IN THE SUPREME COURT OF THE STATE OF DELAWARE

CHARLES ALMOND AS TRUSTEE FOR THE ALMOND FAMILY 2001 TRUST, ALMOND INVESTMENT FUND LLC, CHARLES ALMOND, and ANDREW FRANKLIN,

Plaintiffs Below,
Appellants,

v.

GLENHILL ADVISORS, LLC, GLENHILL CAPITAL LP, GLENHILL CAPITAL MANAGEMENT LLC, GLENHILL CONCENTRATED LONG MASTER FUND LLC, GLENHILL SPECIAL OPPORTUNITIES MASTER FUND LLC, JOHN EDELMAN, GLENN KREVLIN, JOHN McPHEE, WILLIAM SWEEDLER, WINDSONG DB DWR II, LLC, WINDSONG DWR LLC, WINSDONG BRANDS, LLC, HERMAN MILLER, INC, and HM CATALYST, INC.,

Defendants Below,
Appellees,

and

DESIGN WITHIN REACH, INC.,

Intervenor and
Counterclaim-Petitioner Below,
Appellee.

Consolidated
No. 215, 2019
No. 216, 2019

Court below: Court of Chancery of the State of Delaware, C.A. No. 10477

CORRECTED ANSWERING BRIEF OF APPELLEES GLENHILL ADVISORS LLC, GLENHILL CAPITAL LP, GLENHILL CAPITAL MANAGEMENT LLC, GLENHILL CONCENTRATED LONG MASTER FUND LLC, GLENHILL SPECIAL OPPORTUNITIES MASTER FUND LLC, GLENN KREVLIN, WILLIAM SWEEDLER, WINDSONG DB DWR II, LLC, WINDSONG DWR LLC, JOHN EDELMAN, JOHN MCPHEE AND WINDSONG BRANDS, LLC

Dated: August 13, 2019

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NATURE AND STAGE OF THE PROCEEDINGS

In the Memorandum Opinion dated August 17, 2018 (the "Opinion"), issued after a five-day trial, the Court of Chancery entered judgment in favor of Defendants on all 12 counts of Plaintiffs' Fourth Amended Complaint and certain parties' counterclaims brought under Section 205 of the DGCL. The Court of Chancery divided the issues into three distinct categories for analysis.[1] This appeal by three plaintiffs associated with Charles Almond (collectively, "Almond") solely concerns the "Overpayment Claims," a challenge to the fairness of four transactions in 2010-2013 between Design Within Reach, Inc. ("DWR"), on one hand, and one or more of the Individual Defendants (as defined below) or their affiliates, on the other, prior to the July 2014 cash-out merger transaction in which an affiliate of Herman Miller, Inc. ("Herman Miller") acquired DWR ("Merger"). Plaintiffs, who admit the Overpayment Claims are derivative in nature, argued below that they could establish direct claims because the Individual Defendants formed a "control group" with DWR's controlling stockholder. The Opinion correctly holds that Plaintiffs, as former DWR stockholders, do not have standing to pursue the Overpayment Claims because Plaintiffs did not prove the existence of any control group and, therefore,

[1] *See* Opinion 3.

did not prove the Overpayment Claims fall within the narrow category of derivative claims that may also be simultaneously direct in nature.

This brief responds to Almond's appeal on behalf of the Individual Defendants and their affiliates.

The fourth Plaintiff, Andrew Franklin, appeals aspects of the Court of Chancery's rulings on the other two categories of claims and denial of Plaintiffs' request for a fee award. Defendants below/counterclaimants Herman Miller, HM Catalyst, Inc. and DWR respond to that appeal in a separate brief (the "Herman Miller Brief").

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery correctly dismissed the Overpayment Claims because Almond did not prove facts necessary to establish a direct claim under *Gentile v. Rossette*.[2]

a. Denied. The Court of Chancery correctly held that the Individual Defendants did not constitute a control group with DWR's controlling stockholder that collectively expropriated value and voting power from the minority stockholders. Almond argues that it was error for the Court of Chancery to focus its *Gentile* analysis on the existence of a control group. But the Court did so because that is how Plaintiffs presented their argument below.[3] Almond's attempt to take "the trial court to task for adopting the very analytical approach that [he himself] used in presenting [his] position" should be rejected.[4]

In lieu of his control group theory, Almond argues, for the first time on appeal and relying on *Gatz v. Ponsoldt*,[5] that DWR's controlling stockholder "allowed" certain defendants to participate in the transactions underlying the Overpayment Claims for its benefit or to satisfy obligations it owed them, and

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[2] 906 A.2d 91 (Del. 2006).

[3] Almond Appx. A0326-29; Franklin Appx. A2246-54.

[4] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 55 (Del. 2006).

[5] 925 A.2d 1265 (Del. 2007).

therefore the transactions should be viewed as expropriations by the controller alone even though it did not retain the benefits. This argument should be rejected because it was not presented to the Court of Chancery.[6] Furthermore, there is no evidence in the record to support Almond's assertion that the consideration in the transactions was given for the controller's benefit or to discharge its obligations.

b. Denied. The Court of Chancery correctly held—and Almond does not dispute—that each of the transactions underlying the Overpayment Claims diluted the controlling stockholder. Therefore, Plaintiffs cannot satisfy the second prong of *Gentile*, which requires an exchange causing "an increase of the percentage of the outstanding shares owned by the controlling shareholder and a corresponding decrease in the share percentage owned by the public (minority) shareholders."[7] The Court should reject Almond's argument that all of the economic and voting rights that any of the Individual Defendants received in the transactions at issue should be imputed to the controller because it is (i) a new argument, and (ii) not supported by any record evidence.

c. Denied. The Court of Chancery correctly observed that Plaintiffs "chose to file [the Overpayment Claims] after the Merger closed, presumably aware

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[6] Rule 8; *Disney*, 906 A.2d at 55.

