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Case Number 388,2023

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JEFFREY EDELMAN, Plaintiff-Below/Appellants, v. JOHN BRYAN KING, LEE S. HILLMAN, BIANCA A. RHODES, MARK F. MOON, ANDREW B. ALBERT, I. STEVEN EDELSON, RONALD J. KNUTSON, LKCM HEADWATER INVESTMENTS II, L.P., LKCM HEADWATER II SIDECAR PARTNERSHIP, L.P., HEADWATER LAWSON INVESTORS, LLC, LKCM MICRO-CAP PARTNERSHIP, L.P., LKCM CORE DISCIPLINE, L.P., and LUTHER KING CAPITAL MANAGEMENT CORPORATION, Defendants-Below/Appellees, -and- DISTRIBUTION SOLUTIONS GROUP, INC., a Delaware corporation, Nominal Defendant-Below /Appellee.	No. 388, 2023 Court Below: Court of Chancery of the State of Delaware, C.A. No. 2022-0886-JTL **PUBLIC VERSION** **Filed: February 20, 2024**

APPELLANT'S REPLY BRIEF

Of Counsel:

LEVI & KORSINSKY, LLP
Donald J. Enright
(*pro hac vice forthcoming*)
Noah R. Gemma
1101 Vermont Ave, NW, Suite 700
Washington, DC 20005
(202) 524-4290

ASHBY & GEDDES P.A.
Stephen E. Jenkins (No. 2152)
Tiffany Geyer Lydon (No. 3950)
500 Delaware Avenue, 8th Fl.
Wilmington, DE 19801
(302) 654-1888

Attorneys for Plaintiff-Below, Appellant

Dated: January 25, 2024

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INTRODUCTION

In response to Plaintiff's carefully focused appeal of just two discrete issues,[1] Defendants' Brief attempts to muddy the waters with a multitude of irrelevancies and inapposite minutiae. However, upon inspection, it becomes clear that Defendants' legal analysis generally ignores the operative facts that gave rise to this appeal.

First, [redacted]

[1] Unless otherwise defined, all capitalized terms have the same meaning as set forth in Appellant's Opening Brief ("Plaintiff's Opening Brief" or the "Opening Brief"), which is cited to a "Plaintiff Br. at ____." "King-Affiliated Controllers" will now also be referred to herein as "Controllers." Appellee's Joint Answering Brief is referred to herein as "Defendants' Brief" and is cited to as "Def. Br. at ___."

Similarly, Defendants attempt to inappropriately draw inferences in their own favor [redacted] flatly contrary to the standards for an appeal from a granted motion to dismiss.

Second, with respect to Rhodes' nondisclosure of her conflict and false characterization as an independent director, Defendants ignore that "[g]enerally, stockholders are entitled to know whether their fiduciaries face conflicts of interest." *Kihm v. Mott*, 2021 WL 3883875, at *19 (Del. Ch. Aug. 31, 2021), *aff'd* 276 A.3d 462, 2022 WL 1054970 (Del. 2022). Defendants' Brief never acknowledges this core principle, nor does it offer any explicit response to distinguish it. This Court need not venture beyond this Delaware precedent, which it should apply to find that Rhodes' undisclosed conflict of interest was plausibly material.

For these reasons, as further set forth below and in Plaintiff's Opening Brief, the Court of Chancery's erroneous rulings should be reversed.

ARGUMENT

I. ENTIRE FAIRNESS REMAINS THE STANDARD OF REVIEW IF THE STOCKHOLDER VOTE WAS NOT FULLY INFORMED

"When a transaction involving self-dealing by a controlling stockholder is challenged, the applicable standard of judicial review is entire fairness, with the defendants having the burden of persuasion." *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1239 (Del. 2012). This standard shifts to business judgment review if—and only if—the conflicted controller transaction satisfies all six requirements set forth in *MFW*, including the requirement of a fully informed minority vote. *In* re *Dell Techs. Inc. Class V Stockholders Litig.*, 2020 WL 3096748, at *15 (Del. Ch. June 11, 2020).

Despite the foregoing, Defendants argue that merely adhering to one requirement (either approval by an independent special committee ***or*** by a fully informed majority of the minority) should suffice to shift the standard. This is not the current law in Delaware.

