry "to show the motive or intent driving that party's conduct during that appraisal litigation." *Id*. at 228. In light of the controlling

shareholder's pre-litigation conduct, offering of false testimony, and the significant discovery delays and spoliation of evidence he caused, this Court held that it was an abuse of discretion for the Court of Chancery to deny the appraisal petitioner's request for fee shifting there. *Id.* at 227-29.

2. The Trial Court's Findings Establish Bad Faith By ISN Before and During the Litigation.

Here, ISN's conduct throughout the litigation reflects the "dishonest purpose" or motive that is the touchstone of bad faith. *See E.I. DuPont de Nemours & Co.*, 679 A.2d at 438. Indeed, ISN's conduct touches all of the bases outlined in *Montgomery Cellular*: a controlling shareholder who squeezed out the minority without any fair process or protections, resulting in an absurdly lower merger price; interfered with a minority shareholder's exercise of appraisal rights; engaged in repeated discovery abuses and spoliation of evidence; and gave dishonest testimony. 880 A.2d at 227-29. That is essentially what the Trial Court found here: ISN in fact engaged in all of this conduct, and it was clearly wrong. *See, e.g.*, Rearg. Tr. at 29 ("There were violations of the norms under which we must function. Otherwise, we would not be able to achieve justice."). Simply put, this is misconduct that rises to the level of bad faith.

The Trial Court nevertheless refused to shift fees to ISN for four reasons: *first*, the Trial Court had previously shifted fees to remedy ISN's discovery abuses; *second*, the testimony of ISN's controlling shareholder, while engaging in "spin,

partisanship and exaggeration," did not go beyond the pale; *third*, ISN's efforts to interfere with ISN's appraisal decision were "unsuccessful;" and *fourth*, Polaris could have remedied ISN's misconduct in setting the Merger Consideration through a separate breach of fiduciary claim. As set forth below, each of these reasons were in error, and each warrants reversal. *See infra* § C3-6.

3. The Trial Court's Prior, Limited Fee Shifting Does Not Preclude Further Fee Shifting Based on ISN's Discovery Misconduct.

The Trial Court recognized that ISN had engaged in spoliation and numerous other "violations of the norms under which we must function" in discovery. Rearg. Tr. at 29. But the Trial Court rejected this as a basis to shift fees solely because the Trial Court had previously shifted a portion of the fees incurred by Petitioners in connection with their last three motions to compel. *Id.* The Court held: "It may be that given my current frustration with other issues of spoliation in other matters, I might, if this were repeated, do more. But I think having already shifted fees for those, I don't need to further address them here." *Id.* This was legal error for at least two reasons.

First, Polaris did not seek a double recovery for fees that were previously shifted in connection with certain of the motions to compel. Any previously-shifted fees were excluded from Polaris's post-trial fee application. In any event, the earlier shifting of fees in connection with a motion to compel does not preclude the later shifting of other fees incurred by a party based on the totality of a party's

bad faith conduct, as courts have repeatedly held. *See Preferred Invs., Inc. v. T & H Bail Bonds*, 2014 WL 1292362, at *4-5 (Del. Ch. Mar. 25, 2014) (shifting attorneys' fees post-trial for bad faith considering the totality of the litigation, after previously shifting attorney fees on motion to compel); *Creative Research Mfg. v. Advanced Bio-Delivery LLC*, 2007 WL 286735, at *11 (Del. Ch. Jan. 30, 2007) (shifting attorneys' fees for bad faith after shifting limited fees on three prior occasions); *James v. Nat'l Fin., LLC*, 2016 WL 3226434, at *2-4 (Del. Ch. June 3, 2016) (shifting attorneys' fees post-trial after previously imposing sanctions for discovery violations).

