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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE SMILEDIRECTCLUB, INC. DERIVATIVE LITIGATION	No. 205, 2021 Court Below: Court of Chancery of the State of Delaware, C.A. No. 2019-0940-MTZ

APPELLANTS' OPENING BRIEF

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NATURE OF THE PROCEEDINGS

Plaintiffs-Below, Appellants ("Plaintiffs"), stockholders of nominal defendant SmileDirectClub, Inc. ("SDC" or the "Company"), brought this litigation derivatively on behalf of SDC. Plaintiffs' claims relate to purchases by the Company of almost $700 million of units ("LLC Units") in SDC Financial LLC ("SDC Financial"), a subsidiary owning SDC's underlying business, primarily from corporate insiders (the "Insider Transactions"), occurring after the closing of SDC's initial public offering ("IPO" or the "Offering") and three days after Plaintiffs became SDC stockholders. The Insider Transactions provided a massive financial windfall to the corporate insiders, but were not entirely fair to SDC because they involved paying $21.85 for each of the LLC Units while SDC common stock, which was the economic equivalent of an LLC Unit, was trading between $17.81 and $19.00 per share, and closed at $18.90 per share per share on the day of the Insider Transactions. The lack of fairness to SDC was further evidenced by the subsequent decline of SDC's stock price to $8.74 per share as additional adverse facts existing at the time of the Insider Transactions – but which were undisclosed in the IPO prospectus (the "Prospectus") – were publicly disclosed.

On February 17, 2021, the Court of Chancery issued a Memorandum Opinion (the "Opinion"), attached hereto as Exhibit A, granting Defendants' motion to dismiss pursuant to Court of Chancery Rule 12(b)(6). The Opinion held that

Plaintiffs failed to meet their burden of demonstrating standing under 8 *Del. C.* §327 ("Section 327" or the "Statute"). Plaintiffs appeal from the Opinion.

SUMMARY OF ARGUMENT

1. Section 327 governs standing in stockholder derivative actions by requiring a plaintiff to have been "a stockholder of the corporation ***at the time of the transaction*** of which such stockholder complains." 8 *Del. C.* §327 (emphasis added). The "time of the transaction" for purposes of Section 327 is when there existed a binding and enforceable legal agreement or other similar legally binding action which could have been the subject of a damages action. *See, e.g.*, *7547 Partners v. Beck*, 682 A.2d 160, 162 (Del. 1996) (citing *Newkirk v. W.J. Rainey, Inc.,* 76 A.2d 121, 123 (Del. Ch. 1950)); *see also In re Nine Systems Corp. S'holders Litig.*, 2013 WL 771897, at *7-8 (Del. Ch. Feb. 28, 2013); *Leung v. Schuler,* 2000 WL 264328, at *8 (Del. Ch. Feb. 29, 2000); *Lavine v. Gulf Coast Leaseholds,* 122 A.2d 550, 552 (Del. Ch. 1956).

2. Defendants have failed to demonstrate that there was any contract requiring the Company to go forward with the Insider Transactions in which SDC paid $21.85 for each LLC Unit. Instead, the Prospectus, which is the document Defendants identify as creating such a contract, only states that the Company has an intention, rather than an obligation, to proceed with paying $21.85 for each LLC Unit purchased in the Insider Transactions, while also recognizing the Company's broad discretion in using the IPO's proceeds and defining intention as a forward-looking plan subject to change.

3. The Court of Chancery's analysis of Defendants' stated intentions as reflected in the Prospectus is irrelevant to the controlling legal analysis of whether a "transaction" within the meaning of Section 327 took place before Plaintiffs became stockholders of the Company and is also not properly based on the record facts.

4. Allowing Plaintiffs to pursue their Complaint is fully consistent with the statutory purpose of Section 327 because there is no evidence that Plaintiffs acquired their SDC stock for the purpose of instituting this lawsuit because Defendants' wrongdoing was not disclosed, and not known by Plaintiffs, at the time Plaintiffs purchased their SDC stock.