[7] *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248, 1263 (Del. 2016).

of the risk of litigating derivative claims in that context."[8] Regardless whether Almond knew about the transactions underlying the Overpayment Claims before the Merger closed, he was on notice when he filed his claims that the Court of Chancery might dismiss them under the well-settled continuous ownership rule if it concluded (as it ultimately did) that they are solely derivative in nature.

d. Denied. The Opinion does not, as Almond portends, cause a "public policy disaster," give fiduciaries a "roadmap" to breach their duties, or make a "change in the law."[9] Rather, it applies settled law to undisputed facts to conclude that the Overpayment Claims are exclusively derivative (as corporate overpayment claims usually are),[10] and therefore dismisses those claims pursuant to the continuous ownership rule (as is usually the result when a merger extinguishes stock ownership).[11] This has been the law for decades. In addition, stockholders who lose standing to pursue derivative claims because of a merger *do* have resulting direct claims to challenge the merger in appropriate situations. That Almond, who

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[8] Opinion 73.

[9] Almond Appellants' Opening Brief ("AOB") 2, 8.

[10] *Gentile*, 906 A.2d at 99 ("In the typical corporate overpayment case, a claim against the corporation's fiduciaries for redress is regarded as exclusively derivative, irrespective of whether the currency or form of overpayment is cash or the corporation's stock.").

[11] *Feldman v. Cutaia*, 951 A.2d 727, 731 (Del. 2008) ("a corporate merger generally extinguishes a plaintiff's standing to maintain a derivative suit").

conceded the total Merger consideration was fair, had no such claim here does not indicate there is a flaw in the Opinion.

FACTS

This section is drawn predominately from the findings of facts in the Opinion, which in turn is based on five days of live testimony, nine depositions, over 500 exhibits, 298 pages of post-trial briefing and two days of post-trial argument.[12]

A. The 2009 Transaction

In 2004, DWR, a retailer of modern furniture, went public and listed its common stock on NASDAQ.[13] Around May 2009, with the prolonged collapse of the housing market, DWR's lender informed DWR that it needed a capital infusion of $10 million to $15 million to maintain its line of credit.[14] Unable to obtain a financial viability exception from NASDAQ to allow such infusion, DWR delisted its stock effective July 16, 2009.[15]

A special committee of DWR's board of directors ("Board") pursued a private placement with affiliates of defendant Glenhill Capital, L.P., a fund complex managed by defendant Glenn Krevlin, that held approximately 2,500,000 shares or

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[12] *See* Opinion 3.

[13] *Id*. at 4, 7.

[14] *Id*. at 7.

[15] *Id*.

17.2% of DWR's common stock.[16] Glenhill had no Board representation at the time.[17] On July 20, 2009, Glenhill acquired a 91.33% ownership stake for $15 million in the form of 15.4 million shares of DWR common stock for $0.15 per share and 1 million shares of Series A 9% Convertible Preferred Stock (the "Series A Preferred") for $12.69 per share (the "2009 Transaction").[18]

As part of the 2009 Transaction, DWR agreed that Glenhill would have three Board designees.[19] Glenhill initially designated (i) Krevlin, (ii) William Sweedler, the managing member of defendant Windsong Brands, LLC ("Windsong Brands"), an investment and restructuring company, and (iii) David Rockwell, an architect, who joined the two existing directors, CEO Ray Brunner and Peter Lynch.[20]

B. The Brands Grant

From late August 2009 until early 2010, Windsong Brands supplied interim management while DWR investigated allegations of misconduct against CEO

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[16] *Id.* at 5, 8. "Glenhill" includes defendants Glenhill Capital, L.P., Glenhill Advisors LLC, Glenhill Capital Management LLC, Glenhill Concentrated Long Master Fund, LLC ("Glenhill Long Fund") and Glenhill Concentrated Long Master Fund LLC and non-party Glenhill Capital Overseas Master Fund, L.P. ("Glenhill Overseas Fund").

[17] *Id.* at 8.

[18] *Id.*

[19] *Id.* at 12.

[20] *Id.* at 6, 12.

Brunner and performed a top-to-bottom review of DWR's business.[21] Windsong Brands oversaw a reduction of 20% to 30% of DWR's staff and the implementation of other measures to "stop[] the bleeding."[22] On October 16, 2009, DWR terminated the registration of its common stock to save the expense of public company filings.[23] By year-end 2009, Windsong Brands had reduced DWR's expense structure by 20% or approximately $11.4 million, but pre-tax losses still increased to $24.9 million.[24] With losses mounting, the Board considered filing for bankruptcy.[25]

Windsong Brands did not reach an agreement with DWR on compensation before beginning this work.[26] In early 2010, Sweedler began negotiations with Krevlin, seeking a 10% equity interest in DWR, in his view "commonplace" compensation for services of this type.[27] After a long, drawn-out negotiation, Sweedler ultimately agreed to a 1.5% equity interest.[28]

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[21] *Id.* at 13. The investigation eventually culminated in Brunner's termination for cause. *Id.* at 12.

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.* at 13-14.

[28] *Id.* at 14.