Second, Polaris sought to shift attorneys' fees based on the broader pattern of ISN's misconduct in discovery, which extends far beyond the particular motions to compel for which limited fees were shifted. The previous fee shifting was limited to the expenses incurred in bringing those motions, and did not address the totality of ISN's discovery abuses, which included, among other things: failing to institute a written litigation hold; allowing ISN's controlling shareholder to conduct and manage electronic discovery (which ultimately required ISN to redo its document production and delayed the case by a year); and failing to preserve laptops and other electronic devices used by key ISN custodians. This broader pattern of bad faith and misconduct resulted in significant delays and expenses for Polaris. The Trial Court's unwillingness to address this broader pattern—and its

holding that its previous shifting of limited fees precluded further fee shifting for ISN's discovery violations—was legal error. *See Preferred Invs.*, 2014 WL 1292362, at *4-5; *Creative Research*, 2007 WL 286735, at *11; *James*, 2016 WL 3226434, at *2-4.

4. The Misleading Testimony of ISN's Controlling Shareholder Was Far Outside the Norm and Further Justifies Fee Shifting.

The Trial Court agreed that Bill Addy's trial testimony "engaged in spin, exaggeration and partisanship[,]" but held: "if that were the standard for shifting fees, we would simply have the English rule under which the loser pays." Rearg. Tr. at 29. That is incorrect, and the Trial Court's dismissal of Bill Addy's misleading testimony was an abuse of discretion.

Bill Addy's testimony went beyond a simple shading of the truth: he falsely claimed that ISN did not obtain a fairness opinion for the Merger because he knew the prices paid by Polaris and Gallagher for their ISN stock, when the record is clear that he did not know the prices for those transactions. He falsely claimed that ISN had "forensically examined" every computer after Petitioners uncovered damning evidence of spoliation, when in fact there were numerous devices that nobody at ISN ever searched. And he falsely claimed that ISN did not create projections, when in fact he created his own projection scenarios regularly. This is not acceptable behavior by a witness. *See Shawe*, 2017 WL 563180, at *6 (imposing sanctions for "falsehoods" that "wasted the court's time, needlessly

complicated and expanded the proceedings, and caused the court to find erroneous facts in its Merits Opinion"). The Trial Court's rationale for condoning such behavior was that shifting fees here would lead to fee shifting in ***every*** case, but Polaris is not arguing that fee shifting is appropriate in every case; only those cases where, as here, a party engages in a broad pattern of bad faith that includes misleading testimony. Such conduct is far outside the norm and must be deterred; by refusing to shift fees for such conduct, the Trial Court abused its discretion. *See Montgomery Cellular*, 880 A.2d at 228-29.

5. ISN's "Clearly Improper" Merger Process and Its Intentional Interference With Polaris's Appraisal Decision Further Justifies Fee Shifting.

As this Court held in *Montgomery Cellular*, a controlling shareholder's pre-litigation conduct is relevant to the bad faith inquiry "to show the motive or intent driving that party's conduct during that appraisal litigation." *Id.* at 228. Here, the Trial Court found that the method of setting the Merger Consideration was "clearly improper . . . the kind of back-of-the-envelope valuation that cannot satisfy a duty of care for a fiduciary." Rearg. Tr. at 30. The Trial Court also noted the evidence of ISN's intentional interference with Polaris's appraisal decision, including Bill Addy's false and misleading "Halloween Letter" and his "letter alleging that the change to GAAP would result in a lower DCF to try to discourage allegedly the appraisal action." *Id.* Despite this record, the Trial Court denied fee shifting for three reasons, each of which fails as a matter of law.

First, the Trial Court held that ISN's actions to interfere with Polaris's appraisal decision were not "a significant impediment to Polaris valuing its stock because [Polaris] had just bought it, so I'm sure it had some idea of what it thought that valuation was." *Id.* In other words: a controlling shareholder can mislead a minority shareholder with the information he provides with the notice of merger and appraisal rights, and he can then lie to that minority shareholder to pressure it to drop an appraisal demand, so long as that minority shareholder has "some idea" of what it thinks the Company might be worth. That cannot be the correct standard, and indeed it is not: it is the ***controlling shareholder***, who controls the company and all of its information, who has a duty under Delaware law to provide full and accurate information to a minority shareholder who is considering whether to seek appraisal. *See Glassman v. Unocal Expl. Corp.*, 777 A.2d 242, 248 (Del. 2001) (minority stockholders considering appraisal "must be given all the factual information that is material to that decision"); *see also Erickson v. Centennial Beauregard Cellular, LLC*, 2003 WL 1878583, at *5 (Del. Ch. Apr. 11, 2003) (noting that "a forced seller with the exclusive options of accepting an offered price or seeking a higher price through an appraisal remedy is if anything, . . . a more compelling case for the application of the recognized disclosure standards") (internal quotation marks and citations omitted).