STATEMENT OF FACTS

I. THE COMPANY

SDC is a holding company that was formed with the intent of acquiring LLC Units of SDC Financial LLC ("SDC Financial"), the operating entity for SmileDirectClub's dental alignment business, the largest player in the exclusively direct-to-consumer market for orthodontic treatment utilizing at-home impression kits and in-store scanning services. ¶¶2, 32 (A38, A45). Each share of SDC's Class A common stock ("Common Stock") is the economic equivalent of an LLC Unit in SDC Financial. ¶¶2, 44 (A38, A50).[1] SDC's sole material asset is its equity interest in SDC Financial. *Id.*

After the IPO, a Seventh Amended and Restated Limited Liability Company Agreement of SDC Financial (the "LLC Agreement") made SDC the sole managing member of SDC Financial and recapitalized all LLC Units into a single class. SDC Ex. 1 at 62, SDC Ex. 4 at 1 (A214, A395). The LLC Agreement also governs, *inter alia*, the redemption rights of LLC Unit holders. *Id.* at §11.

II. THE PROSPECTUS

On September 11, 2019, SDC issued the Prospectus. ¶1 (A37); SDC Ex. 1 (A142). The Prospectus explained how the Company planned to use the IPO's net

[1] LLC Units are exchangeable on a one-for-one basis for shares of Common Stock. ¶43 (A50). SDC's Class B common stock (the "Class B Stock") has ten votes per share and no economic rights. SDC Ex. 1 at Cover (A142).

proceeds by stating that: "We ***intend*** to use such proceeds as follows: approximately $585.5 million … to purchase and cancel LLC Units from Pre-IPO Investors and shares of Class A common stock from the Blocker Shareholders, in each case at a price [of $21.85]…." Prospectus at 16-17 (A164-65) (emphasis added). The Prospectus also states that the Company's directors and officers would have "broad discretion in the use of the net proceeds from the IPO" and that its "management ***currently intends*** to use the net proceeds from this offering in the manner described in '*Use of Proceeds*'" described above. *Id.* at 55 (A203). Further clarifying matters, the Prospectus explained that the word "'intends'" as used therein did "not guarantee[] future performance and involve risks and uncertainties which are subject to change[.]" *Id.*

III. THE IPO

On September 12, 2019, SDC issued and sold 58,537,000 shares of Common Stock in an IPO at $23.00 per share, receiving net proceeds of $21.85 per share after underwriting discounts and commissions. ¶1 (A37). The IPO closed on September 16, 2019, with the Company receiving approximately $1.286 billion in net proceeds, which then represented SDC's sole material asset. ¶4 (A38).

IV. THE INSIDER TRANSACTIONS

After the IPO closed on September 16, 2019, SDC disclosed that it had "received net proceeds of approximately $1,286 million" and had used: "(i)

approximately $585.5 million to purchase and cancel LLC Units from pre-IPO investors and shares of Class A common stock from the Blocker equityholders, in each case for $21.85; (ii) approximately $38.0 million to pay incentive bonuses to certain employees pursuant to the Incentive Bonus Agreements ("IBAs") and (iii) approximately $81.6 million to fund the tax withholding and remittance obligations related to IBAs." (A710 [SDC Ex. 9, SDC's first Form 10-Q at p.75])]. SDC disclosed that there had "been no material change in the use of proceeds as described in the Prospectus." *Id.*

Members of SDC's board of directors (the "Board") received approximately $628.6 million from the Insider Transactions (¶¶6, 52, (A5, A53)), either directly or through entities they control, as follows:

The "Selling Directors"	LLC Units/ Shares Sold to SDC	Approximate Net Proceeds	Record Citation
David Katzman	8,998,951	$198.4 million	¶13 (A41)
Steven Katzman	663,595	$14.5 million	¶¶14, 75 (A42, A60)
Jordan Katzman	7,141,516	$157 million	¶¶15, 75 (A42, A60)
Alexander Fenkell	6,521,446	$143.75 million	¶16 (A42)
Susan Greenspon Rammelt	29,964	$654,713.40	¶17 (A43)
Clayton, Dubilier & Rice ("CD&R"), of which Defendant and Board member Richard J. Schnall is a member	2,275,857	$49 million	¶18 (A43)

V. SDC HAD NO OBLIGATION TO PAY $21.85 IN THE INSIDER TRANSACTIONS

The LLC Agreement did not obligate the Company to proceed with the Insider Transactions at the $21.85 price. ¶¶41-46 (A48-51). The Prospectus similarly gave the Company "broad discretion" to effectuate its then-"current[] intent" for the use of SDC's net proceeds. *See supra* p. 16-18. The LLC Agreement, which was the key document governing the Company's relationship with the LLC Unit holders, similarly did not mandate that SDC engage in the Insider Transactions. ¶¶5, 36, 43 (A38-39, A46-47, A50); *see also* SDC Ex. 4 (A395).

