EFiled: May 17 2019 12:47PM EDT
Filing ID 63275972
Case Number 81,2019

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JEFFEREY J. SHELDON and ANDRAS KONYA, M.D., P.H.D., Plaintiffs Below-Appellants, PINTO TECHNOLOGY VENTURES, L.P., PINTO TV ANNEX FUND, L.P., PTV SCIENCES II, L.P., RIVERVEST VENTURE FUND I, L.P., RIVERVEST VENTURE FUND II, L.P., RIVERVEST VENTURE FUND II (OHIO), L.P., BAY CITY CAPITAL FUND IV, L.P., BAY CITY CAPITAL FUND IV CO-INVESTMENT FUND, L.P., REESE TERRY and CRAIG WALKER, M.D., Defendants Below-Appellees.	)	No.: 81, 2019 APPEAL FROM THE COURT OF CHANCERY OF THE STATE OF DELAWARE, C.A. No. 2017-0838-MTZ

APPELLEES' CORRECTED ANSWERING BRIEF

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Dated: May 17, 2019

TABLE OF CONTENTS

TABLE OF CITATIONS

Page(s)

CASES

RULES

STATUTES

NATURE OF PROCEEDINGS

The trial court correctly dismissed Plaintiffs' action after concluding that the Stockholder Defendants (defined below) did not constitute a control group because Plaintiffs' conclusory allegations failed to demonstrate the Stockholder Defendants were connected in any legally significant way with respect to approval of the transactions challenged by Plaintiffs.

Plaintiffs are two early stage stockholders in IDEV Technologies, Inc. ("IDEV") who sued later equity investors and certain IDEV directors alleging that a July 2010 investment round had substantially diluted their equity holdings and that, but for that dilution, they would have made millions when IDEV was purchased by Abbott Laboratories three years later in 2013.

Plaintiffs initially sued in Texas state courts but, after the Texas Supreme Court enforced forum selection clauses in the IDEV shareholders agreement (the "Shareholders Agreement"), Plaintiffs filed their initial Verified Complaint (the "Original Complaint") in the Delaware Court of Chancery on November 21, 2017. All Defendants moved to dismiss the Original Complaint. Plaintiffs then filed their Amended Verified Complaint (the "Amended Complaint") on May 30, 2018. Defendants moved to dismiss the Amended Complaint. The motions to dismiss were fully briefed and argued to the lower Court at a hearing on November 1, 2018.

On January 25, 2019, in a well-reasoned 40-page Memorandum Opinion (the "Opinion" or "Op."), the trial court dismissed all of Plaintiffs' claims with prejudice. Plaintiffs timely noticed an appeal to this Court on February 2, 2019. On April 11, 2019, Plaintiffs filed their Opening Appeal Brief.

This is the Answering Brief of Pinto Technology Ventures, L.P., Pinto TV Annex Fund., L.P., PTV Sciences II, L.P. (together, "PTV"); RiverVest Venture Fund I, L.P., RiverVest Venture Fund II, L.P., RiverVest Venture Fund II (Ohio), L.P. (together, "RiverVest"); and Bay City Capital Fund IV, L.P., Bay City Capital Fund IV Co-Investment Fund, L.P. (together, "Bay City" and collectively with PTV and RiverVest, the "Stockholder Defendants").

SUMMARY OF ARGUMENT

1. Denied. The trial court correctly determined that Plaintiffs failed to adequately plead, either in the Amended Complaint or documents properly attached to the Amended Complaint, the existence of a control group of stockholders controlling IDEV. Therefore, The trial court properly held that Plaintiffs' claims are derivative and not direct claims under *Gentile v. Rossette.* And because Plaintiffs failed to make a demand on the IDEV board of directors, failed to plead demand futility, and exchanged their IDEV shares for cash in the IDEV merger with Abbott, the trial court properly dismissed Plaintiffs' claims under Court of Chancery Rule 23.1.

2. Alternatively, dismissal of the Plaintiffs' claims should be affirmed because the Stockholder Defendants, as non-controlling stockholders, owed no fiduciary duties to Plaintiffs.

STATEMENT OF FACTS

A. BACKGROUND INFORMATION

Plaintiff Jeffrey Sheldon and Andras Konya are former stockholders in IDEV.[1] IDEV was "a developer and manufacturer of medical devices used in connection with interventional radiology, vascular surgery and interventional cardiology."[2] IDEV was founded in 1999 and was sold to Abbott Laboratories in August 2013 for approximately $310 million.[3]

Defendants include the Stockholder Defendants, all of which participated in a July 2010 round of equity financing in IDEV (the "July 2010 Financing").[4] Defendants also include co-defendants Reese Terry and Craig Walker, two of IDEV's directors in July of 2010.[5]

Plaintiffs' claims arise exclusively from the July 2010 Financing. Plaintiffs allege that, before the July 2010 Financing, Sheldon owned approximately 2.5%,

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[1] A24-25. Plaintiffs' Amended Complaint is at A22-41. The factual allegations set out herein are, unless otherwise specified, taken from the Amended Complaint. In the instances where Plaintiffs attempt to embellish the factual allegations in their Amended Complaint with allegations made for the first time in their Combined Answering Brief in Response to Defendants' Motions to Dismiss Plaintiffs' Verified Amended Complaint ("Answering Brief"), those factual allegations will be appropriately identified.

[2] A24.

[3] A27, A34-35.

[4] A28 at ¶20.

[5] A25 at ¶¶ 9-10. Plaintiffs define the term "Defendants" to include Pinto Technology, RiverVest, Bay City, Reese Terry ("Terry") and Craig Walker, M.D. "Walker" and Terry and Walker, together, the "Independent Directors").

and Konya owned approximately 1.25%, of IDEV's stock, but that, as a result of the July 2010 Financing, their combined holdings were diluted so that they amounted to "less than 0.012% of the Company's outstanding shares."[6]

Plaintiffs allege that Sheldon founded IDEV and served as its Chief Executive Officer until 2008.[7] Konya did consulting work for IDEV, primarily from 2000 to 2006.[8] Both received common stock early in IDEV's existence, and Sheldon also acquired a small amount of early preferred stock.[9] Plaintiffs never made any subsequent investment in IDEV.