On September 28, 2011, DWR granted 54,796 shares (representing 1.5% of DWR's fully-diluted equity) of restricted stock to Windsong Brands that would vest only if a change of control occurred before March 22, 2016 (the "Brands Grant").[29]

C. DWR Hires Edelman and McPhee

In fall 2009, Sweedler introduced Krevlin to defendants John Edelman and John McPhee, who had recently sold their business to a competitor of DWR.[30]

On December 14, 2009, DWR entered into employment agreements with Edelman (CEO) and McPhee (COO) that included options to purchase 4% and 3% of DWR's equity, respectively.[31] They began work in January 2010 and joined Krevlin and Sweedler on the Board, with Krevlin serving as Chairman.[32]

D. The Windsong Note

DWR's performance continued to decline in the first quarter of 2010.[33] Concerned that DWR would run out of money, the Board began to consider a $5

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[29] *Id*.

[30] *Id*.

[31] *Id*. at 15.

[32] *Id*. Krevlin, Sweedler, Edelman and McPhee are the "Individual Defendants." Brunner, Rockwell and Lynch had resigned in the interim. *Id*. at 15 n.59.

[33] *Id*. at 15-16.

million capital raise.[34] Discussions with potential outside investors were not fruitful.[35] The Board was also concerned about the viability of outside funding due to significant unknown liabilities, including the expense of buying out leases for closed and underperforming stores and a newly-discovered potential multimillion-dollar liability arising from employee "wage and hour" claims.[36]

The capital raise, which closed May 18, 2010, took the form of a $5 million senior secured convertible note (the "Windsong Note").[37] The Windsong Note was priced on the same terms as Glenhill's 2009 investment, so that it would convert at the same exchange ratio if converted immediately.[38] It paid interest at a rate of 5% per year, had a maturity date of October 3, 2012, and contained an option to convert all of the principal and accrued interest into DWR common stock based on a stated conversion matrix.[39] The investor was defendant Windsong DWR, LLC ("Windsong I"), a limited liability company formed for the purpose of making the

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[34] *Id.* at 16.

[35] *Id.*

[36] *Id.* at 17.

[37] Franklin Appx. A0843-51.

[38] Opinion 18.

[39] *Id.* at 19.

loan.[40] Through Windsong I, Edelman invested $2,000,000; Sweedler (through Windsong DB, LLC) $1,150,000; Glenhill Long Fund $1,000,000; McPhee $750,000; and Windsong Brands employee non-party Stuart Jamieson $100,000.[41] Each of Windsong I's members' interest was proportionate with the amount invested.[42]

The Court of Chancery found that the terms of the Windsong Note were the product of a conflicted and deficient process.[43] Seth Shapiro, an analyst at Glenhill, negotiated the transaction on behalf of DWR against Sweedler although his employer was to own part of the Windsong Note.[44] Windsong Brands' outside counsel prepared deal documents, and DWR did not engage an outside financial advisor or involve its outside counsel in negotiations.[45]

On May 24, 2010, DWR issued a Notice of Annual Meeting of Stockholders ("Meeting Notice"), which disclosed the Windsong Note, the conversion matrix and

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[40] *Id*. at 19.

[41] *Id*. at 19-20. Jamieson served as acting CEO of DWR in late 2009. *Id*. at 13.

[42] *See id*. at 19-20.

[43] *Id*. at 17.

[44] *Id*. at 17-18.

[45] *Id*.

the affiliation of all Board members with Windsong I.[46] Evidence that the Meeting Notice had been sent to, and received by, stockholders included a June 7, 2010 email from Almond's counsel about "the annual meeting notice statement you received."[47]

E. The Reverse Stock Splits

In 2010, to address volatility and save costs, the Board implemented a 50-to-1 reverse split of *both* the common stock and the Series A Preferred (the "Reverse Stock Splits"), reducing the number of authorized shares of common stock from 30 million to 600,000, and Series A Preferred from 1.5 million to 30,000.[48] The Court of Chancery found that, although unknown to anyone at the time, there were many flaws in the implementation of the Reverse Stock Splits, including counsel mistakenly "structur[ing the transaction] to reduce by a factor of 2500-to-1 the number of shares of common stock into which the Series A Preferred could convert."[49] "There is ***zero*** evidence in the record that anyone involved intended for the Reverse Stock Splits to cause this double dilution."[50] The Reverse Stock Splits,

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46 *Id.*; B114-81.

47 *See* B182; *see also* B183-84, B185-282.

48 Opinion 21.

49 *Id*. at 22.

50 *Id*. at 42 (emphasis in Opinion); *see also id*. at 50 (finding there is "no credible evidence" the double dilution was anything but an error).

which are a subject of Franklin's appeal, are addressed in detail in the Herman Miller Brief.

F. The 2012 Financing

By the end of 2011, DWR's performance had begun to improve, and Management prepared a 2012 budget contemplating \$3.3 million in capital expenditures.[51] The Board discussed a private placement to fund them.[52]

On July 19, 2012, DWR entered into a series of agreements concerning (i) the sale of stock and granting of options to raise up to \$2.5 million (the "2012 Financing"); (ii) modification of the Windsong Note; and (iii) establishing the date for the conversion of the Series A Preferred as October 3, 2013.[53]

In the stock transaction, DWR entered into a Securities Purchase Agreement with Edelman, McPhee, Glenhill Long Fund, and Sweedler, through defendant Windsong DB DWR II, LLC ("Windsong II"), to sell 401,108 common shares for a total of \$1.8 million, or \$4.49 per share (the "2012 Stock Sale").[54] Edelman and McPhee each received an option to acquire up to \$350,000 worth of additional shares

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[51] *Id*. at 24.

[52] *Id*.