VI. THE INSIDER TRANSACTIONS WERE NOT ENTIRELY FAIR TO THE COMPANY

On September 16, 2019, SDC's common stock price, had already declined dramatically since the IPO and was trading between $17.81 and $19.00 per share, materially below the $21.85 which the Company paid that very day for each LLC Unit in the Insider Transactions. ¶49 (A52). In addition, even that price was artificially inflated by Defendants' failure to disclose material facts which later caused the price of the Common Stock to decline to $8.74 per share. ¶10 (A40).

ARGUMENT

I. THE TERM "TRANSACTION" AS USED IN SECTION 327 MEANS A LEGALLY BINDING AGREEMENT RATHER THAN DISCLOSING AN INTENT TO ENGAGE IN A TRANSACTION

A. Question Presented

Whether a legally binding agreement is required for something to be considered a "transaction" for the purposes of Section 327, or whether a publicly disclosed intention is sufficient to constitute a "transaction." Opinion at 26-27. This issue was preserved below in Plaintiffs' opposition brief to the motion to dismiss and at oral argument. (A774-77, A942-43, A956).

B. Scope of Review

The Court of Chancery's finding that the correct legal test for whether a "transaction" is complete based upon a public disclosure of an intention to engage in that transaction is purely a question of law, and thus reviewed *de novo*. *See e.g.*, *Morris v. Spectra Energy Partners (DE) GP, LP*, 2021 WL 221987 (Del. Jan. 22, 2021).

C. Merits of the Argument

Section 327 limits standing in a stockholder derivative action to situation in which "the plaintiff was a stockholder of the corporation ***at the time of the transaction of which such stockholder complains***...." 8 *Del. C.* §327 (emphasis added). The relevant issue for this appeal, therefore, what constitutes a "transaction" within the meaning of the Statute.

The Court of Chancery held that a stated intent or board authorization to engage in a transaction satisfies the statutory definition of Section 327 except where "the board both [1] failed to disclose [a transaction] before the plaintiff became a stockholder, and [2] modified [the transaction] after the plaintiff became a stockholder." Opinion at 26-27. Plaintiffs respectfully submits that the Court of Chancery erred in its analysis because it has long been Delaware law that "the term 'transaction'... [means] the wrongful acts which plaintiffs want remedied and which are susceptible to being remedied in a legal tribunal." *Newkirk,* 76 A.2d at 123. The relevant time to evaluate standing pursuant to Section 327 is when "the transactions ... were 'executed' or 'consummated[,]'" which in *Newkirk* was prior to the date the plaintiff acquired his stock. *Id.* (citation omitted).[2]

Lavine v. Gulf Coast Leaseholds demonstrates the importance of the date the transaction became legally complete to the issue of standing under Section 327. In *Lavine,* the transaction was finalized before the plaintiff became a stockholder ***except that*** it was subject to stockholder approval occurring after the plaintiff purchased his shares. *Lavine* held that the plaintiff had standing to sue under Section

[2] Specifically, in *Newkirk*, the plaintiffs acknowledged that they had not been stockholders of the Company at the time the controlling stockholder had usurped or diverted corporate opportunities. *Id.* at 122-123. Nonetheless, the plaintiffs claimed they had standing because those earlier transactions were purportedly part of a continuous wrong an argument which the Court of Chancery rejected. *Id.* at 123.

327 because "the transaction of which [the] plaintiff complains was ***legally completed*** when the stockholders voted their approval. This approval was admittedly given after plaintiff became a stockholder." 122 A.2d at 552 (emphasis added).

In *7547 Partners v. Beck*, this Court applied the same definition of "transaction" for the purposes of Section 327 as had been adopted in *Newkirk* and *Lavine*. 682 A.2d at 162 (quoting *Newkirk, supra*). Specifically, in *Beck*, this Court found that the plaintiff lacked standing because the transaction, which consisted of a ***binding agreement*** in a private placement between the defendants, on the one hand, and the corporation, on the other hand, "was ***completed*** with the approval of the allegedly misleading Registration Statement, which went into effect ***the day before the IPO***[.]" *Id.* (emphases added)*; see also In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 922 F. Supp. 2d 445, 465-66 (S.D.N.Y. 2013), *aff'd sub nom., In re Facebook, Inc., Initial Pub. Offering Derivative Litig.*, 797 F.3d 148 (2d Cir. 2015) (applying and discussing *Beck* in an action alleging damages from improper disclosures in an IPO registration statement holding that the plaintiffs lacked standing because "the challenged disclosures were made prior to the IPO and appeared in the Prospectus, which was declared effective by the SEC, ***before the Derivative Plaintiffs acquired their shares***") (emphasis added).