The Stockholder Defendants provided capital to IDEV in exchange for equity, so that, by 2010, they had acquired "substantial holdings of IDEV preferred stock and collectively controlled over 60% of the Company's issued and outstanding shares."[10]

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[6] A30-31 at ¶¶ 27, 28.
[7] A27 at ¶ 17.
[8] A27 at ¶ 18.
[9] *Id.*
[10] A29 at ¶ 23. Plaintiffs omit from their allegations that the Stockholder Defendants paid tens of millions of dollars for their stock in IDEV. "Several of the amendments to the shareholders agreement coincided with financing required for IDEV's growth and solvency. Series A Financing in 2004 raised approximately $1.8 million; Series B in 2006 raised $24 million; and Series C in 2008 raised an additional $25 million. These transactions diluted the Shareholders' interests over time without any apparent dispute." *Pinto Tech. Ventures, L.P. v. Sheldon,* 526 S.W.3d 428, 434-35 (Tex. 2017).

Thereafter, according to Plaintiffs, "Defendants" "determined to act in concert" to undertake a series of steps to dilute the Company's common stock so that the "common stockholders" would "be nearly wiped out altogether" to enable the "[Stockholder] Defendants and their select affiliates" to acquire shares of newly issued IDEV preferred stock and also make IDEV stock available to certain IDEV employees.[11]

Following the July 2010 Financing, Plaintiffs took no action until 2013. At that time, Plaintiffs, apparently having learned of the proposed sale of IDEV to Abbott Laboratories, sued in Texas state court, making the same allegations they initially raised with the trial court.

In Texas, the Stockholder Defendants and the Independent Directors asserted that, under a forum-selection clause in IDEV's Fourth Amended and Restated Shareholders Agreement (the "Shareholders Agreement"), the case could only be brought in Delaware. The Texas trial court agreed and dismissed the case. A divided court of appeals reversed, but the Texas Supreme Court affirmed the dismissal.[12]

[11] A31 at ¶ 28. Plaintiffs again omit from their factual allegations that the "series of steps" we all part of the July 2010 Financing pursuant to which IDEV received approximately $44.8 million in additional capital. *See* A332-40 (Oct. 3, 2010 Form D filing attached as Exhibit 6 to Stockholder Defendants' Brief in Support of Their Motion to Dismiss Plaintiffs' Verified Amended Complaint).

[12] *See Sheldon,* 526 S.W.3d at 434.

After the Texas action was dismissed, Plaintiffs filed this action. The Amended Complaint asserts claims of breach of fiduciary duty, aiding and abetting breaches of fiduciary duty, and unjust enrichment.[13]

B. THE TRIAL COURT OPINION

On January 25, 2019, after the motions to dismiss were fully briefed, and oral argument had been held, the trial court issued its Opinion, dismissing all of Plaintiffs' claims with prejudice. The trial court described Plaintiffs' Amended Complaint as:

> alleg[ing] Defendants used the July 2010 Financing to unlawfully take a large percentage of IDEV's equity at the expense of minority stockholders. Plaintiffs allege the Venture Capital Defendants acted together as a controlling stockholder group, using their combined share holdings and their domination and control of the IDEV Board to complete the July 2010 Financing.[14]

The trial court then considered Plaintiffs' assertion that Defendants were "judicially estopped from arguing Plaintiffs' claims are derivative because Defendants prevailed in enforcing the forum selection clause in the Shareholders Agreement."[15] The trial court rejected that argument, and Plaintiffs do not challenge that holding in their appeal thereby waiving it.[16]

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[13] The Original Complaint also asserted claims for violations of the Texas Securities Act and civil conspiracy. Plaintiffs omitted these claims from their Amended Complaint.

[14] Op. at 14.

[15] Op. at 14

[16] *Emerald Partners v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999) ("Issues not briefed are deemed waived"). In the trial court, Plaintiffs also raised claims of aiding and

The trial court then considered whether Plaintiffs' claims are direct or derivative under the framework established in *Tooley v. Donaldson Lufkin & Jenrette, Inc.*[17] The trial court stated that:

> [d]ilution claims, like the ones Plaintiffs advance here, are classically derivative. Plaintiffs do not argue that a *Tooley* analysis leads to a different conclusion here. Instead, Plaintiffs argue that their breach of fiduciary duty claim is direct under *Gentile v. Rossette.*[18]

Plaintiffs did not allege that any one of the Stockholder Defendants, alone, was a "stockholder having majority or effective control" required for the existence of a direct claim under *Gentile.* Instead, Plaintiffs asserted that "the [Stockholder] Defendants constituted a control group." The trial court correctly stated the legal standard for control as follows:

> [a] group of stockholders "can collectively form a control group where those shareholders are connected in some legally significant way—e.g., by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal". But because "even a majority stockholder is entitled to vote its shares as it chooses, including to further its own interest," Plaintiffs "must allege more than mere concurrence of self-interest among certain stockholders to state a claim based on the existence of a control group."[19]

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abetting breaches of fiduciary duty and unjust enrichment. They did not raise these claims in this Court, therefore these claims are also waived. *Id.*

[17] 845 A.2d 1031 (Del. 2004).

[18] Op. at 22; (citing *Gentile v. Rossette*, 906 A.2d 92 (Del. 2006)).

[19] *Id.* at 23 (citing cases).

