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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

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' REPLY BRIEF ON CROSS-APPEAL

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INTRODUCTION[1]

In Cross-Appellee ISN Software Corporation's ("ISN")[2] Reply Brief on Appeal and Answering Brief on Cross-Appeal ("ISN Answering Brief" or "ISN Ans. Br."), ISN does not dispute any of the extensive evidence of bad faith cited by the Trial Court and set forth by Polaris in its opening brief on cross-appeal ("Polaris Opening Brief" or "Polaris Op. Br."). ISN's statement that it "will not burden this Court with rebutting each attack," should not fool anyone: ISN does not explain its conduct leading up to and throughout this litigation—conduct that the Trial Court described as "***clearly improper***," and ***"violations of the norms under which we must function***"—because there is no good explanation.

ISN nevertheless argues that the Trial Court's "decision not to shift fees . . . fell comfortably within the established Delaware jurisprudence." That is incorrect. ISN's attempt to distinguish *Montgomery Cellular Holding Co. v. Dobler*, 880 A.2d 206 (Del. 2005), only underscores the striking resemblance between the facts of that case and those presented here. As Polaris demonstrated in its Opening Brief, the Trial Court declined to shift fees based on legal reasoning that was

[1] Petitioners Polaris Venture Partners VI. L.P. and Polaris Venture Partners Founders' Fund VI, L.P. (together "Polaris") join in Appellees / Cross-Appellants' Reply Brief on Cross Appeal filed by Ad-Venture Capital Partners, L.P. ("Ad-Venture"), and incorporate by reference all of the points and arguments set forth therein.

[2] Unless otherwise defined, the capitalized terms used herein have the meaning ascribed to them in the Polaris Opening Brief.

flawed in several respects. ISN never addresses any of these legal flaws, and instead recites the Trial Court's transcript ruling and leaves it at that. As Polaris has shown, each of these flaws constitutes an abuse of discretion or error of law, and each warrants reversal of the Trial Court's denial of fee shifting.

ARGUMENT

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

A. ISN Does Not Rebut Any Of The Evidence Of Bad Faith Outlined In Polaris's Opening Brief.

ISN does not seriously dispute or rebut any of the evidence of bad faith detailed in Polaris's Opening Brief. *See* Polaris Op. Br. at 9-24.[3] ISN argues instead that the Trial Court "considered and properly rejected" this evidence, and that the Trial Court's ruling "fell comfortably within the established Delaware jurisprudence." ISN Ans. Br. at 32, 34. Not so.

The parties agree that this Court's decision in *Montgomery Cellular* is front and center here, but ISN's attempt to distinguish the case backfires. *See id.* at 35.

ISN states that *Montgomery Cellular* featured an instance where the company's controller "set a merger price that 'was not based on any legitimate valuation of' the company." *Id.* (citing 880 A.2d at 228). Same here, as the Trial

[3] ISN devotes just one paragraph in its Answering Brief to this evidence, arguing that "Polaris litters its brief with inaccurate recitations of the trial record." ISN Ans. Br. at 36. That is false. First, ISN claims that the self-serving ISN Board minutes from the "meeting in which the ISN Board approved the Merger . . . demonstrate that ISN's Board was not trying to freeze Ad-Venture." *Id.* But Bill Addy himself admitted at trial that the merger had been structured to keep Ad-Venture locked in place and unaffected—and that he was shocked to learn after the fact that ISN had inadvertently triggered Ad-Venture's right to seek appraisal. A318-19. Second, ISN attempts to dismiss Bill Addy's false and misleading GAAP letter on the grounds that Polaris generally preferred to invest in companies with GAAP financials. But that misses the issue: the GAAP letter was false and misleading, and was admittedly sent to interfere with Polaris's appraisal decision.

Court found. *See* Rearg. Tr. 29-30 (finding controller's method of setting the Merger Consideration was "clearly improper. 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").