Leung v. Schuler is on point in holding that "the critical time for determining standing under Section 327 is when the transaction complained of is completed." 2000 WL 264328, at *8. *Leung* rejected the argument that a board of directors authorizing a transaction provided the relevant timing for determining Section 327 standing and, instead, held that the time of the "transaction" occurred when the shares were issued because "no claim for *damage* relief arose or could have arisen until the stock was actually issued." *Id.* at *8 (emphasis in original). The decision in *Leung*, contrary to the Court of Chancery's analysis, was not in any way dependent on whether the facts relating to the transaction had been previously disclosed as evidenced by the issue of disclosure figuring prominently in other portions of *Leung* but not even mentioned once in analyzing and discussing standing under Section 327. *Compare Leung*, 2000 WL 264328, at *3-6 (discussing disclosure at length with respect to class claims) *with id.* at *7-8 (not mentioning disclosure at all with respect to the derivative claims and the plaintiffs standing to assert those claims).

Maclary v. Pleasant Hills, Inc., 35 Del. Ch. 39, 109 A.2d 830 (Del. Ch. 1954), upon which *Leung* relied, is, as this Court observed in *Beck*, a "special case." Opinion at 22 & n.69 (quoting *Beck*, 682 A.2d at 162). However, *Maclary*'s uniqueness relates to a disputed share issuance having taken place prior to the plaintiff becoming a shareholder of the company. *Id.* at 833. *Maclary* deviated from

the rule of *Newkirk* because the defendants in *Maclary* failed to issue the relevant stock certificates at the same time as the transaction was authorized, which was the way matters were handled in the 1940s. As a result, the court concluded that "where the issuance of stock is authorized and where certificates are presumably to be issued therefor at once, and that is the very action under attack, the transaction is not complete for purposes of applying 8 *Del. C.* §327 until the certificates are issued." *Id.* at 833-34. Thus, the special nature of *Maclary* related to the unusual passage of time calling into question the finality of the transaction originally authorized by the board.

In re Nine Systems Corp. S'holders Litig., 2013 WL 771897 (Del. Ch. Feb. 28, 2013), is similarly consistent in holding that the plaintiffs had standing to sue derivatively where they purchased stock prior to the time that the transaction with respect to which they were complaining became legally binding. If anything, *Nine Systems* constitutes an even stronger statement and application of that principal of law. Specifically, the plaintiffs' damages were caused by an April 22, 2002, reverse stock split accompanied by the filing of a Certificate of Cancellation with the Delaware Secretary of State. *Id.* at *3-4. The plaintiffs only became stockholders of the corporation on May 30, 2002, *i.e.,* after April 22, 2002, but ***before*** an August 1, 2002, recapitalization through which the effects of the April 2002 reverse stock split caused the plaintiffs to be damaged. *Id*. at *7. The filing of a certificate of

cancellation would ordinarily make a reverse stock split legally effective but the court denied summary judgment because certain changes had been made to the terms of the original reverse stock split evidencing that its terms had not previously been truly final. *Id.* at *7. *Nine Systems*, like *Leung*, did not mention the defendants' prior disclosures even though those disclosures figured prominently elsewhere in the decision. *Compare id.* at *7 *with id.* at *10-11.

Indeed, the Opinion purported to justify its attempted synthesis of Section 327 precedent by concluding that *Maclary, Leung* and *Nine Systems* were all "special cases" with their decisions "crafted to meet unusual circumstances." Opinion at 28 & n.93. Plaintiffs respectfully submit that the Court of Chancery's analysis of the precedent is mistaken because *Leung* and *Nine Systems* seem to represent the entirety of Delaware cases applying *Beck*, and neither describes the relevant facts as representing a "special case" or an exception to *Beck*'s general rule.[3] Instead, *Maclary, Leung* and *Nine Systems* are fully consistent with the analysis of *Beck,*

[3] The other Delaware decisions identified by Westlaw as citing *Beck* did not decide the issue of standing under Section 327. *In re Coca-Cola Enterprises, Inc.*, 2007 WL 3122370, at *6 n.51 (Del. Ch. Oct. 17, 2007), observed that the claims may have been time barred under Section 327 because the alleged wrongdoing occurred in 1986 while the plaintiff acquired the company's stock in 2003. *In re Bally's Grand Derivative Litig.*, 1997 WL 305803, at *1 n.2 (Del. Ch. June 4, 1997), cited *Beck* without discussing Section 327. Finally, *Balin v. Amerimar Realty Co.*, 1996 WL 684377, at *5 (Del. Ch. Nov. 15, 1996), noted a standing issue existed but declined to decide that issue because it not been properly raised at trial.