The trial court then considered each of Plaintiffs' factual allegations regarding control and held that Plaintiffs' factual allegations did not raise a reasonable inference that the Stockholder Defendants controlled IDEV as a group.[20]

Because Plaintiffs failed to adequately plead the existence of a control group, the trial court properly concluded Plaintiffs' claims were solely derivative. Because Plaintiffs had not complied with Court of Chancery Rule 23.1 by making pre-suit demand or pleading demand futility and because the Plaintiffs' shares in IDEV were extinguished in the Abbott merger, the trial court dismissed their claims.[21]

[20] *Id.* at 23-29.
[21] *Id.* at 32-33.

ARGUMENT

THE TRIAL COURT CORRECTLY CONCLUDED THAT THE STOCKHOLDER DEFENDANTS WERE NOT A CONTROL GROUP

A. QUESTION PRESENTED

Whether the trial court properly dismissed Plaintiffs' claims for failure to adequately plead the existence of a control group. This issue was preserved for appellate review at: A99-109, A187-200, A1284-95, A1449-56.

B. STANDARD OF REVIEW

The Supreme Court reviews *de novo* the dismissal of a complaint pursuant to Rule 12(b)(6). *Allen v. Encore Energy Partners, L.P.*, 72 A.3d 93, 100 (Del. 2013). In reviewing a motion to dismiss, this Court accepts "all well-pleaded allegations as true and draw[s] all reasonable inferences in the plaintiff's favor." *Id.; see also In re General Motors (Hughes) S'holder Litig.,* 897 A.2d 162, 167-68 (Del. 2006). The Supreme Court will affirm the dismissal of a plaintiff's claims if the Court concludes that the plaintiff would not be able to recover under "any set of provable facts supporting his claims." *Encore Energy,* 72 A.3d at 100. The Court does not, however, "credit conclusory allegations that are unsupported by specific facts or draw unreasonable inferences in the plaintiff's favor." *Id.* (*citing Gantler v. Stephens,* 965 A.2d 695, 704 (Del. 2009)).

C. MERITS OF ARGUMENT

Plaintiffs raise a single controlling question in their appeal: did Plaintiffs sufficiently plead "factual allegations" so as to make it reasonably conceivable that

the Stockholder Defendants comprised a "control group under *Gentile*?"[22] In phrasing the question, Plaintiffs contend that:

> the well-pleaded factual allegations of the complaint and documents incorporated by reference in the complaint demonstrate that the stockholder group (i) collectively controlled over 60% of the outstanding shares, (ii) entered into a Voting Agreement granting them direct control over three of IDEV's seven board seats (for a total of four) and indirect control over an additional two board seats (in addition to their control over the CEO selection who filled the remaining board seat), (iii) invested in tandem in similar companies at the same time, and (iv) simultaneously appointed directors of other companies.[23]

Plaintiffs' "control group" allegations appear at pages 8 and 9 of the Amended Complaint.[24] Plaintiffs' Amended Complaint alleges:

(1) the Stockholder Defendants *collectively* held over 60% of IDEV's issued and outstanding shares;[25]

(2) by virtue of a voting agreement, the Stockholder Defendants "directly controlled three of the six seats on the IDEV Board of Directors" and that

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[22] Because Plaintiffs do not challenge, and therefore accept, the trial court's dismissal of their disclosure claims. *Emerald Partners v. Berlin*, 726 A.2d at 1224.

[23] Opening Brief at 3. Plaintiffs add a second Question Presented: "Whether Plaintiffs sufficiently alleged facts establishing that the Venture Capital Defendants constituted a control group of IDEV and supporting direct claims that survived Abbott's acquisition of IDEV." *Id.* This second question is duplicative of the first in that it also depends on the existence of a control group. Accordingly, to the extent that the Court determines that a response to Plaintiffs' second Question Presented is appropriate, the Stockholder Defendants hereby incorporate their response to Plaintiffs' first Question Presented into their response to Plaintiffs' second Question Presented.

[24] A29-30 at ¶¶ 23-26.

[25] A29 at ¶ 23.

these three directors, by majority vote, designated two additional board members, and appointed their chosen Chief Executive Officer;[26]

(3) that "two or more of the Venture Capital Defendants" have invested in four named health technology startups;[27] and

(4) by exercising their right to convert preferred stock to common stock, the Stockholder Defendants were able to act by written consent to amend the IDEV Certificate of Incorporation in order to "extract economic benefit for their own selfish gain while unfairly diluting the economic and voting interests of the Plaintiffs."[28]

These allegations are similar, but not identical to the four points Plaintiffs assert in the "control group" questions they present to this Court. In their Opening Brief, Plaintiffs revise their third point so that it now asserts that the Stockholder Defendants "invested in tandem in similar companies at the same time."[29] The fourth point has been replaced with an allegation that was not pled in the Amended Complaint —that the Stockholder Defendants "simultaneously appointed directors of other companies."[30] Plaintiffs' Amended Complaint contains no allegations supporting the Stockholders Defendants' simultaneous appointment of directors and Plaintiffs' Answering Brief below merely makes reference to representatives of PTV and RiverVest being directors of Tryton Medical.[31]

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[26] *Id.* at ¶ 24.
[27] *Id.* at ¶ 25.
[28] *Id.* at ¶ 26.
[29] Opening Brief at 3, 13.
[30] *Id*.
[31] A1094 (Answering Brief at 28).

As discussed below, each of the four factors relied on by Plaintiffs, or variations of those factors, has been considered by the Delaware courts and the trial court correctly held they did not support a finding of a control group, either singularly or in the aggregate.

1. Minority Stockholders Do Not Become Controlling Stockholders Because Their Stock Holdings Aggregate "[O]ver 60%"

Plaintiffs do not allege that any one of the Stockholder Defendants controlled more than 50% of IDEV's stock,[32] and do not allege that any one of the Stockholder Defendants controlled IDEV. Instead, Plaintiffs plead that all three Stockholder Defendants owned, in total, over 60% of IDEV's shares.