ISN states that in *Montgomery Cellular* the company "admitted that it destroyed . . . computers *after* the Court of Chancery had ordered their production." ISN Ans. Br. at 35 (citing 880 A.2d at 229 (emphasis in original)). The Trial Court found evidence of destroyed computers here as well, on top of a litany of other discovery abuses by ISN including the deliberate and targeted destruction of emails related to expressions of interest by third parties. *See* Rearg. Tr. 29. ("There was spoliation here. There were violations of the norms under which we must function. Otherwise, we would not be able to achieve justice."); *see also* Polaris Op. Br. at 18-19 (detailing, *inter alia*, how ISN failed to issue a written document hold; failed to suspend its document destruction policy; permitted Bill Addy to personally conduct ISN's electronic document collection; never interviewed ISN custodians about their documents; and failed to timely search or preserve various devices used by key ISN custodians at the time of the Merger).[4]

[4] ISN also emphasizes that the destruction described in *Montgomery Cellular* took place after the court ordered production. ISN Ans. Br. at 35. However, the timing of the destruction does nothing to rebut ISN's bad faith

ISN states that *Montgomery Cellular* featured a controller who "testified falsely." ISN Ans. Br. at 35. That is the case here as well. *See* Rearg. Tr. at 29 (Bill Addy "engaged in spin, exaggeration and partisanship"). 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 finding documents for this litigation." A322. Bill Addy also 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, even though the record is clear that neither Bill Addy nor Eastin knew those prices and, what is more, the prices are not mentioned anywhere in the ISN Board meeting minutes where the Merger was discussed. A280. Bill Addy admitted at trial that he had "[p]retty regularly" prepared "personal little valuation scenarios" on his "own little spreadsheet" even though he repeatedly testified that "[w]e don't prepare long-term financial projections." A314-16.

Lastly, ISN states that *Montgomery Cellular* featured an expert witness that "'developed his expert testimony' to fit into a 'predetermined valuation figure,'"

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conduct, and the Trial Court recognized this by finding that ISN committed "violations of the norms under which we must function." Rearg. Tr. at 29. *See also Beard Research, Inc. v. Kates*, 981 A.2d 1175, 1185-86 (Del. Ch. May 29, 2009) (holding that a "party in litigation or who has reason to anticipate litigation has an affirmative duty to preserve evidence that might be relevant to the issues in the lawsuit" and that a "court may sanction a party who breaches this duty").

and offered testimony that was "fatally flawed." ISN Ans. Br. at 35 (citing 880 A.2d at 229). Same here. *See, e.g.*, Polaris Op. Br. at 12, 15, 20; *see also* Ad-Venture Br. at 23-24 (ISN's expert adopted an unreasonable valuation that was even lower than the 2011 Phalon Valuation that was manipulated by ISN's controller by, among other things, directing the appraiser to lower projected revenue and earnings). In fact, the difference between the Merger consideration and the Trial Court's conclusion of fair value, expressed as a multiple of the Merger consideration, is even greater in this case than in *Montgomery Cellular*. *Cf.* 880 A.2d at 210. In short, ISN's conduct touches all of the bases of bad faith outlined in *Montgomery Cellular*. This is clear evidence of ISN's bad faith, and it supports fee shifting here. *See* Polaris Op. Br. at 28-29.

ISN's attempt to distinguish *In re Shawe & Etling LLC*, 2016 WL 3951339 (Del. Ch. July 20, 2016), is likewise unavailing. *See* ISN Ans. Br. at 35-36. The Court of Chancery in *Shawe & Etling* pointed to several categories of conduct as evidencing bad faith, including the plaintiff's attempt to delete data on his laptop, his failure to safeguard evidence on his iPhone, and subsequent misstatements concerning this conduct. 2016 WL 3951339, at *19. In shifting fees there, the Chancellor described plaintiff's behavior as the "epitome of subjective bad faith" and noted that the conduct "needlessly complicated the litigation." *Id.* And in affirming the Chancellor's ruling, the Delaware Supreme Court made clear that

"there is no single definition of bad faith conduct." *Shawe v. Etling*, 2017 WL 563180, at *5 (Del. Feb. 13, 2017). ISN's behavior here rises to that level, as ISN engaged in a similar pattern of discovery abuses and spoliation that left the Trial Court to conclude that "[t]here were violations of the norms under which we must function." Rearg. Tr. at 29.

B. ISN's Answering Brief Ignores The Legal Errors In The Trial Court's Fee Ruling.

In its Answering Brief, ISN ignores the legal errors identified by Polaris in the Trial Court's decision not to shift fees to ISN, each of which warrants reversal of the ruling below. *See* Polaris Op. Br. at 28-38. ISN offers no analysis in response, instead falling back on block quotes from the Trial Court's ruling that end up missing the point.