Newkirk and *Lavine* that the "time of the transaction" in Section 327 looks to whether Plaintiffs were stockholders at the time that the Company entered into a final, binding and legally enforceable agreement with Defendants for the Insider Transactions.[4]

[4] *In re Beatrice Cos., Inc. Litig.*, 522 A.2d 865 (Del. 1987), cited by the Court of Chancery, Opinion at 20 & n.60, is consistent with a "transaction" under Section 327 requiring a binding legal agreement because a merger agreement is precisely such a binding legal agreement. *See, e.g.*, *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 834 (Del. Ch. 2007) ("The Merger Agreement, of course, is a contract…."). Indeed, lawsuits seeking to enforce the terms of merger agreements have become increasingly common in recent years. *See, e.g.*, *Forescout Techs., Inc. v. Ferrari Grp. Holdings, L.P.*, C.A. No. 2020-0385-SG (Del. Ch.); *Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE et al*., C.A. No. 2020-0768 (Del. Ch.). *Omnicare, Inc. v. NCS Healthcare, Inc.*, 809 A.2d 1163 (Del. Ch. 2002) *Dieter v. Prime Computer, Inc.*, 681 A.2d 1068 (Del. Ch. 1996), *Brown v. Automated Mktg. Sys., Inc.*, 1982 WL 8782 (Del. Ch. Mar. 22, 1982), the other cases cited in the Opinion's footnote – aside from *Newkirk* which is discussed above (*see* p. 10, *supra*) – all similarly involved mergers, with *Omnicare* being even further afield because the relevant statement was *dicta* in a case dealing with the issue of bidder rather than stockholder standing.

II. SDC DISCLOSING ITS "INTENT" TO ENGAGE IN THE INSIDER TRANSACTIONS DID NOT CREATE A BINDING AGREEMENT TO PROCEED WITH THE INSIDER TRANSACTIONS

A. Question Presented

Whether disclosing an "intent" to conduct an LLC Unit purchase in the context of a forward-looking statement that was "subject to change" was sufficient to trigger the existence of a "transaction" within the meaning of 8 *Del. C.* §327 and support the finding that Plaintiffs lacked standing to pursue a derivative claim. Opinion at 31. This issue was preserved below in Plaintiffs' opposition brief to the Motion to Dismiss and at oral argument. (A773-75, A940-43).

B. Scope of Review

The Court of Chancery's finding with respect to the governing principle of law is reviewed *de novo*. *See e.g.*, *Morris*, 2021 WL 221987 at *128.

C. Merits of the Argument

Defendants, rather than arguing that disclosure constituted a transaction for purposes of Section 327, contended that the disclosure contained in the Prospectus constituted a binding contract. *See* A957-59. The Court of Chancery did not adopt Defendants' argument, and for good reason, because the term "intent" has a well understood meaning as a usually clearly formulated or planned determination to act in a certain way. *See* https://www.merriam-webster.com/dictionary/intent; https://www.merriam-webster.com/dictionary/intention.

The Prospectus further confirms that the purchase of LLC Units and Common Stock was not mandatory by explaining that the term "intends" was used regarding "plans" because such plans were "***subject to change*** based on various important factors, some of which are beyond [SDC's] control." SDC Ex. 1 at 58 (A203). That definition is consistent with the well-understood definition of "intend" as ***not*** being an affirmative promise or guaranteeing a result. *See, e.g., Delmarva Power & Light Co. v. First S. Util. Const., Inc.*, 2007 WL 2758777, at *2 (Del. Super. Ct. Sept. 18, 2007), *vacated*, 2007 WL 3105112 (Del. Super. Ct. Oct. 11, 2007) (quoting Bryan A. Garner, *A Dictionary of Modern Legal Usage* 457 (2d ed. 1995) ("defining 'intend' to mean 'to desire that a consequence will follow from one's conduct.'")). There not having been a binding contract to proceed with the Insider Transactions is further evidenced by, as Plaintiffs have alleged, the Prospectus repeatedly stating that the Company "intends" to purchase the LLC Units in the Insider Transactions with the proceeds of the IPO, and the Prospectus explains that it uses "intends" to discuss forward-looking plans that are subject to change. *See* ¶44 (A50).[5] That