The trial court correctly stated Delaware law when it held that shareholders do not become "controlling shareholders" whenever some number of them, in the aggregate, control over 50% of a corporation's stock.[33] For example, in *Emerson Radio Corp. v. Int'l Jensen, Inc.,* 1996 WL 483086 (Del. Ch. Aug. 20, 1996), two shareholders, Blair Fund and Shaw, owned 37% and 26%, respectively, of Jensen (the acquired company). The plaintiffs argued that the two minority shareholders should be viewed collectively, as a single majority shareholder owing fiduciary

[32] 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 . . ." *Kahn v. Lynch Commc'ns Systems, Inc.,* 638 A.2d 1110, 1113-14 (Del. 1994).
[33] Op. at 28 n. 129.

duties to the other shareholders of Jensen. The Court of Chancery rejected that argument:

> The argument finds no support in our law, because Shaw and Blair Fund, as individual minority stockholders, have no fiduciary duty to Jensen's remaining stockholders to support Emerson's proposal or any other proposal. If Shaw and Blair Fund could be viewed collectively as a "controlling" stockholder, they would have fiduciary duties to the minority in certain limited circumstances, but the record does not establish that these two stockholders are connected together in any legally significant way (*e.g.*, by common ownership or contract).

Emerson, 1996 WL 483086, at * 17.

Here, the trial court correctly rejected Plaintiffs' allegations regarding the Stockholder Defendants' "over 60%" aggregate stock ownership in a footnote, noting that "that threshold is not dispositive without indicia of coordination" based on well-established Delaware law. *See* Op. at 28, n. 129 (citing *Zimmerman v. Crothall*, 62 A.3d 676, 700 (Del. Ch. 2013) (stating that two large stockholders who together owned 66% of the company's voting shares and appointed two of the board's five directors were not controlling stockholders because there was "no showing that they acted as one unit or that one exerted control over the other"); *Dubroff v. Wren Holdings, LLC*, 2009 WL 1478697, at * 4 (Del. Ch. May 22, 2009) (granting motion to dismiss and holding that entities that owned 56% of voting stock and controlled four of the five directors were not a control group because they were not 'tied together in some legally significant way'); *Feldman v. Cutaia*, 936 A.2d 644, 657-58 (Del Ch. 2007) (finding no control group when complaint only alleged

that the board members and their families controlled 60% of the company's equity but alleged no agreement between them), *aff'd,* 951 A.2d 727 (Del. 2008). Accordingly, the trial court correctly determined that the Stockholder Defendants did not comprise a control group because, in the aggregate, they held over 60% of IDEV's stock.

2. The Voting Agreement is Unrelated to the July 2010 Financing, and Does Not Indicate that the Stockholder Defendants Controlled IDEV as a Group

Plaintiffs insist that the required level of "coordination" among the Stockholder Defendants can be found in the Shareholder's Agreement, to which all of IDEV's Shareholders, including Plaintiffs, were parties. Section 7 of the Shareholders Agreement is a voting agreement (the "Voting Agreement").[34] The Voting Agreement deals exclusively with selection of board seats for IDEV.[35] The

[34] A265 ("So long as this Section 7 is in effect, each Shareholder will vote all of the Shareholder's Restricted Shares and take all other necessary or desirable actions (in its capacity as a Shareholder of the Corporation), and the Corporation will take all necessary or desirable actions, as are reasonably requested **to cause the Corporation's Board of Directors to consist of six (6) members and to cause the following persons to be elected to the Corporation's Board of Directors** . . .") (emphasis added). Shareholder is defined in the Shareholders Agreement as including all "Key Shareholders" and all "Significant Shareholders," [A257], and Restricted Shares is defined as "all shares of Common Stock and Preferred Stock and any other series or classes of the Corporation's capital stock . . .." Sheldon and Konya both allege that they were designated in the Shareholder Agreement as a Significant Shareholders. A28 at ¶ 20. Konya is actually listed in the Shareholders Agreement as a Key Shareholder, and Plaintiffs refer to him as such in their Opening Brief. *See* Opening Brief, p. 6.

[35] A264-66.

trial court directly and correctly rejected Plaintiffs' argument. "Plaintiffs make much of the voting agreement in the Shareholders Agreement. That provision did ensure PTV, RiverVest, and Bay City could each appoint one director to the Board,"[36] But, as the trial court found, the "details" of the Voting Agreement "undercut" Plaintiffs' conclusory allegations.[37]

The Voting Agreement related solely to director elections and was not implicated in the approval of the July 2010 Financing. Section 7(a) of the Voting Agreement required each Shareholder to vote their shares so that the board would consist of one individual designated by each of the Stockholder Defendants,[38] IDEV's Chief Executive Officer, and two individuals chosen by the three Stockholder Defendant designees. As to all other matters:

> Each Shareholder will **retain at all times the right to vote the Shareholder's Restricted Shares in its sole discretion** on all matters presented to the Corporation's Shareholders for a vote **other than the matters set forth in Sections 7(a) and (b)** above, . . .[39]

Voting agreements are common in Delaware corporations and expressly permitted under Delaware law. *See* 8 *Del. C.* § 218(c). Voting agreements, such as that contained in the IDEV Shareholders Agreement, often deal with the right to

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[36] Op. at 26.
[37] *Id.*
[38] A265, § 7(a)(i)-(iii).
[39] A265-66 (emphasis added). Section 7(b) generally prohibited removal of directors unless certain situations existed.

appoint directors. *See Harrah's Entertainment, Inc. v. JCC Holding Co.,* 802 A.2d 294, 314 (Del. Ch. 2005) (discussing common purposes for voting agreements). Thus, the Stockholder Defendants' right to each "designate" one director is not unusual and, alone draws little scrutiny.[40] *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984). Indeed, appointment by a large shareholder is "the usual way a person becomes a corporate director." *Id.*

A plaintiff attempting to plead that a stockholder controls a director must "plead *particularized facts* alleging that directors, constituting a majority of the board, were dominated or controlled by a party with an interest in the transaction and thus unable to independently exercise business judgment." *Kandall on behalf of FXCM, Inc. v. Niv,* 2017 WL 4334149, at * 15 (Del. Ch. Sept. 29, 2017) (emphasis supplied). Plaintiffs plead, in conclusory fashion, that, pursuant to the Voting Agreement, the Stockholder Defendants "directly controlled" three of the six seats on the IDEV board,[41] and, through their control of the directors, "controlled and directed" IDEV.[42] But, Plaintiffs plead no facts that would support an inference that the Stockholder Defendants collectively "controlled" or "directed" a majority of directors. *Aronson*, 473 A.2d at 816 (simply reciting "[t]he shorthand shibboleth of dominated and controlled directors' is insufficient"); *In re Coca-Cola Enterprises,*

[40] A265.
[41] A29 at ¶ 24.
[42] A32 at ¶ 29(d).