[53] *Id*. The conversion of the Series A in 2013, another subject of Franklin's appeal, is addressed in the Herman Miller Brief.

[54] *Id*. at 25.

of common stock at the same per share price, which they exercised in December 2012.[55] Edelman invested a total of $750,000 in the 2012 Financing; McPhee $750,000; Glenhill Long Fund $500,000; and Windsong II $500,000.[56]

By fixing a conversion date for the Series A, Glenhill agreed to end all PIK dilution.[57] Windsong I also agreed to convert its outstanding principal at a conversion price of $3.5339 per share, forfeit $600,000 of accrued interest and extend the maturity date a year to October 3, 2013.[58] In Krevlin's view, everyone gave something up to benefit DWR: Glenhill its PIK interest, Windsong I its 5% interest, and management demonstrated its commitment to DWR.[59]

The Court of Chancery found that, as with the Windsong Note, the 2012 Financing was the product of a conflicted and deficient process.[60] DWR did not hire a financial advisor, there are no Board minutes reflecting deliberations (the 2012

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[55] *Id*.

[56] *Id*.

[57] *Id*.

[58] *Id*. at 26-27.

[59] *Id*. at 27.

[60] *Id*.

Financing was approved by written consent), and Shapiro was again tasked with negotiating against Sweedler.[61]

G. The Anti-Dilution Grants

On July 17, 2012, DWR (i) granted 19,654 restricted shares of common stock to Windsong Brands; and (ii) awarded Edelman and McPhee 55,459 and 41,594 options (together, the "Anti-Dilution Grants").[62] The restricted stock had the same terms as in the Brands Grant.[63] The Anti-Dilution Grants were made to offset the PIK dilution incurred since execution of the Brands Grant and employment agreements.[64]

H. The Merger

In November 2013, the Board retained Financo LLC as its financial advisor in connection with a potential sale of DWR.[65] The process led to the transaction with Herman Miller, its largest supplier.[66]

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[61] *Id*.

[62] *Id*. at 28.

[63] *Id*.

[64] *Id*. at 29.

[65] *Id*. at 31.

[66] *Id*.

In July 2014, Herman Miller agreed to purchase DWR for an enterprise value of $183 million or an estimated equity value of approximately $170.4 million, subject to certain adjustments.[67] To effect the Merger: (i) Herman Miller purchased approximately 83% of DWR's total equity from the Selling Shareholders at $23.9311 per share subject to a working capital adjustment;[68] (ii) Edelman and McPhee, who would remain as management, exchanged some of their DWR shares (approximately 14% of DWR's equity) for an 8% interest in a newly formed subsidiary of Herman Miller; and (iii) DWR ended up as the surviving entity of a short-form merger with defendant HM Catalyst, Inc., in which the remaining stockholders of DWR were cashed out for the same per share price as the Selling Shareholders.[69] The Merger closed on July 28, 2014.[70]

In August 2014, DWR mailed a Notice of Merger and Appraisal Rights (the "Merger Notice") to DWR's stockholders of record.[71] The Merger Notice provided

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[67] *Id.*

[68] The "Selling Shareholders" were the Glenhill Overseas Fund, the Glenhill Long Fund, Windsong Brands, Windsong DB, LLC, Jamieson Investments, LLC, Edelman and McPhee. *Id.* at 32 n.142.

[69] *Id.* at 31-32. Unlike other stockholders, the Selling Shareholders were required to place $18.5 million of their proceeds into escrow to secure certain of DWR's contingent liabilities. *Id.* at 32 n.143.

[70] *Id.* at 32.

[71] *Id.* at 33.

background information about DWR, described the Merger, outlined the stockholders' appraisal rights, and attached copies of three years of audited financial statements and a fairness opinion from Financo.[72] Plaintiffs tendered their shares in August 2014 for the Merger consideration.[73] Throughout this litigation, they have never challenged the Merger consideration's fairness.[74]

I. Procedural History

On December 14, 2014, Plaintiffs filed their initial Verified Complaint, which was amended March 12, 2015, against Glenhill and the Individual Defendants alleging breach of fiduciary duty and conversion in connection with the Windsong Note, Brands Grant, 2012 Financing and 2013 Conversions and for allegedly benefiting from "void" acts due to alleged errors in 2012 and 2013 amendments of DWR's certificate of incorporation.[75]

On November 13, 2015, plaintiffs filed a Second Amended Complaint, which added Herman Miller as a defendant and asserted that the Merger was void because

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[72] *Id.*

[73] *Id.* at 4.

[74] *Id.* at 77.

[75] *See generally* B294-325.

Selling Shareholders owned only approximately 60% of DWR's common stock as a result of defects in the Reverse Stock Splits and 2013 Conversions.[76]

Following the close of fact discovery, and about three months before trial, Plaintiffs filed a Fourth Amended Complaint, adding claims based on alleged misleading statements and omissions in the Merger Notice and payment of bonuses to certain members of management in lieu of their exercising their options.[77]

Plaintiffs' twelve causes of action brought to trial coalesce around three categories.[78] The one category implicated by Almond's appeal posits that Glenhill, as controlling stockholder, and the Individual Defendants caused DWR to enter into four transactions—the Windsong Note, the Brands Grant, the Anti-Dilution Grants and the 2012 Stock Sale (collectively, "Overpayment Transactions")—that allegedly unfairly benefited those defendants (the "Overpayment Claims").[79] As damages, Plaintiffs sought less than $1.1 million.[80]

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[76] Opinion 33-34.

[77] *Id*. at 37-38. The Third Amended Complaint had added claims that Franklin had purportedly acquired from four former stockholders. The bonuses are addressed in detail in the Herman Miller Brief.