[5] *See also* Prospectus at p.13 (A161) ("[w]e ***intend*** to use substantially all of the net proceeds we receive from this offering … to purchase a number of newly issued LLC Units from SDC Financial … In addition, we ***intend*** to use a portion of the net proceeds to purchase shares of Class A common stock from the Blocker Shareholders at" $21.85 per share); *id.* at 16 (A164) ("We ***intend*** to use such proceeds as follows…"); *id.* at 62-65 (A214-17) ("We ***intend*** to use substantially all of the net proceeds we receive from this offering … to purchase a number of newly issued LLC Units from SDC Financial…. We ***intend*** to cause SDC Financial to use a portion of the net proceeds it receives from the sale of LLC Units to us to purchase

statement of intent contrast sharply with the Prospectus stating, for example, that the Company "will" purchase the Blocker shares. *See* SDC Ex. 1 at p.13 (A159). This demonstrates – or at the very least makes it reasonably conceivable as required on a Rule 12(b)(6) motion – that a binding contract covered the purchase of the Blocker shares but did ***not*** exist with respect the purchase of the LLC Units. *See* ¶43 (A50) & SDC Ex. 1 at pp.17-18 (A165-66). Plaintiffs respectfully submit, therefore, that these and similar factual findings by the Court of Chancery are inconsistent with the reasonably conceivable standard governing Rule 12(b)(6) motions under Delaware law. *See, e.g., Cent. Mortg. Co. v. Morgan Stanley Morgt. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011). (The governing "conceivability" standard in Delaware "is more akin to 'possibility'..." [citations omitted]).

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and cancel LLC Units from Pre-IPO Investors" for $21.85 per share); *id.* at 152-153 (A310-11) ("We ***intend*** to use approximately $616.3 million… the net proceeds we receive from this offering to purchase and cancel LLC Units from Pre-IPO Investors and shares of Class A common stock from the Blocker Shareholders at a price per LLC Unit and share of Class A common stock" for $21.85 per share).

III. THE OPINION'S CONCLUSIONS AS TO WHEN THE INSIDER TRANSACTIONS WERE SET ARE IRRELEVANT AND BASED ON IMPROPER INFERENCES FROM THE RECORD FACTS

A. Question Presented

Whether the Court of Chancery's findings of fact were appropriate on a Rule 12(b)(6) motion to dismiss, given their reliance on purported facts not contained in the record and the failure to accord Plaintiffs all reasonable inferences, and, if so, whether such findings were relevant to the governing legal test for whether Plaintiffs have standing under 8 *Del. C.* §327? Opinion at 20-21. This issue was preserved below in Plaintiffs' opposition brief to the Motion to Dismiss and at oral argument. (A788-794, A940-42).

B. Scope of Review

The Court's review of a decision granting a motion to dismiss is *de novo*. *Olenik v. Lodzinski*, 208 A.3d 704, 714 (Del. 2019).

C. Merits of the Argument

The Opinion acknowledged that "[o]n a motion to dismiss under Rule 12(b)(6), [the] Court accepts as true all well-pled factual allegations, including even vague allegations ... and draws all reasonable inferences in favor of the non-moving party." Opinion at 15 & n.40 (citing *Cent. Mortg. Co.*, 27 A.3d at 535). Nonetheless, Plaintiffs respectfully submit that the Court of Chancery failed to properly apply this standard in evaluating the facts of this case.

The failure of the Court of Chancery to do so is evident in its factual finding that the Board approved the $21.85 price for each LLC Unit ***prior*** to the IPO (Opinion at 11) and that the ***only*** contingency relating to the Insider Transactions was that they were "dependent on raising capital[.]" Opinion at 31. However, there exists ***no record evidence*** that final Board approval to proceed with the Insider Transactions took place before the IPO – the Complaint does not allege those facts, the IPO Prospectus does not make any such statement (and instead suggests to the contrary) and no Company documents such as Board minutes containing any such approval are currently before the Court. Similarly, there is no record fact demonstrating that the only contingency to proceeding with the Insider Transactions was raising the necessary capital in the IPO. Instead, those factual conclusions, contrary to the standards governing Rule 12(b)(6) motions, improperly drew inferences in favor of Defendants, rather than in favor of Plaintiffs.