A sweeping range of parties interested in the development of Delaware law—including 23 corporate law professors from schools across the country, a leading corporate governance expert, and an asset manager—have persuasively explained that such a shift in Delaware law would have disastrous consequences for

stockholders of Delaware corporations. *See Amicus Curiae* Brief of Academics in Support of Appellants at 2, *In Re: Match Group, Inc. Derivative Litigation* ("*Match*"), Case No. 368, 2022 (Del. 2022) (Dkt. No. 141) (23 corporate law professors from schools across the country explaining that narrowing *MFW* "would radically depart from theory- and evidence-backed doctrine" and would "practically invite tunnelling through strategic transactional framing and manipulation"); Corrected *Amicus Curiae* Brief of Professor Charles M. Elson in Support of Appellants at 2-3, *Match,* Case No. 368, 2022 (Del. 2022) (Dkt. No. 145) (leading corporate governance expert explaining that "[b]y applying entire-fairness review to conflicted-controller transactions where only one cleansing device is sued, the Court of Chancery is faithfully applying black-letter Delaware doctrine established by an unbroken line of decisions from this Court"); Corrected Brief of *Amicus Curiae* Alpha Venture Capital Management, LLC in Support of Appellants at 1, *Match,* Case No. 368, 2022 (Del. 2022) (Dkt. No. 148) (asset manager that invests in publicly traded microcap companies filing brief because it "witnessed the ability of overweening insiders to secure independent director support for even the most obvious self-dealing"). By contrast, it appears that no *amicus* briefs were submitted in support of the *Match* appellees' attempts to narrow *MFW*.

In addition, the *Match* appellants also demonstrated that "applying the business judgment rule to all controller transactions that are not freeze-out mergers is inconsistent with 85 years of Delaware corporate law and is bad policy." Appellants' Supplemental Answering Brief, at 2-3, *Match*, Case No. 368, 2022 (Del. 2022) (Dkt. No. 105).

For the reasons that the *Match* appellants, 23 corporate law professors, and other interested parties persuasively articulated in the *Match* appeal, this Court should not narrow the applicability of *MFW*, and it should also find that Controllers cannot shift the burden at this procedural juncture because they failed to shoulder their burden of demonstrating that the minority vote was fully informed.

II. THE CONTROLLERS FAILED TO SATISFY THE REQUIREMENTS OF *MFW* TO SHIFT THE STANDARD OF REVIEW

The Controllers failed to satisfy *MFW* because they have not met the "burden of demonstrating that the stockholders were fully informed . . . ." *Firefighters' Pension Sys. v. Presidio, Inc.*, 251 A.3d 212, at 261 (Del. Ch. Jan. 29, 2021) (internal quotation omitted). "[A] plaintiff only needs to plead the existence of one disclosure violation" to establish that *MFW*'s informed vote requirement was not satisfied. *Goldstein v. Denner*, 2022 WL 1671006, at *19 (Del. Ch. May 26, 2022). In this instance, Plaintiff sufficiently pleaded at least two material omissions that rendered the minority vote materially uninformed.

A. [redacted]

To draw the inferences that Cowen's dramatic increases in TestEquity's valuations were merely "ordinary refinements," "bends in the roads," and "evolution[s] one would reasonably expect," [redacted]

- [redacted]

[redacted]

- [redacted]
- [redacted]

In fact, the Cowen argument section of Defendants' Brief does not cite any numerical values at all—not an EBITDA multiple, nor a TestEquity valuation, nor any other numerical value—from any of Cowen's presentations. *See* Def. Br. at 25-36. This speaks volumes. *See, e.g., Lebanon County Employees' Retirement Fund v. Collis*, 2023 WL 8710107, at *13 (Del. 2023) (reasoning that on the appeal of a motion to dismiss, the Court cannot weigh the evidence, but must accept the facts as true).

Taken together, these facts support the reasonable inference that [redacted]

[redacted]. This is material information that Delaware courts have long required to be disclosed. *See, e.g., Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018) (information material if there is a "substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote") (internal quotation omitted); *In re Topps Co. S'holders Litig*., 926 A.2d 58, 74-77 (Del. Ch. 2007) (enjoining stockholder vote for failure to disclose earlier valuation analyses in order to make the proposed deal "look much more attractive"); *Clements v. Rogers*, 790 A.2d 1222, at 1243-44 (Del. Ch. 2001) (rejecting summary judgment for defendants because facts supported inference that financial advisor changed its analysis to justify bargaining outcome).

In fact, the Court of Chancery [redacted] Telephonic Rulings at 12. Instead, the Court of Chancery erred by finding that such changes had been disclosed, which was clear error (and which Defendants never even attempt to defend). *See id.*; Def. Br. at 25-36.