[78] *See id*. at 3, 38.

[79] *Id*. at 54-55.

[80] B411 (damages calculation for all breach of fiduciary claims); Franklin Appx. A2043-44.

In their answers to each successive complaint, as well as the pretrial order, Glenhill and the Individual Defendants asserted that Plaintiffs' claims were derivative in nature and briefed the issue in their pre- and post-trial briefs.[81] Despite notice of the standing issue since at least April 2015, Plaintiffs failed to address it in their pretrial brief or opening post-trial brief. Plaintiffs first did so in their post-trial *reply* brief, where they argued that they had standing to bring direct claims because the Individual Defendants and Glenhill "were part of a control group."[82]

The Court of Chancery held that Plaintiffs' standing to bring the Overpayment Claims, which Plaintiffs had conceded were derivative in nature, was extinguished in the Merger.[83] The exception stated in *Gentile* did not apply because Plaintiffs had not proven that Glenhill was in a "control group" with Edelman, McPhee and Sweedler; at most, the evidence demonstrated "parallel interests."[84] Glenhill was never limited in any way from "vot[ing] its shares in the Company as it saw fit," and all four Overpayment Transactions diluted Glenhill.[85]

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[81] *See* AOB 22; B323; Pretrial Order 35 (Franklin Appx. A1374); B533-42.

[82] Almond Appx. A0326-30.

[83] Opinion 57, 72.

[84] *Id.* at 65-67.

[85] *Id.* at 69-71.

ARGUMENT

THE COURT OF CHANCERY CORRECTLY DISMISSED PLAINTIFFS' OVERPAYMENT CLAIMS FOR LACK OF STANDING.

A. Question Presented

Did the Court of Chancery correctly hold that Plaintiffs' derivative Overpayment claims could not be asserted directly under the *Gentile* paradigm? The Defendants raised this issue below.[86]

B. Standard of Review

Whether the Plaintiffs proved they have standing under *Gentile* presents a mixed question of law and fact. The factual findings underpinning the Court of Chancery's holding are reviewed for abuse of discretion, reversible only if they were "arbitrary and capricious."[87] The Court of Chancery's application of the law to the facts-as-found is ordinarily reviewed *de novo*.[88] However, Almond's arguments that were raised for the first time on appeal should not be considered.[89]

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[86] B533-42.

[87] *Ams. Min. Corp. v. Theriault*, 51 A.3d 1213, 1262 (Del. 2012).

[88] *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248, 1256 (Del. 2016).

[89] Rule 8.

C. Merits of Argument

It is undisputed that Plaintiffs are no longer DWR stockholders, and therefore, by operation of the continuous ownership rule, lack standing to maintain the Overpayment Claims to the extent that they are solely derivative in nature.[90] In an attempt to escape dismissal for lack of standing, Almond argues that each Overpayment Claim may be asserted as a direct claim under *Gentile*.

Under *Gentile*, a "corporate overpayment claim" can be both direct and derivative in nature where:

> (1) a stockholder having majority or effective control causes the corporation to issue "excessive" shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders.[91]

This Court recently construed *Gentile* in *El Paso*, in which it reversed a $171 million damages judgment because the plaintiff's standing to maintain derivative claims had been eliminated by a merger that closed late in the litigation.[92] In so doing, this Court reinforced the significance of the direct/derivative distinction and the

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[90] Opinion 55-56 (citing May 1, 2018 Tr. 85 (Franklin Appx. A2253)).

[91] *Gentile*, 906 A.2d at 99-100.

[92] *El Paso*, 152 A.3d at 1250-51.

continuous ownership rule that have been hallmarks of Delaware law for decades.[93] It declined to expand *Gentile*, lest the exception swallow the general rule that corporate overpayments are exclusively derivative,[94] instead making clear that *Gentile* may be invoked only when the transaction in question causes "an improper transfer of both economic value *and* voting power from the minority stockholders to the controlling stockholder."[95]

El Paso's holding that a stockholder must suffer harm to both economic value and voting rights to state a direct claim emanates from *Tooley*,[96] the seminal case for determining whether a claim is direct or derivative. Under *Tooley*, "a plaintiff 'must demonstrate,'" among other things, "'that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.'"[97] Thus, for a direct claim to be viable, the stockholder "must have suffered some individualized harm not suffered by all of the stockholders at large."[98]

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[93] *See, e.g.*, *In re New Valley Corp. Deriv. Litig.*, 2004 WL 1700530, at *3 (Del. Ch. June 28, 2004) (describing the continuous ownership rule as a "bedrock tenet of Delaware law that is adhered to closely").

[94] *El Paso*, 152 A.3d at 1264.

[95] *Id.* at 1263-64.

[96] *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004).

[97] *El Paso*, 152 A.3d at 1260 (quoting *Tooley*, 845 A.2d at 1039).

[98] *Id.* at 1263 n.76 (quoting *Feldman*, 951 A.2d at 733).

The claims in *El Paso* were solely derivative because (among other reasons) the plaintiff did not prove that he or the partnership's other limited partners suffered any individual harm,[99] instead contending only that they had been harmed *pro rata* in proportion to their ownership, a quintessentially derivative claim.[100]

1. Almond Does Not Challenge The Court of Chancery's Conclusion That The Individual Defendants Were Not Part of a Control Group, and His New Argument Should be Rejected.

