EFiled: May 28 2019 04:23PM EDT
Filing ID 63300802
Case Number 81,2019

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JEFFERY J. SHELDON and ANDRAS KONYA, M.D., PH.D., Plaintiffs Below-Appellants, v. 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

APPELLANTS' REPLY BRIEF

WILKS, LUKOFF & BRACEGIRDLE, LLC
Thad J. Bracegirdle (No. 3691)
Scott B. Czerwonka (No. 4844)
4250 Lancaster Pike, Suite 200
Wilmington, DE 19805
Telephone: (302) 225-0850

Attorneys for Plaintiffs Below-Appellants

Dated: May 28, 2019

TABLE OF CONTENTS

TABLE OF CITATIONS

STATUTES

RULES

ARGUMENT[1]

I. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE VENTURE CAPITAL DEFENDANTS WERE NOT A "CONTROL GROUP"

Defendants do not dispute the core legal principles applicable to a "control group" analysis under *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), nor do they dispute Delaware courts' reluctance to definitively declare the absence of a control group at the pleading stage. A control group exists when stockholders "are connected in some legally significant way—*e.g.*, by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal." *Dubroff v. Wren Holdings, LLC*, 2011 WL 5137175, at *3 (Del. Ch. Oct. 28, 2011) ("*Dubroff II*") (quoting *Dubroff v. Wren Holdings, LLC*, 2009 WL 1478697, at *3 (Del. Ch. May 22, 2009)). "Because the analysis for whether a control group exists is fact intensive, it is particularly difficult to ascertain at the motion to dismiss stage when 'dismissal is inappropriate unless the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof.'" *In re Hansen Med., Inc. Stockholders Litig.*, 2018 WL 3025525, at *6 (Del. Ch. June 18, 2018) (quoting *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006)). *See also Williamson v. Cox Commc'ns, Inc.*, 2006 WL 1586375, at *6 (Del. Ch. June 5, 2006) (denying motion

[1] Capitalized terms used herein are defined in the Appellants' Opening Brief on Appeal ("OB").

to dismiss and noting that "whether a shareholder is a controlling one is highly contextualized and is difficult to resolve based solely on the complaint"). "Although parallel interests alone are 'insufficient as a matter of law to support the inference that the shareholders were part of a control group,' … parallel interests, in addition to other facts alleged by [plaintiffs]," can support a reasonable inference that a control group existed. *Hansen*, 2018 WL 3025525, at *6 (citations omitted).

Through well-pled factual allegations, documents that are integral to their complaint, and undisputed evidence of which the Court may take judicial notice, Plaintiffs have done more than enough to merit discovery and further adjudication of their claims. Defendants should not be allowed to avoid answering for their misconduct based on an overly restrictive application of pleading standards.[2]

[2] The Director Defendants claim that "Plaintiffs did not participate in the [July 2010] financing" and "were diluted as a result of their own choosing." Director Defendants' Answering Brief ("DAB") at 8. Dr. Konya's dilution was not of his "choosing," he was prohibited from participating because he did not qualify under certain applicable securities laws. A1584, A1589. Moreover, only certain common stockholders were permitted to participate in the valuable Exchange for their shares, and Dr. Konya (whose intellectual property was the foundation of IDEV) was not one of them, since he never held Prior Preferred Stock. *See* A1592 ("The Exchange shall apply only to shares of Common Stock issued upon conversion of Prior Preferred Stock and shall not apply to other shares of Common Stock held by the Company's stockholders."). With respect to Mr. Sheldon (founder and former CEO of IDEV), the vast majority of his stockholdings (96.5%) were also ineligible to participate in the Exchange. It is this disparate treatment of their fellow common stockholders that Defendants are attempting to shield from judicial review.

1. The Venture Capital Defendants' Collective Ownership Is Relevant To The Control Group Determination

Plaintiffs allege that the Venture Capital Defendants collectively owned more than 60% of IDEV's issued and outstanding shares. A29. In their Answering Brief, the Venture Capital Defendants spill much ink arguing that this fact *alone* is not sufficient to establish a control group. Venture Capital Defendants' Answering Brief ("AB") at 13-15. Plaintiffs acknowledged this in their Opening Brief and never argued otherwise. OB at 17. Instead, Plaintiffs' position is (and always has been) that the Venture Capital Defendants' collective ownership is but *one* of several factors that the Court should consider in its analysis, particularly when the Venture Capital Defendants' collective holdings allowed them to control IDEV and exploit that control when their interests aligned.