1. Defendants' Attempts to Distinguish Delaware Precedent are Without Merit

Disregarding the aforementioned facts and analysis, Defendants attempt to distinguish then-Vice Chancellor's Strine's express reasoning and holding in *Clements*. In *Clements*, then-Vice Chancellor Strine reasoned that the facts supported the inference that the financial advisor changed its analysis to justify the bargaining outcome because the record lacked any evidence that there were good "reasons for the large differences" of approximately twenty percent "between the two Presentations." 790 A.2d, at 1243-44. As a result, *Clements* found that the Proxy's nondisclosure of the earlier financial advisor's presentation was plausibly a material omission. *Id.*

[redacted]

[redacted] This inference is not only utterly unsupported, but also improper on an appeal from a dismissal on a Rule 12(b)(6) motion, as all reasonable inferences are to be drawn in Plaintiff's favor exclusively. *See, e.g., Lebanon County*, 2023 WL 8710107, at *13.[2]

While studiously ignoring [redacted].

In response to Plaintiff's analysis that the changes that were plausibly material in "the *Clements* discounted cash flow analysis had yielded only a 20% difference

[2] In any event, the passing of a few months is insufficient to render Cowen's August earlier analysis immaterial. *See Dell Technologies,* 2020 WL 3096748, at *41 ("It is reasonable to infer that a Class V stockholder would have wanted to know that just three months before the Special Committee approved the Committee-Sponsored Redemption, the Special Committee received materials from a reputable advisory firm opining that the Class C stock was worth far less.").

[redacted] Defendants reach for *In re BioClinica, Inc. S'holder Litig*., 2013 WL 5631233 (Del. Ch. Oct. 16, 2013). Distinguishing this case is a simple matter. Unlike Cowen and the *Clements* advisor, the *BioClinicia* financial advisor [redacted]. *See id*. At bottom, a 20% difference in valuations was sufficiently material in *Clements*, [redacted]

Moreover, *Clements* considered that the omitted presentation was plausibly "real valuation information," *id*. at 1243, [redacted]. *See* Def. Br. at 34-36. But any inference that Cowen's [redacted] cannot be drawn in Defendants' favor on the appeal of a motion to dismiss. *See, e.g*., *Lebanon County*, 2023 WL 8710107, at *13.

This inference is also undercut by several facts that Defendants have ignored. For example, [redacted]

[redacted]

[redacted] confirming that they are "real valuation information" that a reasonable stockholder would find important. *Clements*, 790 A.2d at 1243. Accordingly, this Court should find that [redacted]

3 [redacted]

[redacted]

2. Defendants' Other Attempts to Dispute Materiality are Without Merit

Defendants raise the proverbial "red herring" by disputing the impact of Cowen's manipulation on the combined company's pro forma ownership structure. But this matter is irrelevant. *See Clements*, 790 A.2d, at 1243-44 (finding that non-disclosure of financial advisor's change in analysis to justify outcome was plausibly material without regard to changes in ownership percentages).

Crucially, [redacted].

Even if they were relevant, Defendants cherry-pick the wrong pro forma changes to compare. [redacted]. *See* Def. Br. at 33; Plaintiff Br. at 23-26. In this regard, [redacted] This undisclosed drastic change in value is something that a reasonable stockholder would find important.

4 [redacted]

Additionally, Defendants claim (while omitting facts to the contrary) that "even with the higher multiple, [redacted].[6]

Finally, Defendants cry "fair summary" as though this mantra has talismanic power in justifying their requested dismissals. However, a fair summary would not [redacted] *See Topps*, 926 A.2d, at 74-77; *Clements*, 790 A.2d, at 1243-44. Similarly, a fair summary would not [redacted]

[5] [redacted]

[6] This calculation uses 20,100,000 for total shares, which is based on the 19,400,000 shares plus the 700,000 earnout shares.

[redacted]. [redacted] Ultimately, a stockholder would find it important that [redacted]

B. Director Rhodes' Conflict was Plausibly Material

As an initial matter, Defendants have not disputed that the Court of Chancery held that Rhodes was conflicted for demand futility, nor do they dispute that the Court of Chancery's decision never addressed whether it was reasonably

conceivable that Rhodes' conflict was material to the stockholder vote. *See generally* Def. Br.