First, the Trial Court erred in refusing to shift fees to ISN because of prior limited fee shifting in connection with certain discovery motions. *See* Polaris Op. Br. at 29-31. In response, ISN states only that "[h]aving already shifted fees twice, the Trial Court's decision not to shift fees again fell comfortably within established Delaware jurisprudence." ISN Ans. Br. at 34. But none of the cases cited by ISN address the shifting of fees based on a pattern of discovery abuses, much less do these cases even suggest that prior fee shifting in connection with specific motions to compel somehow precludes post-trial fee shifting. *See RBC Capital Mkts., LLC v. Jervis*, 129 A.3d 816, 876-79 (Del. 2015) (analyzing fee shifting based on the

financial advisor's conflicts without any discussion of alleged discovery abuses or previous fee shifting); *see Lawson v. State*, 91 A.3d 544, 552 (Del. 2014) (analyzing fee shifting based on the trial court's holding that the State had violated the Real Property Acquisition Act without any discussion of alleged discovery abuses or previous fee shifting).

In fact, Delaware courts have repeatedly held that earlier shifting of fees in connection with a motion to compel does ***not*** preclude the later shifting of fees. *See* Polaris Op. Br. at 29-30, citing, *inter alia*, *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). Here, the previous fee shifting was limited to expenses incurred in connection with three of the five motions to compel brought by Petitioners, and did not address the totality of ISN's conduct throughout this case. *See* Polaris Op. Br. at 18-20, 29-31.

Second, the Trial Court abused its discretion by dismissing Bill Addy's misleading testimony, despite finding that he had "engaged in spin, exaggeration and partisanship." *See* Polaris Op. Br. at 31-32 (citing Rearg. Tr. at 29). ISN accuses Polaris of making "(unfortunately) unwarranted personal attacks on Bill Addy;" claims that these (unspecified) "inflammatory statements do nothing to demonstrate that the Trial Court abused its discretion;" and declares that ISN "will

not burden this Court with rebutting each attack." *See* ISN Ans. Br. at 37. It is no surprise that ISN would prefer not to address Bill Addy's testimony, which 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. Polaris Op. Br. at 31. This is clear evidence of bad faith that must be deterred; the Trial Court abused its discretion by refusing to shift fees in the face of such conduct. *Id.* at 32.

Third, the Trial Court erred in dismissing ISN's "clearly improper" Merger process because it was not "a significant impediment to Polaris valuing its stock." Polaris Op. Br. at 32-34 (citing Rearg. Tr. at 30). ISN does not even try to defend the Merger process. Instead, ISN argues that the bad faith exception does not apply to conduct that gives rise to the substantive claim itself and that "the process used by ISN's board of directors to effectuate the Merger and the value paid in connection with the Merger cannot provide the basis necessary to shift fees." ISN Ans. Br. 34-35. That is incorrect. *See Montgomery Cellular*, 880 A.2d at 228

(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").

Fourth, the Trial Court erred in holding that even if ISN's letters and actions were meant to discourage the legitimate pursuit of appraisal, Polaris's fee request must be denied because ISN's efforts "were unsuccessful." *See* Polaris Op. Br. at 34 (quoting Rearg. Tr. 30-31). The Trial Court specifically identified evidence of ISN's intentional interference with Polaris's appraisal decision, including Bill Addy's false and misleading "Halloween Letter" and his February 21, 2013 "letter alleging that the change to GAAP would result in a lower DCF to try to discourage allegedly the appraisal action." Rearg. Tr. at 30. That is evidence of bad faith, plain and simple, and it is sufficient to warrant fee shifting. It is not the law in Delaware that a party must "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 & Etling*, 2017 WL 563180, at *5. ISN addresses none of this in its brief.