There can be no mistaking the dishonest purpose behind Bill Addy's interference with Polaris's appraisal decision: to change the cost-benefit analysis for Polaris, forcing Polaris to rethink its potential recovery and weigh that against the substantial cost of litigating a protracted appraisal case against ISN. Even if Polaris had "some idea" of what it believed its ISN stock to be worth, ISN's interference with Polaris's decision-making is bad faith conduct that must be deterred. *See Montgomery Cellular*, 880 A.2d at 227-29.

Second, the Trial Court held that even if it were to accept that ISN's letters and actions were meant to discourage the legitimate pursuit of appraisal, "they were unsuccessful." Rearg. Tr. at 30-31. "There was an appraisal case. Despite the discovery problems, it did result in a valuation . . . ." *Id.* at 31.

But that is not the law in Delaware. There is no requirement that a party "succeed in his efforts to thwart [the other party's] ability to prosecute the merits of the case for the Court of Chancery to have the power to sanction him." *Shawe*, 2017 WL 563180, at *5. In *Shawe*, for example, this Court upheld the Court of Chancery's award of attorneys' fees when the deletion of certain computer files "prejudiced [the moving party's] ability to litigate effectively" even though the vast majority of the files were ultimately recovered prior to trial. *Id*. Similarly, in *Montgomery Cellular*, the minority shareholders persevered with their appraisal action despite the controlling shareholder's misconduct, and the court was

ultimately able to reach a determination of fair value. 880 A.2d at 227-29. In short, the fact that ISN did not "successfully" deter Polaris from seeking appraisal, and the fact that the Trial Court was able to conduct a valuation, does not preclude the shifting of attorneys' fees to ISN here.

Indeed, the Trial Court's holding would undermine the purpose of the bad faith exception: to deter wrongdoing and compensate victims. It would mean, in effect, that a controlling shareholder is permitted to act in bad faith as long as the minority shareholder has the means and stamina to continue to pursue the appraisal action despite the controlling shareholder's bad faith conduct. Under the Trial Court's ruling, gamesmanship would become part of the process, increasing both costs and risks for appraisal petitioners, who are already at the mercy of the controlling shareholder for information about the company. Future minority shareholders may not have the means to front the millions of dollars and endure years of litigation to get to a determination of fair value—even where, as here, fair value is nearly three times what the controlling shareholder offered in the merger.

Third, the Trial Court held that ISN's "clearly improper" method of setting the Merger Consideration, which "didn't make any sense," "[i]n another case, . . . might be quite telling to me in consideration of a request to shift fees," but concluded that there was no avoiding an appraisal action here because Polaris pursued an expert valuation that was "two and a half times the ultimate valuation I

determined." Rearg. Tr. at 29-30, 31. There is, however, no equivalence between the bad-faith, self-serving, low-ball price offered by Bill Addy to Polaris, and the expert valuation offered by Polaris at trial. The unfair price offered by ISN in the Merger set this appraisal litigation in motion, and it was part of the broader pattern of bad faith by ISN and Bill Addy. That Polaris's expert valuation—submitted years later in the course of discovery—exceeded the Trial Court's valuation does not change those facts, and is no reason to deny fee shifting here.

6. Polaris Did Not Waive Its Right To Seek Attorneys' Fees By Declining To Bring a Fiduciary Duty Claim.

The Trial Court suggested that ISN's misconduct in connection with setting the Merger price could have been remedied through a breach of fiduciary duty claim, instead of a post-trial motion to shift fees. Specifically, the Trial Court asked whether Bill Addy's misconduct "was bad faith of a kind that could be remedied not simply by a suit alleging that there had been a breach of fiduciary duty which—was eschewed here—but that needs to be remedied post-trial[.]" Rearg. Tr. at 30. But there is no rule that says that an appraisal petitioner who declines (for whatever reason) to bring a fiduciary duty claim somehow waves its right to seek fee shifting for a party's bad faith prior to and during the appraisal litigation. Nor is there a rule that a successful fiduciary duty plaintiff will recover its attorneys' fees. Fiduciary duty claims and fee shifting are separate, independent

remedies that protect distinct interests, and the Trial Court erred by conflating the two. Again, this was no reason to deny fee shifting here.