2. Defendants Misconstrue The Voting Agreement Contained In The Shareholders Agreement

In their Opening Brief, Plaintiffs explained how the Court of Chancery mistakenly concluded that the Shareholders Agreement bound "all Shareholders." OB at 18. The Court of Chancery cited *van der Fluit v. Yates*, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017), for the proposition that "where agreements with no relation to the actual transaction were entered into by the *entirety of the stockholders* instead of just the control group, those agreements do not create a control group." OB, Ex. A at 27. Based on its erroneous view of the Shareholders

Agreement, the trial Court then applied *van der Fluit* and found incorrectly that "[t]he Shareholders Agreement does not compel a finding that the Venture Capital Defendants were a control group." *Id.* Rather than acknowledge or address this error, Defendants ignore it and repeat the same mistake. *See* AB at 15 (stating that "all of IDEV's Shareholders" were parties to the Shareholders Agreement); *see id.* at 19 ("[T]he Stockholder Defendants merely agreed, along with all Shareholders, to vote for the directors that each had designated."). In actuality, only select "Significant" and "Key" shareholders were parties to the Shareholder Agreement. A257. Not all shareholders executed the Shareholders Agreement and, as stated therein, "[t]his [Shareholders] Agreement shall become effective at such time it is executed by the Corporation and, with respect to a Shareholder, by such Shareholder." A270 (§ 20).[3]

As Plaintiffs also noted in their Opening Brief, the trial Court's error then led to the conclusion that "Plaintiffs offer no explanation for why the [Venture Capital Defendants] are members of an alleged control group while the numerous other signatories to these agreements are not." OB, Ex. A at 27 (citing *van der*

[3] In fact, the Texas Supreme Court declined to dismiss claims brought by Plaintiffs against Owens and Burke precisely because they *did not* sign the Shareholders Agreement. *See Pinto Tech. Ventures, L.P. v. Sheldon*, 526 S.W.3d 428, 445 (Tex. 2017), *reh'g denied* (Sept. 22, 2017) (declining to dismiss claims against Owens and Burke under the forum selection clause in the Shareholders Agreement because they were not parties to that contract).

Fluit, 2017 WL 5953514, at *6)). This ignores the following undisputed facts: (1) only the Venture Capital Defendants had director appointment rights, to the exclusion of the other signatories to the Shareholders Agreement (*see* A265 (§ 7(a)(v)), (2) IDEV's Chairman of the Board was also affiliated with one of the Venture Capital Defendants (*see* A1193), and (3) the Voting Agreement legally bound the Venture Capital Defendants (through their appointed directors) to act together as a group and designate additional directors. A265 (§ 7(a)(v)).[4] Those are legally significant connections – none of which were present in *van der Fluit* – that readily distinguish the Venture Capital Defendants from the other signatories to the Shareholder Agreement. Defendants pay virtually no attention to the first two undisputed facts, which undercut the Court of Chancery's holding, focusing primarily on the third.

Ignoring the well-pled facts of the Amended Complaint and the documents integral to the Amended Complaint, the Defendants argue that Plaintiffs did not allege any facts demonstrating that the Venture Capital Defendants controlled the IDEV Board. AB at 18. Moreover, Defendants oddly claim that Plaintiffs somehow waived the issue by not including it in their Opening Brief. *Id*. n.43.

[4] Defendants accuse Plaintiffs of incorrectly alleging that the Venture Capital Defendants were required to vote together and designate additional directors. AB at 25. Both the Amended Complaint and Plaintiffs' Opening Brief, however, make clear that it is the Venture Capital Defendants' affiliated designees alone who are empowered to select the additional directors. OB at 8, 17.

Plaintiffs' Opening Brief cited directly to the transaction documents incorporated into the Amended Complaint (which the Court below and the parties also cited and relied upon extensively) and identified the directors at the relevant time:

- Rick Anderson (affiliated with PTV Sciences and Chairman of Board);[5]
- Matt Crawford (affiliated with PTV Sciences);
- Jay Schmelter (affiliated with RiverVest Capital);
- Jeanne Cunicelli (affiliated with Bay City Capital);
- Reese Terry ("Significant Shareholder" designated by the Venture Capital Defendants);
- Craig Walker ("Significant Shareholder" designated by the Venture Capital Defendants); and
- Christopher Owens (CEO handpicked by the Venture Capital Defendants).[6]

OB at 8-9 (citing A1131). Moreover, in the Information Statement distributed to stockholders in connection with the challenged transaction, the Company disclosed

[5] In addition, Rick Anderson and Jay Schmelter shared director positions in connection with the investment of PTV and RiverVest's in Tryton Medical. A1183.