Specifically, the Court of Chancery misconstrued the facts in the Complaint in finding that "[t]he Complaint alleges the Board's decision to pursue the Insider Transactions was set before the IPO[.]" Opinion at 28-29. Further, the Court of Chancery analyzed the standing issue as if the "challenged conduct" was only "the technicalities of [the Insider Transactions'] actual consummation," and thus concluded that the "time of the challenged transaction" was when the transactions' terms were established." Opinion at 19-20.

In so finding, the Court of Chancery ignored well pleaded facts and misconstrued the gravamen of Plaintiffs' claims. Plaintiffs did not take issue with the consummation of a transaction the terms of which had been set before the IPO. Rather, the Complaint and the Prospectus indicate that the terms of the Insider Transactions were never firmly and finally established as contractual obligations before the IPO. Indeed, Plaintiffs challenge the acts of the Board in implementing the Insider Transactions after the IPO in light of the facts that: (a) the terms of the Insider Transactions had never been committed to or formalized in a binding agreement before the IPO; (b) the Prospectus itself repeatedly stated that the Board merely "intend[ed]" to use the IPO proceeds for the Insider Transactions; (c) the Prospectus clearly stated that the Board's intentions for the use of the IPO proceeds were "subject to change"; and (d) the Prospectus further explicitly stated that the Board retained "broad discretion" in the use of those proceeds. Prospectus at 13, 16-17, 55, 58, 64-65, 152-53 (A164-65, A203, A206, A212-13, A300-01). The Court of Chancery thus erred in its interpretation of the Complaint's allegations of when the "challenged conduct" took place for purposes of 8 *Del. C.* §327 and failed to accord all reasonable inferences to Plaintiffs' well pled facts.

In any event, even if the Court of Chancery's interpretations of the facts were correct (and they were not), they still do not add up to the binding agreement necessary to constitute a "transaction" within the meaning of Section 327. *See*

Section I, *supra; see also Universal Prod. Co. v. Emerson*, 36 Del. 553, 179 A. 387, 394 (1935) ("Where it is dearly understood that the terms of a proposed contract, though tentatively agreed on, shall be reduced to writing and signed before it shall be considered as complete and binding on the parties, there is no final contract until that is done."). This is particularly true as it relates to the capital raise because it was not complete until the IPO closed on September 16, 2019, *i.e.*, after the time Plaintiffs became stockholders of the Company. ¶4 (A16); *see also* Prospectus at Cover (A142).[6] Therefore, even according to the Court of Chancery's interpretation of the facts, Plaintiffs should satisfy the standing requirements of Section 327.

Absent a legally binding contract to proceed with the Insider Transactions at the IPO price less expenses, Defendants had "unremitting" fiduciary duties that "must be effectively discharged in the specific context of the actions that are required with regard to the corporation or its stockholders as circumstances change."

[6] Other subsidiary and similar factual findings made by the Court of Chancery contrary to Rule 12(b)(6)'s requirements that all reasonable inferences be drawn in Plaintiffs' favor include the Court of Chancery's finding that "the pricing of those transactions [*i.e.,* the Insider Transactions] — which is Plaintiffs' principal complaint—was set" prior to the time of the IPO and "was baked into the IPO." Opinion at 31-32. Those findings ignore that: (1) a fundamental premise of the pricing of the Insider Transactions was that the pricing of SDC's common stock in the IPO was set fairly based upon proper disclosure of all relevant material; and (2) there was no binding agreement requiring the Company to proceed with paying $21.85 for LLC Units in the Insider Transactions when they were clearly worth materially less than that amount.

Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 938 (Del. 2003); *see also Firefighters' Pension Sys. of City of Kansas City, Missouri Tr. v. Presidio, Inc.*, 2021 WL 298141, at *35 (Del. Ch. Jan. 29, 2021) ("A board has an unremitting fiduciary obligation to adjust its strategy as circumstances unfold if it believes in good faith that the change is in the best interest of the corporation and its stockholders.") (citing *In re Rural Metro Corp.*, 88 A.3d 54, 93 (Del. Ch. 2014), *aff'd sub nom. RBC Cap. Markets, LLC v. Jervis*, 129 A.3d 816 (Del. 2015)). Here, Plaintiffs more than adequately allege than any prudent fiduciary would have declined to proceed with the Insider Transactions at $21.85 for each LLC Unit when LLC Units were worth substantially less than that amount as evidenced by, among other things, the market price of SDC stock being between $17.81 and $19.00 per share, and closing at $18.90 per share, on the date of the Insider Transactions. ¶4, (A16).[7]