Relatedly, Defendants do not dispute that Rule 12(b)(6) is "less stringent than" Rule 23.1, which means that a "complaint that survives a Rule 23.1 motion to dismiss", such as the Complaint here, "'generally will also survive a Rule 12(b)(6) motion to dismiss, assuming it otherwise contains sufficient facts to state a cognizable claim.'" *In re Boeing Company Derivative Litigation,* 2021 WL 4059934, at *23 (Del. Ch. Sep. 7, 2021) (quoting *In re Walt Disney Co. Deriv. Litig*., 825 A.2d 275, 285 (Del. Ch. 2003)). Instead, Defendants mischaracterize Plaintiff's Opening Brief as claiming that because Rhodes' conflict was "material for purposes of demand futility it was *necessarily* material for purposes of a vote of minority stockholders." Def. Br. at 39 (emphasis altered). This is an obvious mischaracterization because Plaintiff's Opening Brief simply quoted the *Boeing* decision. *See* Plaintiff Br. at 28-29. Defendants' attempt to turn this case into one of the rare exceptions is without merit.

1. Generally, Stockholders are Entitled to Know Whether Their Fiduciaries Face Conflicts of Interest

Plaintiff's Opening Brief cited Delaware law emphasizing that stockholders are generally entitled to know that their fiduciaries face a conflict of interest. Plaintiff

Br. at 30. In this regard, Plaintiff quoted a Court of Chancery decision, which this Court recently affirmed. *Kihm*, 2021 WL 3883875, at *19, *aff'd* 276 A.3d 462, 2022 WL 1054970 (Del. 2022). This decision reasoned that "[g]enerally, stockholders are entitled to know whether their fiduciaries face conflicts of interest." *Kihm*, 2021 WL 3883875, at *19.

Here, stockholders were entitled to know that purportedly independent director Rhodes was actually subject to hidden conflicts. *See* Plaintiff Br. at 28-29; *see also Millenco L.P. v. meVC Draper Fisher Jurveston Fund I, Inc.*, 824 A.2d 11, 15 (Del. Ch. 2002) (stating that the "relevant inquiry is not whether an actual conflict of interest exists, but rather whether full disclosure of potential conflicts of interest has been made"). Without having identified one Delaware case that refused to apply the aforementioned rule to an actual, undisclosed conflict, Defendants ignore this rule, and they only offer implicit attempts at distinguishing it.[7] Each attempt fails.

[7] Defendants mistake a sufficient condition for a necessary one when claiming that "each case underscores that potential conflicts are material *only* where the director in question played a significant role in the challenged transaction." Def. Br. at 42. They posit this argument as if a director's vote in favor of a merger transaction were somehow insignificant – a position unsupported in Delaware law. Moreover, none of Defendants' cases refused to apply Delaware's general rule to an actual, undisclosed fiduciary conflict.

2. Delaware's General Rule Should Be Applied Here

First, Defendants discuss two cases in hopes to make this matter into an exception to the general rule, but neither case refused to apply Delaware's general rule to an actual, undisclosed conflict. In *Kihm*, the company affirmatively disclosed that its director was also a partner of a different company, which meant that the company's disclosures complied with Delaware law. *See id*. at *22 (reasoning that the company "specifically states that Mott is a general partner at NEA . . . . Mott's conflict was disclosed"). Unlike the forthcoming *Kihm* disclosures, Rhodes concealed that she was also a conflicted Operating Partner of King Capital Equity. *See* ¶ 148 (A00085). In fact, Rhodes failed to disclose this conflict during her entire tenure as a director of Lawson. *See* ¶ 38 (A00034). Instead, she falsely purported to be an independent director, which in turn imposed greater disclosure obligations for conflicts and potential conflicts under Delaware law. *See, e.g., In re Orchard Enterprises, Inc. S'holder Litig*., 88 A.3d 1, 21 (Del. Ch. 2014) (reasoning that independent directors must disclose potential conflicts in addition to actual conflicts).

Defendants' second case is distinguishable because the Court swiftly found that plaintiff "allege[d] no facts" to plead "an actual conflict," and this alleged conflict did not involve a purportedly independent director voting in favor of a

merger with the company's controller in which the director held an undisclosed interest. *In re Om Group, Inc. Stockholders Litigation*, 2016 WL 5929951, at *15 (Del. Ch. Oct. 12, 2016).[8]

Here, by contrast, the Court of Chancery found that Rhodes' "Operating Partner" conflict was strong enough to render her conflicted for demand futility. *See* Telephonic Rulings at 12. And, of course, it is undisputed that this conflict was undisclosed.