[6] The Director Defendants erroneously contend that "Owens did not become a director until July 16, 2010." DAB at 6 n.4. That is wrong. Owens was appointed as President and Chief Executive Officer of IDEV on November 17, 2009, thereby entitling him to a board seat pursuant to the Shareholders Agreement. *See* A265, § 7(a)(v).

that, by virtue of their relationship and affiliation with the Venture Capital Defendants, each of Messrs. Anderson, Crawford, Schmelter and Ms. Cunicelli "may have, or may be deemed to have, a financial interest in the Transactions." A1193.

The authorities selectively cited by Defendants demonstrate that the directors' affiliation is relevant to the control group determination. *See Williamson*, 2006 WL 1586375, at *4 ("The fact that an allegedly controlling shareholder appointed its affiliates to the board of directors is one of many factors Delaware courts have considered in analyzing whether a shareholder is controlling.") While Defendants rely on *Williamson* in an attempt to separate and analyze the director designation issue in isolation (AB at 18-19), that same opinion made clear that "the question whether a shareholder is a controlling one is *highly contextualized and is difficult to resolve based solely on the complaint*," and ultimately held that "the complaint succeeds because it pleads a *nexus of facts* all suggesting that the Cable Companies were in a controlling position and that they exploited that control for their own benefit." *Williamson*, 2006 WL 156375, at *6 (emphasis added).

These affiliations and the Company's own disclosures support, at the pleading stage, a fair inference that the Venture Capital Defendants controlled the IDEV Board. Moreover, a contractual obligation to elect (through their affiliate

designees) two directors to the exclusion of the other stockholders is a legally significant connection that establishes joint control. *See Dubroff II*, 2011 WL 5137175, at *3 (noting that a connection evidencing a control group can be through "contract, common ownership, agreement, or other arrangement—to work together toward a shared goal").

3. The Venture Capital Defendants' Coordinated Investments In Other Companies And Shared Board Memberships Offer Further Proof Of A Control Group

In their Answering Brief, the Venture Capital Defendants appear to take issue with certain words used in Plaintiffs' Opening Brief, going so far as to accuse Plaintiffs of creating the false impression that all three Venture Capital Defendants participated in various financing rounds at other companies. *See* AB at 22. Plaintiffs' statement of facts, however, states clearly:

> In addition to IDEV, the Venture Capital Defendants have made coordinated investments in at least four other companies that Plaintiffs could identify from public sources (and likely many more). Two or more of the Venture Capital Defendants count Cameron Health among their portfolio companies and have participated in a $14 million financing with Tryton Medical, Inc., a $8.25 million financial with Accumetrics, a $28.8 million financing with Accumetrics, Inc., a $42.2 million financial of Calpyso Medical Technologies, Inc. and a $50 million financing of Calypso Medical Technologies, Inc.

OB at 9 (*citing* A1167-1185). Indeed, the passage cited by the Venture Capital Defendants was only a summary of these facts included subsequently in Plaintiffs' Argument. OB at 20.

The documents referenced by Plaintiffs make clear which Defendants participated in each financing. While it is true that all three of the Venture Capital Defendants did not participate in every single one of the identified financings (and Plaintiffs have never alleged otherwise), Plaintiffs have identified instances where *each* of the Venture Capital Defendants coordinated their investments in some combination with other fellow Venture Capital Defendants. These allegations, combined with the other facts Plaintiffs have identified, support a reasonably conceivable inference of coordination and control.

Defendants also ask this Court to ignore plain evidence that representatives of two Venture Capital Defendants – Rick Anderson (of PTV) and Jay Schmelter (affiliated with RiverVest) – held seats on Tryton Medical's board of directors <u>*at the same time*</u> both served as directors of IDEV. A1183. While Defendants attempt to downplay these facts as contained within an "internet article" that lies outside the pleadings (AB at 26), the Court may consider "judicially noticeable facts," such as press releases. *See In re Duke Energy Corp. Deriv. Litig.*, 2016 WL 4543788, at *4 n.34 (Del. Ch. Aug. 31, 2016) (taking judicial notice of a "publicly available press release" in deciding a motion to dismiss); *In re Gardner Denver*,

Inc. S'holders Litig., 2014 WL 715705, at *9 (Del. Ch. Feb. 21, 2014) (taking judicial notice of webpages when plaintiff did not "contest the authenticity of any of these documents"); D.R.E. 201(b)(2) (Court may take judicial notice of facts that "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned"). Plaintiffs are not relying on a random, third-party internet source, the contents of which Defendants could legitimately question. Rather, Plaintiffs rely on a press release that appears on the website of *RiverVest*, one of the Venture Capital Defendants, and thus its contents are not susceptible to dispute. A1183.