[7] A contractual provision obliging SDC to proceed with the Insider Transactions at the IPO Price might deprive Plaintiffs of standing. *See Halifax Fund, L.P. v. Response USA, Inc.*, 1997 WL 33173241, at *2 (Del. Ch. May 13, 1997) ("[T]here is no Delaware case that holds that the management of a Delaware corporation has a fiduciary duty that overrides and, therefore, permits the corporation to breach, its contractual obligations."). However, even if such a contract existed – and there are no record facts demonstrating the existence of any such contract – the Insider Transactions were not implemented with unrelated third parties. Thus, although a trustee benefiting from "factors extrinsic to [his] duties as a trustee" in transaction with the trust is not self-dealing (*see In re Thomas,* 311 A.2d 112, 115 (Del. Supr. 1973)), here the situation would differ based upon Plaintiffs' allegations that Defendants knew the IPO Prospectus was otherwise materially misleading. *See also U.S. W., Inc. v. Time Warner Inc.*, 1996 WL 307445, at *23 (Del. Ch. June 6, 1996) ("It is elementary in fiduciary law that the existence of a legal power or right in the hands of a fiduciary does not preclude equitable relief

IV. PLAINTIFFS STANDING TO SUE IS CONSISTENT WITH THE STATUTORY PURPOSE OF SECTION 327

A. Question Presented

Whether Plaintiffs having standing to pursue their derivative claims is consistent with the statutory purposes of Section 327 and whether that is an issue that is relevant to deciding the merits of whether Plaintiffs have standing? This issue was preserved below at oral argument. (A942-43).

B. Scope of Review

The Court of Chancery did not directly address this issue and, as a result, the issue is reviewed *de novo*. *See e.g.*, *Morris*, 2021 WL 221987 at *128.

C. Merits of the Argument

Newkirk held that in close cases the Court should look to whether allowing standing to sue is consistent with the statutory purposes of Section 327. 76 A.2d at 436-37. This Court in *Beck* called into question the importance of the plaintiff having pure motives by adhering closely to the statutory language without regard to the plaintiffs' intent in purchasing the corporation's stock. 682 A.2d at 163. Nonetheless, a leading Delaware treatise states that "[s]o long as [Delaware's] policy [of preventing strike suits] is not frustrated, the stock-ownership requirements will

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restraining exercise of that power or right in equity in appropriate circumstances. The distinction between legal right and equitable obligation is the foundation of trust law and of much in corporation law.").

be construed liberally so as not 'to unduly encourage the camouflaging of transactions and thus prevent reasonable opportunities to rectify corporate aberrations.'" 1 R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations and Business Organizations* § 13.11 (3d ed. 2009) (citing *Maclary,* 109 A.2d at 833; *Jones v. Taylor,* 348 A.2d 188 (Del. Ch. 1975); *Helfand v. Gambee,* 136 A.2d 558, 561 (Del. Ch. 1957)).

Here, Plaintiffs did not know, and could not have known, that the Company would purchase LLC Units at a price far in excess of their true and market values, despite not being subject to a binding contract, if the price of SDC stock fell after the IPO. These are, instead, facts which only could have emerged after the time the IPO was completed. ¶¶50-52 (A52-53). The Court of Chancery's focus on the disclosure of an intent to engage in the transactions (Opinion at 31), Plaintiffs respectfully submit, misses the point that those disclosures did not enable Plaintiffs to learn at the time they became SDC stockholders of the adverse facts which subsequently developed or were belatedly disclosed.

Nor does it matter as the Court of Chancery points out that its holding "does not mean Plaintiffs are without recourse." Opinion at 33. Presumably the Court of Chancery is referring to potential federal securities claims which are being litigated in another jurisdiction. *See* Opinion at 33 n.109 (recognizing Plaintiffs may have a claim of inadequate disclosure in connection with the offering). However, the

availability of a parallel remedy under the federal securities laws does not obviate or eliminate Plaintiffs' right to pursue claims based upon Delaware law for breach of fiduciary duty. *See, e.g.*, *Kahn v. Kolberg Kravis Roberts & Co.*, L.P., 23 A.3d 831, 838–39 (Del. 2011) (concluding that breach of duty of loyalty claim for insider trading under the *Brophy* doctrine remained viable "irrespective of arguably parallel remedies grounded in federal securities law" designed to address unlawful insider trading).

CONCLUSION

Therefore, for the reasons stated above, Plaintiffs respectfully submit that the Court of Chancery's judgment dismissing this action should be reversed and this action remanded to the Court of Chancery for further proceedings.

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