Although Plaintiffs bore the burden of proving they have standing to maintain the Overpayment Claims,[101] they did not argue they had standing under *Gentile*—or even cite *Gentile*—until their post-trial reply brief.[102] Plaintiffs' late-raised argument asked to the Court of Chancery to look at each Overpayment Transaction

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[99] *Id.* at 1264, 1265.

[100] *Id*. at 1264 ("Were Brinckerhoff to recover directly for the alleged decrease in the value of the Partnership's assets, the damages would be proportionate to his ownership interest. The necessity of a pro rata recovery to remedy the alleged harm indicates that his claim is derivative."); *Feldman*, 951 A.2d at 733 ("Where all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock because they are stockholders, then the claim is derivative in nature.").

[101] *El Paso*, 152 A.3d at 1260 n.57 (quoting *Dover Historical Soc'y v. City of Dover*, 838 A.2d 1103, 1109 (Del. 2009)).

[102] *See* AOB 24 (citing post-trial reply brief, Almond Appx. A0326-33, for the proposition Almond's standing argument was preserved). The single page of Plaintiffs' pretrial brief cited by Almond, *see id.* (citing A0243), contains no reference to standing.

as if it had been undertaken with a "control group" made up of Glenhill and all four Individual Defendants.[103] Plaintiffs framed their argument this way because Glenhill (i) was a minority participant in the Windsong Note and 2012 Financing; and (ii) did not participate at all in the Brands Grant and Anti-Dilution Grants.[104] Thus, Plaintiffs realized they could not prevail on an argument that Glenhill alone had engaged in expropriation under *Gentile*. During post-trial oral argument, Plaintiffs continued to premise their *Gentile* argument on the notion that the Individual Defendants constituted a control group with Glenhill.[105]

The Court of Chancery held that Plaintiffs failed to prove the Individual Defendants constituted a control group with Glenhill.[106] That holding had two consequences: (i) there was no basis for a direct claim against Edelman, McPhee or

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[103] Almond Appx. A0326, A0327 (Windsong Note "result[ed] in expropriation of economic and voting power from the minority to benefit the controlling group"), A0328-29 (arguing challenge to the Anti-Dilution Grants trigger *Gentile* because the recipients were part of a "control group"), A0329 (same regarding Brands Grants), *id*. (2012 Financing increased ownership stake of the "control group").

[104] *See* Opinion 71 (concluding that Plaintiffs raised their novel control group argument because Glenhill was diluted by each of the transactions underlying the Overpayment Claims and "Plaintiffs do not contend otherwise").

[105] Franklin Appx. A2246-47, A2249, A2254.

[106] Opinion 68.

Sweedler, who were not DWR's controlling stockholders;[107] and (ii) because Glenhill was diluted by each of the Overpayment Transactions, there was no transfer of economic value or voting power to Glenhill.[108]

In this Court, Almond argues for the first time that the Court of Chancery erred by "focus[ing] its and the parties' attention" on whether "the Individual Defendants could constitute a control group for *Gentile* purposes."[109] Instead, according to Almond, now relying on *Gatz*, the analysis should have focused on whether Krevlin expropriated economic value and voting power for his benefit and then transferred it to the others.[110]

This is a new argument and should be rejected for that reason alone.[111] The Opinion focused on the control group issue because that is how Plaintiffs framed their standing argument below.[112] Plaintiffs did not argue below that the

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[107] *See Sciabacucchi v. Liberty Broadband Corp.*, 2018 WL 3599997, at *10 (Del. Ch. July 26, 2018) (stating that to invoke *Gentile* there must be a "dilutive stock issuance to the controlling stockholder").

[108] Opinion 68-69.

[109] AOB 25.

[110] *Id*. at 29, 31.

[111] *See* Rule 8; *Danby v. Osteopathic Hosp. Ass'n of Del*., 104 A.2d 903, 908 (Del. 1954) ("it is our duty to adhere to the well settled rule which precludes a party from attacking a judgment on a theory which was not advanced in the court below").

[112] *See supra* nn. 103-105.

Overpayment Transactions were undertaken for Glenhill's sole benefit or cite *Gatz*, and Almond offers no reason why this Court should now consider a brand new argument. Accordingly, this Court should not reach its merits.[113]

Almond's new argument would fail on its merits even were this Court to consider it. The result in *Gatz* stemmed from the concept that equity looks at substance rather than form.[114] Thus, this Court in *Gatz* considered the practical effect of two simultaneous transactions for the purposes of its *Gentile* analysis. The controlling stockholder first expropriated shares and voting power from the minority and then instantly transferred the shares it acquired to a third party.[115] While to "an outside observer" the controller never apparently possessed the expropriated shares, equity saw the transactions for what they were: an expropriation of shares followed by a seamless transfer to a third party.[116] Almond asks this Court to take *Gatz* a step further: treat the Overpayment Transactions, in which DWR conveyed something to Windsong Brands, Edelman, McPhee or Sweedler, as if the assets were first

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[113] *Disney*, 906 A.2d at 55 (declining to reach a new argument that was not fairly presented below).

[114] 925 A.2d at 1280.

[115] *Id*. at 1281.

[116] *Id*.

transferred to Glenhill and then transferred to the others for Krevlin's "own benefit" to satisfy obligations he supposedly owed to "his management team."[117]

There is nothing in the record to support Almond's version of events. Almond cites a total of three pages of testimony, which only concern the Windsong Note, to show that Edelman and McPhee "understood they were to invest in DWR" and Sweedler would invest in DWR only "if the investment had security."[118] This testimony says nothing about benefitting Krevlin or Glenhill, and does not even suggest that the economic substance of the Windsong Note (let alone the other three Overpayment Transactions) was that it was actually a two-stage transaction to discharge obligations to Krevlin. Instead, this testimony underscores that Edelman, McPhee and Sweedler received a security in exchange for investing directly in DWR.