Inc., 2007 WL 3122370, at * 2 (Del. Ch. Oct. 17, 2007) ("The bald assertion that 'Coke ultimately controls [CCE] is conclusory.").

Indeed, Plaintiffs fail to plead *any* facts supporting their "control" allegations. Plaintiffs did not even identify, by name, any director, other than the two Independent Directors, in the Amended Complaint. They seek to embellish this omission in their Opening Brief, p. 8, but even then provide nothing beyond the directors' names and the claim that each of the newly-named directors was "affiliated" with either PTV, RiverVest, or Bay City.[43]

Plaintiffs' cited authorities confirm, PTV, RiverVest, and Bay City nominating directors to IDEV's board "does not, without more, establish actual domination or control. To hold otherwise would have a chilling effect on transactions that depend on a particular shareholder being able to appoint representatives to an investee's board of directors." *Williamson v. Cox Communications, Inc.*, 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006). Authorities relied on by Plaintiffs explain why this argument should not be the law:

[43] In their Answering Brief below, Plaintiffs had appended documents, including a Confidential Information Statement, which they relied on for this identification. Plaintiffs apparently identified additional directors by name and alleged "affiliation" in an attempt to add, for the first time, a direct claim under *Gentile* based on an alleged lack of director independence. A1088. The trial court rejected Plaintiffs' attempt to secure a "pleadings-stage inference of disloyalty." Plaintiffs waived this issue by failing to raise it in their Opening Brief. *Emerald Partners*, 726 A.2d at 1224.

> If plaintiffs' argument were the law, then whenever a director is affiliated with a significant stockholder, that stockholder automatically would acquire the fiduciary obligations of the director by reason of that affiliation alone. The notion that a stockholder could become a fiduciary by attribution (analogous to the result under the tort law doctrine of respondeat superior) would work an unprecedented, revolutionary change in our law, and would give investors in a corporation reason for second thoughts about seeking representation on the corporation's board of directors.

Id. at *4n.51 (quoting *Emerson*, 1996 WL 483086, at *20 n. 18).

The trial court's determination that the Voting Agreement was "in no way related to the Financing" at issue in this case is well supported by the record and Delaware law. Op. at 29 (citing *van der Fluit v. Yates*, 2017 WL 5953514, at *6 (Del. Ch. Nov. 30, 2017) (finding no control group where investor rights agreement contained no "voting, decision-making, or other agreements that bear on the transaction challenged in the instant case").[44] The Stockholder Defendants merely agreed, along with all Shareholders, to vote for the directors that each had designated. Plaintiffs have pled no facts from which it can be reasonably inferred that the Voting Agreement bound them together in any other way.

[44] *See also In re Nine Systems S'holders Litig.,* 2014 WL 4383127 (Del. Ch. Sept. 4, 2014) ("A plaintiff must prove that the group of stockholders was 'connected in some legally significant way—e.g., by contract, common, ownership, agreement, or other arrangement—to work toward a shared goal. The standard does not necessarily require control 'over the day-to-day operations' of a corporation, 'actual control with regard to the particular transaction that is being challenged' may suffice.").

Plaintiffs incorrectly allege that the Voting Agreement "contractually bound the [Stockholder] Defendants (and not the other Shareholders) to vote together and designate additional directors."[45] Under the Voting Agreement, however, the three *directors* designated by the three Stockholder Defendants, not the Stockholder Defendants, would vote for the two additional directors.[46] In any event, Plaintiffs have alleged nothing to indicate that these three directors were interested or disloyal, and as the trial court correctly held, "well-settled Delaware law" establishes that "a director's independence is not compromised simply by virtue of being nominated to a board by an interested stockholder." Op. at 32, citing *In re: KKR Fin. Hldgs. LLC S'Holder Litig.*, 101 A.3d 980, 996 (Del. Ch. 2014) *aff'd sub nom*, *Corwin v. KKR Fin. Hldgs. LLC*, 125A.3d 304 (Del. 2015); *see also Frank v. Elgamal*, 2014 WL 957550, at *22 (Del. Ch. Mar. 10, 2014) ("[m]erely because a director is nominated and elected by a large or controlling stockholder does not mean that he is necessarily beholden to his initial sponsor").

Accordingly, the trial court correctly determined that the Stockholder Defendants were not sufficiently "intertwined, collaborative, or exclusive" to constitute members of a control group.[47]

[45] Opening Brief, p. 19.
[46] A265, § 7(a)(v).
[47] Op. at 25.

In addition, the legally significant connection requirement imposed by Delaware law for purposes of evaluating a control group based on the existence of a voting agreement plays an important function. *van der Fluit*, 2017 WL 5953514, at *6 (explaining how the ability of a group of stockholders to approve a subject transaction through the exercise of a contractual right can distinguish between stockholders with a mere concurrence of interests as opposed to those able to operate as a control group). As noted, voting agreements, specifically those among equity investors in private companies, are common. In the absence of a requirement that a plaintiff identify a legally significant connection from which it can be inferred that parties to a voting agreement gained an advantage over the minority with respect to the specific transaction at issue, the existence of a run-of-the-mill voting agreement among a grouping of stockholders holding over 50% of a company's stock would, in every instance, preclude dismissal at the pleading stage. This result would seem to be at odds with the Delaware legislature's endorsement of and the regular use of voting agreements. *See* 8 *Del. C.* § 218(c).