* * *

There is one final flaw in the Trial Court's legal reasoning. It is well established that a court must "evaluate[ ] ***the totality of a party's misconduct*** to determine whether the party litigated in bad faith and to determine the amount of fees to award." *In re Shawe & Elting LLC*, 2016 WL 3951339, at *19 (Del. Ch. July 20, 2016) (emphasis added), *aff'd*, *Shawe v. Elting*, 2017 WL 563180 (Del. Feb. 13, 2017) (citing *ATR-Kim Eng Fin. Corp. v. Araneta*, 2006 WL 3783520, at *22 (Del. Ch. Dec. 21, 2006), *aff'd sub nom. Araneta v. Atr-Kim Fin. Corp.*, 930 A2d 928 (Del. 2007)); *see also In re Carver Bancorp, Inc.*, 2000 WL 1336722, at *4 (Del. Ch. Aug. 28, 2000) (requiring the court to "examine the totality of circumstances") (internal quotation marks & citation omitted); *see also Choupak v. Rivkin*, 2015 WL 1589610, at *23 (Del. Ch. Apr. 6, 2015), *aff'd*, 129 A.3d 232 (Del. 2015) (holding that the "pervasive nature of [defendant's] conduct warrants shifting all of the attorneys' fees and expenses that [plaintiff and counterclaim defendants] incurred").

Here, the numerous examples of ISN's misconduct—the manipulation of the Merger price; the bullying of a minority shareholder weighing its appraisal decision; the serial discovery violations; and the misleading testimony—form a

broad pattern of bad faith by ISN, designed to drive the minority out at the lowest price and make this appraisal litigation as costly as possible. By considering each "category" of misconduct separately—and deeming each insufficient, standing alone, to support fee shifting—the Trial Court minimized the impact of each category and failed to consider the totality of ISN's misconduct before and throughout this appraisal litigation. As set forth above, the Trial Court's reasoning with respect to each category of misconduct does not withstand scrutiny, and those are sufficient grounds to reverse the ruling below. The Trial Court's failure to evaluate the ***totality*** of ISN's misconduct simply reinforces that conclusion.

CONCLUSION

For the foregoing reasons, the Trial Court improperly denied Polaris's post-trial request to shift attorneys' fees and expenses to ISN under the bad faith exception to the American Rule. Accordingly, Polaris respectfully requests that this Court reverse and vacate the Trial Court's rulings on Polaris's request to shift attorneys' fees and expenses, and remand this action to the Court of Chancery with instructions to award reasonable attorneys' fees and expenses to Polaris.

OF COUNSEL:

Anthony S. Fiotto
William B. Brady
GOODWIN PROCTER LLP
100 Northern Avenue
Boston, MA 02210
(617) 570-1000

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/s/ John M. Seaman
John M. Seaman (#3868)
Matthew L. Miller (#5837)
ABRAMS & BAYLISS LLP
20 Montchanin Road, Suite 200
Wilmington, Delaware 19807
(302) 778-1000

Attorneys for Petitioners-Below, Appellees and Cross-Appellants Polaris Venture Partners VI, L.P. and Polaris Venture Partners Founders' Fund VI, L.P.

CERTIFICATE OF SERVICE

I, John M. Seaman, hereby certify that on April 20, 2017, my firm caused true and correct copies of the foregoing *Public Version of Polaris Petitioners Corrected Answering Brief and Opening Brief on Cross-Appeal* to be served upon the following counsel of record by File & Serve*Xpress*:

Raymond J. DiCamillo
Kevin M. Gallagher
RICHARDS, LAYTON & FINGER, P.A.
920 North King Street
Wilmington, DE 19801

Jon E. Abramczyk
John P. DiTomo
Matthew R. Clark
Zi-Xiang Shen
MORRIS, NICHOLS, ARSHT & TUNNELL LLP
1201 North Market Street
Wilmington, DE 19801

/s/ John M. Seaman
John M. Seaman (#3868)