The Court of Chancery's unchallenged findings about the Overpayment Transactions show the substance of the transactions:

- **The Windsong Note** evidenced Windsong I's $5 million convertible loan to DWR.[119] "Sweedler dictated the terms of the transaction."[120]

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[117] AOB 29-30.

[118] *Id*. (citing Almond Appx. A0365-67).

[119] Opinion 19.

[120] *Id*. at 18.

Each of the Individual Defendants (individually or through a designee) owned a membership interest in, and was entitled to distributions from, in Windsong I in proportion to the percentage of the $5 million that each contributed to the loan.[121] The Windsong Note diluted Glenhill.[122]

- **The Brands Grant** was a grant of restricted shares from DWR to Brands in consideration for the restructuring work Brands performed *for DWR* in 2009.[123] The terms of the Brands Grant came as a result of "vigorous and protracted" negotiations in which Brands was adverse to Glenhill.[124] Glenhill received no securities via the Brands Grant.[125]
- **The Anti-Dilution Grants** were restricted shares awarded to Windsong Brands and options awarded to Edelman and McPhee as additional employment compensation "to offset dilution they each would have suffered as a result of the dilutive events that occurred after" the Brands Grant and after they signed their employment

[121] *Id*. at 19-20.

[122] *Id*. at 71.

[123] *Id*. at 54.

[124] *Id*. at 64-65.

[125] *Id*. at 71.

agreements.[126] Glenhill received no securities in the Anti-Dilution Grants.[127]

- **The 2012 Financing** included DWR's sale of stock to the Individual Defendants for cash and extension of the Windsong Note.[128] Each Individual Defendant paid DWR the same price per share for the shares acquired.[129] The 2012 Financing diluted Glenhill.[130]

Almond does not dispute these fact-findings.[131] Accordingly, Almond's new *Gentile* theory fails as a matter of fact.

Lacking any evidence, Almond speculates without record citation, "These transactions must have provided Krevlin a benefit because there is no other explanation for why he allowed them to occur."[132] This case, which was tried after years of discovery, has progressed far beyond conjecture about what the parties'

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[126] *Id*. at 55; *accord id.* at 29.

[127] *Id*. at 71.

[128] *Id*. at 55.

[129] *See id*. at 25.

[130] *Id*. at 71.

[131] *See* AOB 9 (Almond has "no quarrel with the facts as found by the Court below" with one exception, discussed in subpart 3 below).

[132] *Id*. at 30.

intent might have been. In any event, Almond's speculation is just wrong: as explained, the Court of Chancery made fact-findings about why and how these transactions occurred; none of them was for Krevlin's benefit.

Moreover, contrary to Almond's invitation,[133] the Court should not infer that Krevlin somehow benefitted from the Overpayment Transactions just by virtue of being DWR's controlling stockholder. In most any corporation with a controlling stockholder, the controller would have to approve a dilutive issuance in order for it to occur. If the mere fact that the controller approved a share issuance were proof of benefit for the purposes of *Gatz*, then nearly every dilutive share issuance involving a controlled corporation would give rise to a direct claim under *Gentile*. Adopting this argument would dramatically expand *Gentile* and would swallow the general rule that challenges to dilutive issuances are exclusive derivative—precisely the result *El Paso* intended to rule out.

2. The Court of Chancery Correctly Held The Overpayment Transactions Did Not Result in an Improper Transfer of Either Economic or Voting Power from the Minority Stockholders to Glenhill.

Almond lacks standing to bring the Overpayment Claims directly under *Gentile* for yet another reason. The Court of Chancery held that the Overpayment Transactions did not result in a transfer of either economic or voting power from the

[133] *Id*.

minority stockholders to Glenhill, as would be required to satisfy the second prong of *Gentile*.[134] That is so, the Court of Chancery concluded, because Glenhill was diluted by each Overpayment Transaction.[135] Almond does not contest that finding; it is undisputed for the purposes of this appeal.

Almond's lone argument in response is that, again, the Court should treat the Overpayment Transactions as benefitting Krevlin.[136] For the reasons discussed above, the argument fails because it was not fairly presented or proved below.[137]

3. The Court of Chancery Correctly Observed That Plaintiffs Brought Their Claims Aware of the Risk That They Lacked Standing.

Near the end of the Opinion's discussion of standing, the Court of Chancery recognized dismissal was necessary because the circumstances required to invoke *Gentile* "simply do not exist here."[138] The discussion on this topic closed with the observation that, unlike in *El Paso*, Plaintiffs cannot claim to have been ambushed

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[134] Opinion 68-69 (quoting *El Paso*, 152 A.3d at 1263).

[135] *Id*. at 68-72.

[136] AOB 31-32.

[137] *See El Paso*, 152 A.3d at 1265 ("Finally, Brinckerhoff never presented evidence at trial of specific harm suffered by the limited partners, as the Court of Chancery stated. It follows that the General Partner should not be penalized for failing to defend at trial an element of a claim (*e.g.*, that the unitholders were directly harmed by the Fall Dropdown) that the plaintiff never attempted to prove.").

[138] Opinion 72.

by the conclusion that they lack standing since they were "presumably aware of the risk of litigating derivative claims" after the Merger that cashed them out of their DWR shares.[139] Almond argues that this observation is so incorrect as to call into question the Court of Chancery's entire analysis of the standing issue.[140] Almond is wrong.