3. The Stockholder Defendants Did Not "Invest[] in Tandem in Similar Companies at the Same Time"

Plaintiffs' chosen phrasing here betrays the weakness in this allegation.[48] Plaintiffs *did not* allege any facts from which it could be reasonably inferred that the

[48] Opening Brief at 3, 13.

three Stockholder Defendants invested in "tandem in similar companies at the same time." Opening Brief, p. 13. Plaintiffs make assertions in their Opening Brief that are unsupported by the Amended Complaint and record below and are demonstrably false based on Plaintiffs' own newly submitted information. Plaintiffs argue that:

> In addition to IDEV, the **[Stockholder] Defendants** have made several coordinated investments in at least five other instances, including (i) a $14 million financing with Tryton Medical, Inc.; (ii) a $8.25 million financing with Accumetrics, Inc.; (iii) a $28.8 million financing with Accumetrics, Inc; a $42.2 million financial of Calypso Medical Technologies, Inc.; and (iv) a $50 million financing of Calypso Medical Technologies, Inc.[49]

The implication of Plaintiffs statement is that **all three** of the Stockholder Defendants participated in all five of these investment rounds. That is not true and is unsupported by the Amended Complaint.

All of Plaintiffs' well-pleaded factual allegations on this subject appear in paragraph 25 of their Amended Complaint. Plaintiffs allege that:

> **two or more** of the [Stockholder] Defendants count Cameron Health among their portfolio companies and have participated in a $14 million financing with Tryon [sic] Medical, Inc., a $28.8 million financing with Accumetrics, Inc., and a $50 million financing of Calypso Medical, Inc."[50]

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[49] Opening Brief, p. 20 (emphasis added) (the $8.25 million financing with Accumetrics and the $42.2 million financing in Calypso did not appear in the Amended Complaint).

[50] A30 at ¶ 25.

Plaintiffs did not plead that all three Stockholder Defendants invested together at any time in any entity. Plaintiffs' attempt to now embellish their factual allegations by submitting internet articles[51] about two follow-on investments is inappropriate and should be rejected.[52] Moreover, the news articles identified by Plaintiffs fail to identify even a single occasion where all three Stockholder Defendants participated in any investment.[53]

Plaintiffs' factual allegations in their Amended Complaint that support their claim of a "long and close" investment relationship consist of allegations that: (i) RiverVest and PTV both invested in Tryton Medical, Inc. in September of 2010 along with two other investors; (ii) RiverVest and PTV both invested in two rounds of investments in Accumetrix, Inc., beginning in February of 2006; and (iii) Bay City, along with RiverVest and fifteen other investors, made one investment in

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[51] *See* A1166 (Transmittal Affidavit of Scott B. Czerwonka in Support of Plaintiffs' Combined Answering Brief in Response to Defendants' Motions to Dismiss Plaintiffs' Verified Amended Complaint, Exhibit C).

[52] *See Orman v. Cullman*, 794 A.2d 5, 28 n. 59 (Del. Ch. 2002) ("Briefs relating to a motion to dismiss are not part of the record and any attempt contained within such documents to plead new facts or expand those contained in the complaint will not be considered."); *Gerber v. EPE Holdings*, 2013 WL 209658, at *4 n. 38 (Del. Ch. Jan. 18, 2013) (noting that an answering brief in response to a motion to dismiss is not the appropriate vehicle "for expanding claims").

[53] In fact, Plaintiffs' selected articles show the opposite. Five are selected, all listing investors in the various financings. They show that Plaintiffs' searched for and accessed these articles in either May or August of 2018. In none of them did all three of the Stockholder Defendants invest in the same company. Plaintiffs obviously looked; this is the best they could find. They are disproving their own claim.

Calypso Medical.[54] Plaintiffs offer no information, either in their Amended Complaint or in their Opening Brief, alleging which of the Stockholder Defendants were allegedly the "two or more" of the Defendants alleged to have invested at some time in Cameron Health.

In sum, Plaintiffs allege only that, in addition to IDEV, over a twelve year period, RiverVest and PTV, joined by numerous other investors, invested together in either two or three healthcare startups (Tryton Medical, Accumetrics, and, maybe, Cameron Health); that RiverVest and Bay City invested together in either one or two, healthcare startups (Calypso and, maybe, Cameron Health); and that PTV and Bay City invested together in either one healthcare startup, Cameron Health, or perhaps never at all. The trial court correctly found that Plaintiffs "have not alleged that all of the [Stockholder] Defendants have invested together in any other company, that they coordinated their investments, or that they have declared themselves as a group of investors to the SEC or any other authority." Instead, the trial court concluded that "Plaintiffs' allegations merely indicate that venture capital firms in the same sector crossed paths in a few investments."[55] If anything, the prior financings of other healthcare companies show parallel interests and competition among investors in the same industry. *Dubroff*, 2009 WL 1478697, at *3.

[54] *See A1166 [*Czerwonka Affidavit in Support of Plaintiffs' Answering Brief, at Exhibit C.].
[55] Op. at 25.

Plaintiffs complain that the trial court's interpretation of their allegations regarding the Stockholder Defendants' prior investments "denies Plaintiffs the reasonable inferences to which they are entitled and ignores key facts alleged by Plaintiffs."[56] They are mistaken. The trial court correctly found that Plaintiffs never pled that all three of the Stockholder Defendants ever invested in *any* other company beyond IDEV. Plaintiffs are entitled to "reasonable inferences that logically flow" from actual facts pled. *See Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001). However, the Court is not required to "accept every strained interpretation of the allegations proposed by the plaintiff." *Id.; see also In re General Motors (Hughes) S'holder Litig.,* 897 A.2d 162, 168 (Del. 2006). It is not reasonable to infer, from Plaintiffs factual allegations, that the three Stockholder Defendants "invested in tandem in the same companies at the same time" or "had a long and close history of investing together." Plaintiffs are not seeking a reasonable inference from their factual allegations, they are improperly asking the Court to indulge in speculation.[57]

4. The Stockholder Defendants Did Not "[S]imultaneously Appoint[] Directors of Other Companies."

[56] Opening Brief, p. 20.