Second, Defendants baselessly claim that Rhodes was permitted to conceal her conflict because her vote supposedly made no difference, as she did not cast a deciding vote or vote as a Special Committee member. *See* Def. Br. at 39. As directors seldom join special committees or cast deciding votes, adopting Defendants' proposed reasoning would have the effect of swallowing the general rule stated in a Court of Chancery decision affirmed by this Court. Specifically, the rule that "[g]enerally, stockholders are entitled to know whether their fiduciaries face conflicts of interest" would be swallowed to a rule that merely applies to a small

[8] After *Om* found that no conflict exists, it unnecessarily presumed that plaintiff pled a conflict. *See* id. at *16. The Defendants' *Om* analysis is selectively taken from this later unnecessary *obiter dictum*. *See In re MFW Shareholders Litigation*, 67 A.3d 496, 502 (Del. Ch. 2013) (defining dictum); Def. Br. at 41. This Court should not depart from Delaware's general rule, which was stated in a Court of Chancery opinion affirmed by this Court, for earlier *obiter dictum*.

percentage of conflicts. *Kihm*, 2021 WL 3883875, at *19 (Del. Ch. Aug. 31, 2021); *cf. Brookfield Asset Management, Inc. v. Rosson,* 261 A.3d 1251, 1275 (Del. 2021) (applying precedent so as to avoid "swallow[ing] the general rule").[9]

Indeed, Defendants' proposed reasoning is in tension with Delaware's materiality standard. Under this standard, information is material if a reasonable stockholder would find it important, not whether it would have changed the stockholders' vote. *Morrison*, 191 A.3d, at 283; *Rosenblatt v. Getty Oil Co*., 493 A.2d 929, 944 (Del. 1985). Here, a reasonable stockholder would obviously find it important that a purportedly independent director, who was one of just two non-

[9] In any event, "[w]hen undisclosed conflicts of interest exist even" decisions that were "reasonable 'must be viewed more skeptically.'" *Goldstein v. Denner*, 2022 WL1671006, at *35 (Del. Ch. May 26, 2022) (internal citation omitted). Indeed, "'no one can tell what would have happened'" if Rhodes had disclosed her conflict and abstained from voting, and it is "reasonable to infer that the 'process would have played out differently'" if she had been forthcoming. *Id*. (internal citations omitted). [redacted]

Special Committee members to vote to approve a transaction using Lawson equity to rescue two of Controllers' companies, was actually conflicted due to her partner position with one of Controllers. *See, e.g.*, *Orchard Enterprises*, 88 A.3d, at 21 (reasoning that independent directors have greater obligations for disclosing conflicts). Ultimately, this Court should not ignore Delaware's recently affirmed rule that fiduciary conflicts should generally be disclosed, and instead should apply the rule to find that Rhodes' undisclosed conflict was plausibly material.[10]

3. Rhodes' Claims of Independence Rendered the Proxy Materially Incomplete and Misleading

Once directors take it upon themselves to disclose information, that information must not be misleading. *In re The MONY Grp. Inc. S'holder Litig.*, 852 A.2d 9, 24-25 (Del. Ch. 2004). To that end, once directors travel down the road of a "partial disclosure," they become obligated to provide stockholders with an

[10] In a footnote, certain Defendants erroneously imply that they have a continued right to contest demand futility. *See* Def. Br. at 38 n.5. The Court of Chancery already indicated that this right was forfeited when explaining that "it would have been a better call to preserve the argument and come at it on summary judgment." Appendix Tab 11 (A01839). Defendants' authority explains that they "generally should expect one bite at the demand-futility apple." *In re McDonald's Corporation Stockholder Derivative Litigation*, 2023 WL 2293575, at *700 (Del. Ch. Mar. 1, 2023). Defendants already took their bite when they chose to dispute facts that were plainly listed on King-Affiliated Controllers' own website. *See, e.g.,* Appendix Tab 11 (A01796-97).

accurate, full, and fair characterization. *Id.* at 25; *see also In re Staples, Inc. S'holders Litig.*, 792 A.2d 934, 954 (Del. Ch. 2001) ("[D]irectors must also avoid partial disclosures that create a materially misleading impression").