Moreover, ISN misses the issue related to its February 21, 2013 letter. *See* ISN Ans. Br. at 37 (arguing that it is "unclear how the provision of financial statements prepared in accordance with GAAP could deter Polaris"). It was the timing of ISN's sudden restatement (coming within weeks of Polaris's appraisal

demand), the false statements in Bill Addy's letter that accompanied it (falsely claiming that the switch to GAAP "will reduce the DCF value of ISN" and that "the Deferred Revenue Liability will eliminate any excess cash"), and the intention behind it (Bill Addy admitted he sent the GAAP letter in hopes that "that Polaris would change their mind and accept the merger consideration"), that provide clear evidence of ISN's bad faith. *See* Polaris Op. Br. at 14. Again, ISN concedes all of these facts.[5]

Fifth, the Trial Court erred in holding 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. Polaris Op. Br. at 36-37. There is no rule that says that an appraisal petitioner who declines to bring a fiduciary duty claim waives its right to seek fee shifting for a party's bad faith prior to and during an appraisal action. *Id.* Nor is there a rule that says that a successful plaintiff in a fiduciary duty action is entitled to fee shifting. Fiduciary duty claims and fee shifting are separate, independent remedies that protect

[5] It was also legal error for the Trial Court to refuse to shift fees because Polaris pursued an expert valuation that was "two and a half times the ultimate valuation [the Trial Court] determined." Polaris Op. Br. at 35-36. The expert valuation submitted by Polaris during the course of the appraisal action had no relation to the bad faith exhibited by ISN and its controlling shareholder in setting the Merger consideration or their attempt to interfere with Polaris's appraisal decision. Again, ISN does not argue otherwise in its Answering Brief.

different interests. *Id.* ISN does not even attempt to defend the Trial Court's legal reasoning here.

C. ISN's Remaining Arguments Are Unpersuasive.

ISN contends that Polaris's request must fail because Polaris does not explain why it is entitled to all of its attorneys' fees and costs. That is false. The affidavits submitted by Polaris in support of its fee request were consistent with Chancery Court Rule 88. ISN also never argued before the Trial Court that the affidavits were insufficient or that only a portion of Polaris's fees should be shifted. This is a new argument that ISN is raising for the first time on appeal and is accordingly waived. *See* Del. Sup. Ct. R. 8; *see also Clark v. Clark*, 47 A.3d 513, 518 (Del. 2012).[6]

Moreover, this Court has held that in cases where fees have been shifted because of a party's bad faith, the victim of such bad faith conduct is not required to parse out the specific fees incurred because of this behavior. *Johnston v. Arbitrium (Cayman Islands) Handels AG*, 720 A.2d 542, 546-47 (Del. 1998) (rejecting Defendant's requests for further discovery to determine if the fees claimed by petitioner and his attorneys were reasonable). This was exactly the argument recently rejected in *Shawe & Etling*, 2017 WL 563180. There the

[6] In any event, to the extent this Court entertains ISN's new and waived argument, Polaris is prepared to provide any additional information regarding its fee application that the Trial Court requires upon remand.

respondent argued that the petitioner did not "submit a shred of evidence of how she incurred additional fees . . . by the limited misconduct found." *Id*. at *7. In affirming shifting of fees due to the misconduct, the Court of Chancery awarded the petitioner all of her attorneys' fees related to the litigation of the sanctions motion and found it appropriate to further sanction respondent for the "bad-faith misconduct [that] significantly complicated and permeated the litigation of the Merits Trial" by awarding petitioner "33% of the fees she incurred from litigating the merits of the case." *Id*. at *4, 7. The Delaware Supreme Court affirmed the ruling holding that because of the deterrent rationale, a broader set of fees can be shifted. *Id*. at *7. In any event, that is no basis for the outright denial of Polaris's fee request.

Finally, ISN argues that "it is noteworthy" that Ad-Venture decided not to move for reargument or appeal the Trial Court's denial of fee shifting, but never explains why. ISN Ans. Br. at 31-32. In fact, this is just another red-herring: it has nothing to do with the merits of Polaris's fee request, nor was it a basis cited by the Trial Court in its ruling below. In any event, Ad-Venture was differently situated than Polaris. Polaris Op. Br. at 18 n.5. None of this should distract from the clear evidence of bad faith here, or the legal errors that resulted in the Trial Court's denial of Polaris's fee request.

CONCLUSION

For the foregoing reasons, and for all the reasons stated in Polaris's Opening Brief, this Court should reverse and vacate the Trial Court's ruling on Polaris's request to shift attorneys' fees and expenses, and remand this action to the Court of the Chancery with instructions to award reasonable attorneys' fees and expenses to Polaris.

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