[57] See *Clinton v. Enterprise Rent-A-Car Co.*, 977 A.2d 892, 895 (Del. 2009) (Supreme Court does not "simply accept conclusory allegations unsupported by specific facts, nor [does it] draw unreasonable inferences in the plaintiff's favor.").

The allegation that the "stockholder group," by which Plaintiffs presumably mean PTV, RiverVest, *and* Bay City, "simultaneously appointed directors of other companies," appears nowhere in the Amended Complaint. Instead, it first appeared in a footnote in their Answering Brief below.[58] Plaintiffs now allege, based on an internet article attached to that Brief,[59] that "representatives of two Venture Capital Defendants," PTV and RiverVest, occupied board seats in Tryton Medical at the same time.[60] That article[61] should not be considered by the Court as part of any "well-pleaded factual allegation" of the existence of a control group. *Orman,* 794 A.2d at 28 n. 59. But even if the Court were inclined to consider this allegation, it only amounts to an allegation that two of the three Stockholder Defendants appointed directors in one company at one time besides IDEV. There are no "other companies," and plaintiffs do not even allege that Bay City and either of the other two stockholders appointed directors to any other company anywhere. Plaintiffs are grasping at straws here.

Accordingly, the allegations in Plaintiffs' Amended Complaint fail to support a reasonable inference that the Stockholder Defendants simultaneously appointed directors of other companies.

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[58] *See* A1073, n. 4.
[59] *See* A1166 [Czerwonka Affidavit in Support of Plaintiffs' Answering Brief, at Exhibit C.]
[60] Opening Brief, p. 8, n.3 (citing A1183).
[61] See Opening Brief, p. 20 (citing A1183).

5. Plaintiffs' Allegations, in the Aggregate, Fail to Support a Reasonable Inference that the Stockholder Defendants Operated as a Control Group.

The trial court analyzed together all of the "control group" factors alleged by Plaintiffs, and noted Plaintiffs' attempt to equate the facts they had alleged to those found in *In re Hansen Medical, Inc., Stockholders Litigation*,[62] where the Court of Chancery had held that the plaintiffs had pled facts from which a reasonable inference of a control group existed. As discussed by the trial court, the Complaint in *Hansen* included allegations that the two investors alleged to constitute a control group:

- Owned 31% and 35% of the acquired company and had a more than twenty year history of investing together, including in one company where they had identified themselves to the United States Securities and Exchange Commission as a "group" of stockholders;
- "Coordinated" their investment strategy in at least seven other companies;
- Were the only two participants in the private placement that made them the largest Hansen stockholders;

[62] 2018 WL 3030808 (Del. Ch. June 18, 2018).

- Entered into agreements that identified them as Key Stockholders and allowed them, but only them, to negotiate with the acquirer and required them to vote for the merger; and
- Received exclusively the opportunity to rollover their Hansen stock into stock in the acquiring company.[63]

Based on the facts, the *Hansen* court concluded that:

> [a]though each of these factors alone, or perhaps even less than all these factors together, would be insufficient to allege a control group existed, all of these factors, when viewed together in light of the [defendants'] twenty-one year investing history, ma[d]e it reasonably conceivable that the Controller Defendants functioned as a control group during the Merger.[64]

The trial court properly held that Plaintiffs' allegations here more closely resemble those in *van der Fluit*, where no control group was found, than in *Hansen.* The trial court correctly recognized that, as in this case, the alleged control group in *van der Fluit*: held three of seven board seats[65] and were parties, along with other shareholders, to an investor rights agreement which "gave registration and information rights to early stage investors" but was unrelated to the transaction at

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[63]Op. at 24-25.

[64] *Id.* at 25, *quoting Hansen*, 2018 WL 3030808, at * 7. Plaintiffs admit in their Opening Brief that they allege "somewhat less than *Hansen.*" Opening Brief, p. 21.

[65] Plaintiffs allege in their Opening Brief that in this case "the [Stockholder] Defendants directly controlled *four* of seven board seats." Opening Brief, p. 22 (emphasis in original). The allegation of the fourth directly controlled director appeared for the first time in a document attached to their Answering Brief. *See* Opening Brief, p. 22, n. 5 (citing A1193).

issue.[66] The trial court found that the Shareholders Agreement, like the investor rights agreement in *van der Fluit*, was unrelated to the transactions at issue.

The *Hansen* Court distinguished *van der Fluit* as follows:

> There the plaintiff attempted to show a "contract, common ownership, agreement, or other arrangement—to work together toward a shared goal" by pointing to (1) agreements with no relation to the actual transaction; (2) agreements entered into by the entirety of the stockholders instead of just the control group; or (3) agreements entered into by only a subsect of the control group. *Id.* at *5. Most importantly, the plaintiff pled no facts nor offered any explanation for why these agreements show the purported control group was bound together in a legally significant way rather than merely evidencing a concurrence of self-interest. *Id.* at *6. Nor did the plaintiff allege any other facts to support any connection between the members of the purported control group.[67]

The trial court further distinguished *Hansen* on the grounds that the Stockholder Defendants were not the only investors in IDEV's investment rounds.[68] And particularly the fact that Covidien Group S.A.R.L., which was not even a stockholder prior to the financing, ended up investing more in the financing than any of the Stockholder Defendants.[69] *Hansen*, by contrast, involved an exclusive private placement among members of an alleged control group. 2018 WL 3030808, at *9 (describing the "exclusive benefit" afforded to members of the alleged control group).