Here, Defendants had repeatedly referenced Rhodes as an independent director. For example, the Proxy incorporated by reference Lawson's Schedule 14A filed with the Securities and Exchange Commission ("SEC") on April 1, 2021, Appendix Tab 4 (A00438), which explicitly described Rhodes as "independent."[11] Having chosen to speak as to Rhodes' purported independence, Defendants had an obligation to speak truthfully and completely. The failure to disclose Rhodes' "Operating Partner" conflicts in the context of this controller-conflicted transaction and these claims of independence rendered the Proxy materially incomplete and

[11] This April 1, 2021 Schedule 14A stated: "The Company's Board of Directors has determined that directors Andrew B. Albert, I. Steven Edelson, Charles D. Hale, Lee S. Hillman, Mark F. Moon and Bianca A. Rhodes are independent within the meaning of the rules of The Nasdaq Stock Market. In determining independence, the Board of Directors considered the specific criteria for independence under The Nasdaq Stock Market rules and also the facts and circumstances of any other relationships of individual directors with the Company." Appendix to Appellant's Reply Brief Tab 1 (AR0017).

This Court may take judicial notice of SEC filings to consider what public statements a company had made. *See, e.g., DFC Global Corporation v. Muirfield Value Partners, L.P.*, 172 A.3d 346, 351 n.7 (Del. 2017).

misleading. *See Kihm*, 2021 WL 3883875, at *19; *Orchard Enterprises*, 88 A.3d, at 21; *Morrison*, 191 A.3d, at 283.

III. BECAUSE ENTIRE FAIRNESS REMAINS THE STANDARD OF REVIEW, THE MOTIONS TO DISMISS SHOULD HAVE BEEN DENIED

Where, as here, a plaintiff has pled "a reasonably conceivable set of facts showing that any or all of those enumerated [*MFW*] conditions did not exist, that complaint [] state[s] a claim for relief that would entitle the plaintiff to proceed and conduct discovery." *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014). This is because "[o]nce entire fairness applies, the defendants must establish to the court's satisfaction that the transaction was the product of both fair dealing and fair price." *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 459 (Del. Ch. 2011). "[A]pplication of the entire fairness standard typically precludes dismissal under Rule 12(b)(6), because a determination of whether the defendant has met that burden will normally be impossible by examining only the documents the Court is free to consider on a motion to dismiss[.]" *Carr v. New Enter. Assocs.*, 2018 WL 1472336, at *15 (Del. Ch. Mar. 26, 2018) (cleaned up); *see also Manti Holdings, LLC v. Carlyle Grp. Inc.*, 2022 WL 1815759, at *8 (Del. Ch. June 3, 2022) ("Because the entire fairness inquiry is fact-intensive, a determination that the entire fairness standard applies to a transaction normally will preclude dismissal of a complaint on a Rule 12(b)(6) motion to dismiss.").

CONCLUSION

Therefore, for the reasons stated above and in Plaintiff's Opening Brief, Plaintiff respectfully submits that the Court of Chancery's judgment dismissing this action should be reversed and this action remanded for further proceedings.

Of Counsel:

LEVI & KORSINSKY, LLP
Donald J. Enright
(*pro hac vice* motion forthcoming)
Noah R. Gemma
1101 30th Street, N.W., Suite 115
Washington, DC 20007
(202) 524-4290

ASHBY & GEDDES, P.A.

/s/ Tiffany Geyer Lydon
Stephen E. Jenkins (No. 2152)
Tiffany Geyer Lydon (No. 3950)
500 Delaware Avenue, 8th Floor
P.O. Box 1150
Wilmington, DE 19899
(302) 654-1888

Attorneys for
Plaintiff-Below, Appellant

Dated: January 25, 2024

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CERTIFICATE OF SERVICE

I, Tiffany Geyer Lydon, Esquire, do hereby certify that on the 20th day of February 2024, I caused a true and correct copy of the public version of *Appellant's Reply Brief* to be served on the following counsel of record via File & Serve*Xpress:*

Robert L. Burns
Alexander M. Krischik
Nicholas F. Mastria
RICHARDS, LAYTON & FINGER, P.A.
One Rodney Square
920 North King Street
Wilmington, DE 19801

David J. Teklits
MORRIS, NICHOLS, ARSHT & TUNNELL LLP
1201 N. Market Street, 16th Floor
Wilmington, DE 19801

David Ross
Michael Sirkin
Roger S. Stronach
ROSS ARONSTAM & MORITZ LLP
1313 North Market Street, Ste. 1001
Wilmington, DE 19801

/s/ Tiffany Geyer Lydon
Tiffany Geyer Lydon (#3950)