For starters, the observation was accurate. Plaintiffs admitted in their original complaint that they had ceased to be DWR stockholders because of the Merger.[141] Thus, Plaintiffs knew from day one that they faced the risk that the Court would find their claims for corporate overpayment to be exclusively derivative in nature and therefore barred by the continuous ownership rule.[142] Moreover, as Plaintiffs admit, Defendants raised a standing defense predicated on the derivative nature of

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[139] *Id*. at 73.

[140] AOB 32-33, 36.

[141] B296-97 ¶¶4-5 (Plaintiffs alleging they were DWR stockholders until the Merger date), ¶45 (alleging shares were converted in the Merger into the right to receive the merger consideration).

[142] The rule has been consistently followed since at least 1984. *See*, *e.g.*, *Ark. Teacher Ret. Sys. v. Countrywide Fin. Corp*., 75 A.3d 888, 890 (Del. 2013) ("we ratify and reaffirm the continuous ownership rule"); *Lewis v. Anderson*, 477 A.2d 1040, 1049 (Del. 1984).

Plaintiffs' claims,[143] and so even if Plaintiffs had failed to recognize this issue on their own, they were alerted to it by Defendants.

Nonetheless, Almond argues that the Court of Chancery's observation is wrong because he did not have sufficient information to bring his claims before the Merger.[144] That argument misses the point, which is that Almond cannot claim to be surprised when the risk the Court of Chancery would find he did not have standing came to fruition. At bottom, the Court of Chancery's observation is that Plaintiffs are in an even less sympathetic position than was the plaintiff in *El Paso*, who could not have known that he would face a risk that his claims would be dismissed under the continuous ownership rule because the merger that cashed him out occurred after he had filed his lawsuit.

Almond does not explain how this concluding remark could constitute reversible error all by itself. The Opinion's *Gentile* analysis consists of 19 thorough and well-reasoned pages, preceded by 34 pages of unchallenged fact-findings. Almond's argument does not change the essential fact: Almond did not prove he has direct standing under *Gentile*.

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[143] *See* AOB 22; B323.

[144] *Id*. at 34-35; *but see* text accompanying nn. 46-47, *supra* (discussing the 2010 Meeting Notice).

4. Almond's "The Sky Is Falling" Argument Is Without Merit.

Finally, Almond urges reversal because the Opinion is a "public policy disaster" that gives fiduciaries a "roadmap" to escape liability for self-dealing.[145] Almond's parade of horribles is contrary to Delaware law in at least two ways. First, this Court has rejected that very argument many times over the last 50 years.[146] Yet, Delaware courts have carried on in applying the continuous ownership rule and the sky has not fallen. As the outcome in *El Paso* illustrates, the direct/derivative analysis does not depend on the merits of a plaintiff's claims.[147]

Second, Almond's concern about the implications of the result here is unfounded because, in appropriate cases, stockholders are not left without a remedy after losing standing to pursue derivative claims due to a merger. Upon the closing of a merger, ownership of derivative claims passes by operation of law to the

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[145] AOB 2, 8; *see also id*. at 38.

[146] *See*, *e.g*., *Lewis*, 477 A.2d at 1050 ("Finally, we take up plaintiff's policy contention that to permit dismissal of plaintiff's suit against former management of Old Conoco will leave a 'wrong' unremedied. Plaintiff argues... this will leave former shareholders of Old Conoco 'without a remedy to redress wrongs', thereby permitting purported wrongdoers to escape accountability. Defendants disagree.... We agree [with defendants]."); *Bokat v. Getty Oil Co.*, 262 A.2d 246, 249 (Del. 1970) ("The plaintiff argues that this result [i.e., dismissal of derivative claims] opens wide the door to unscrupulous management to play fast and loose with the rights of minority stockholders. But we think to the contrary.").

[147] *See Strategic Asset Mgmt., Inc. v. Nicholson*, 2004 WL 2847875, at *2 (Del. Ch. Nov. 30, 2004) ("One of the benefits of the 'continuous ownership requirement' is that it is straightforward.").

corporation's new owners.[148] If the acquired corporation's stockholders believe the directors sold the litigation asset to the acquirer at too low a price, the stockholders could (if the facts warrant) seek appraisal or bring direct fiduciary claims challenging the fairness of the merger.[149]

Plaintiffs here never attempted to assert such a claim, nor could they. Although Plaintiffs filed the Fourth Amended Complaint shortly before trial to add claims directly attacking the Merger, they did not contend that the stockholders had been unfairly compensated for the value of DWR's derivative claims that passed by operation of the Merger. On the contrary, "as Almond and Franklin both testified, plaintiffs have never contended—even after full discovery and the retention of experts—that the Merger consideration was unfair."[150]

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[148] *Feldman*, 951 A.2d at 731.

[149] *See El Paso*, 152 A.3d at 1252 ("The derivative plaintiff's recourse was to file a money damages challenge to the merger and prove that the failure to accord value to the limited partnership in the merger was somehow violative of his rights."); *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455, 477-89 (Del. Ch. 2013) (analyzing a post-merger direct claim); *In re Massey Energy Co.*, 2011 WL 2176479, at *29 (Del. Ch. May 31, 2011) ("appraisal petitioners can argue that the Merger price did not constitute fair value because the [m]erger price did not adequately account for the value of the [d]erivative [c]laims belonging to [the corporation]").

[150] Opinion 77 (footnote omitted).

CONCLUSION

Almond admits his claims are derivative. He cannot escape the continuous ownership rule by attempting to invoke a direct claim that he neither pled nor proved below. For the foregoing reasons, the judgments of the Court of Chancery should be affirmed.

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