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[66] Op. at 28-29.
[67] 2018 WL 3030808, at *6, n. 79.
[68] Op. at 25-26.
[69] *Id.* at 26.

Thus, according to *Hansen,* agreements, like the Voting Agreement in the present case, that do not relate to the actual transaction at issue and to which all stockholders, not just the alleged control group, are parties, do not indicate the existence of a control group.

Plaintiffs contend that the trial court failed to recognize that *van der Fluit* is distinguishable from the instant case because the other signatories to the Shareholders Agreement did not have the right to appoint directors, IDEV's Chairman was purportedly affiliated with certain of the Stockholder Defendants and the Stockholder Defendants were similarly bound by the Voting Agreement.[70] However, none of the points identified by Plaintiffs change the fact that the Voting Agreement at issue here was unrelated to approval of the July 2010 Financing.

Additional Delaware authority further supports the trial court's decision. In *Dubroff v. Wren Holdings, LLC,* 2009 WL 1478697 (Del. Ch. May 22, 2009), plaintiffs alleged that three investors as a group controlled a company called Streaming Media, and caused a recapitalization which diluted plaintiffs' equity. Plaintiffs alleged a litany of factors in support of their allegation of a control group. These included, *inter alia,* assertions that: the three investors' stockholdings totaled 56%; that the three investors controlled 4 of 5 directors who voted for the transaction; and that the three investors had voted together by written consent to

[70] Opening Brief at 18.

effectuate the transaction.[71] The *Dubroff* plaintiffs asserted that the action by written consent was powerful evidence of the existence of a control group.[72] The court rejected this assertion, stating:

> [T]his document demonstrates nothing more than the fact that the Entity Defendants each voted for the Recapitalization. And, as discussed, *shareholders are entitled to vote based on their own self-interest*, regardless of whether their interests are consistent with the interests of other shareholders.[73]

Simplified, Plaintiffs' well-pleaded factual allegations are that: the stock holdings of the three Stockholder Defendants, in the aggregate, are over 60%; and the Stockholder Defendants were parties, along with all of IDEV's shareholders, to a Shareholders Agreement which contained the Voting Agreement relating to directors, but which was unrelated to the July 2010 Financing transaction Plaintiffs now challenge. That is it. Plaintiffs do not allege or inadequately allege that all three Stockholder Defendants coordinated on any other investments and notwithstanding the belated and unfounded implications in their briefs, Plaintiffs do not and cannot plead that all three Stockholder Defendants ever shared the right to fill any board seats in any other company. Accordingly, the trial court correctly

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[71] See *Dubroff*, 2009 WL 1478697, at *4. Plaintiffs actually listed a total of ten factors.

[72] Plaintiffs plead a similar action by written consent [A30], but do not discuss the action by written consent in the Argument portion of their Opening Brief.

[73] *Id.* at * 5 (emphasis added).

dismissed Plaintiffs' claims consistent with van der Fluit and similar Delaware precedent.

6. The Trial Court's Determination That The Stockholder Defendants are not a Control Group Also Requires Dismissal

In the trial court, the Stockholder Defendants argued that a finding that the Stockholder Defendants did not operate as a control group must result in dismissal of Plaintiffs' claims against them because it would mean the Stockholder Defendants owed no fiduciary duties to Plaintiffs.[74] The trial court did not consider this argument in its Opinion. However, based on settled Delaware law,[75] this Court should, and can, dismiss Plaintiffs' claims against the Stockholder Defendants with prejudice on that basis in addition to the reasons stated by the trial court.[76]

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[74] A195-96 [Stockholder Defendants' Brief in Support of Motion to Dismiss Plaintiffs' Verified Amended Complaint]; A1294-95 [Stockholder Defendants' Reply in Support of Motion to Dismiss Plaintiffs' Verified Amended Complaint at 12-13] ("Because the Stockholder Defendants did not comprise a control group owing fiduciary duties to Plaintiffs, Plaintiffs' breach of fiduciary duty claim must fail."); A1509-10 [Oral Argument Transcript].

[75] *Weinstein Enter., Inc. v. Orloff*, 870 A.2d 499, 507 (Del. 2010) ("[A] stockholder that owns less than half of a corporation's shares will generally not be deemed to be a controlling stockholder, with concomitant fiduciary duties.").

[76] *Candlewood Timber Group LLC v. Pan American Energy, LLC*, 589 A.2d 989, 1004 (Del. Ch. Oct. 4, 2004) (deciding an issue in "the interests of judicial economy" without regard to whether it was fairly raised below, in part, because "the issue is one of law and if resolved in favor of [the defendant] would result in an affirmance") (citing Supr. Ct. R. 8); *see also Standard Distributing Co. Through Pennsylvania Mffrs. Ass'n Ins. Co. v. Nally*, 630 A.2d 640, 647 (Del. 1993) ("Notwithstanding the Superior Court's failure to rule on the matter, we may dispose of it, in the interests of judicial economy, since the issue was 'fairly presented to the trial court.'") (citations omitted).

CONCLUSION

The trial court correctly dismissed Plaintiffs' action for failure to comply with Court of Chancery Rule 23.1 after concluding that the Stockholder Defendants did not constitute a control group because Plaintiffs' conclusory allegations failed to adequately plead facts sufficient to establish that the Stockholder Defendants were bound in any legally significant way with respect to approval of the July 2010 Financing. Accordingly, the Court of Chancery's judgment dismissing Plaintiffs' Amended Complaint with prejudice should be affirmed. Alternatively, the Court of Chancery's judgment should be affirmed because Plaintiffs' failure to allege facts sufficient to permit an inference that the stockholder Defendants constituted a control group means the Stockholder Defendants owed no fiduciary duties to Plaintiffs as a matter of law.

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Dated: May 17, 2019

CERTIFICATE OF SERVICE

I hereby certify that on May 17, 2019 the foregoing document was caused to be served upon the following counsel of record via File & Serve*Xpress*:

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