Discovery undoubtedly will reveal additional connections and relationships between the Venture Capital Defendants, but at this stage of the proceeding Plaintiffs alleged enough to support a reasonable inference of cooperation and coordination and establish a control group under *Gentile*.

4. The Court Of Chancery Ignored Critical, Undisputed Facts In Analogizing This Case To *van der Fluit*

At the pleading stage, the Court of Chancery must consider all relevant factors *together* to determine whether Plaintiffs satisfied their burden to allege a "reasonably conceivable" scenario where the Venture Capital Defendants constitute a control group. All parties agree that *van der Fluit* and *Hansen* are key opinions for the Court to consider. It is also clear that Plaintiffs here have alleged far more than the unsuccessful plaintiff in *van der Fluit*. In considering which

facts are sufficient to establish a control group, the *Hansen* Court's discussion of *van der Fluit* is instructive:

> Most importantly, the plaintiff [in *van der Fluit*] 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 . . . nor did the plaintiff allege any other facts to support any connection between the members of the purported control group.

Hansen, 2018 WL 3025525, at *6. By contrast, Plaintiffs here have set forth in detail several legally significant connections between the Venture Capital Defendants that, when taken together, support a reasonable inference that they constituted a control group. *See* OB at 17-23.

IV. THE DIRECTOR DEFENDANTS' ALTERNATIVE GROUND FOR DISMISSAL IS MERITLESS

The Director Defendants do not dispute that they were "Significant Shareholders" in IDEV and participated in the challenged transactions at issue. A302-303. As discussed in Plaintiffs' Opening Brief, the Director Defendants served on the Company's board while beholden to the Venture Capital Defendants (who effectively controlled their board seats) and approved a transaction that granted the Venture Capital Defendants disparate benefits at Plaintiffs' expense. OB at 8-11.[7] Nevertheless, the Director Defendants contend that the Complaint

[7] The Director Defendants suggest that the 2010 financing was no different than the 2004, 2006 and 2008 financings, which "diluted the Shareholders' interests

pleads only duty of care claims for which they are exculpated under 8 *Del. C.* § 102(b)(7) and IDEV's charter. Drawing all reasonable inferences in Plaintiffs' favor, however, the Amended Complaint more than adequately pleads non-exculpated breaches of the duty of loyalty. *See In re Cornerstone Therapeutics Inc., S'holder Litig.*, 115 A.3d 1173, 1180-81 (Del. 2015) ("When [entire fairness] is invoked at the pleading stage, the plaintiffs will be able to survive a motion to dismiss by interested parties regardless of the presence of an exculpatory charter provision because their conflicts of interest support a pleading-stage inference of disloyalty.").

Statutory or charter exculpation does not insulate directors "from alleged acts of bad faith or other breaches of the duty of loyalty." *In re Saba Software, Inc. Stockholder Litig.*, 2017 WL 1201108, at *19 (Del. Ch. March 31, 2017). At the motion to dismiss stage, factual allegations should be construed liberally to support claims for breaches of the duty of loyalty, rather than limited to a claim that "solely implicates a violation of the duty of care." *OTK Assocs., LLC v. Friedman*, 85 A.3d 696, 725 (Del. Ch. 2014) (emphasis added) (finding it necessary to hear evidence at trial to determine whether a breach involves only the

---

over time without any apparent dispute." AB at 9. After the 2008 financing, however, Plaintiffs still maintained approximately 3.75% of the total equity of IDEV. A30. And unlike IDEV's previous financings, the 2010 transactions orchestrated by Defendants treated their fellow common stockholders in a disparate and unfair manner, and effectively wiped out Plaintiffs' equity stake in IDEV. A31-35.

duty of care or also reaches duties of loyalty). Here, as noted above, the Director Defendants were financially interested in the transactions at issue and beholden to the Venture Capital Defendants, who constituted a control group.

CONCLUSION

The Court of Chancery's dismissal of Plaintiffs' well-pled allegations at an early stage of the proceedings was contrary to Delaware law and allows the actions of faithless fiduciaries to evade judicial scrutiny. For the reasons stated above and in Appellants' Opening Brief, Plaintiffs respectfully request that this Court reverse the Court of Chancery's holding as inconsistent with *Gentile* and remand the action to allow Plaintiffs to prosecute their claims on their merits.

WILKS, LUKOFF & BRACEGIRDLE, LLC

/s/ Scott B. Czerwonka
Thad J. Bracegirdle (No. 3691)
Scott B. Czerwonka (No. 4844)
4250 Lancaster Pike, Suite 200
Wilmington, DE 19805
(302) 225-0850

Attorneys for Plaintiffs Below-Appellants

Dated: May 28, 2019