IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROBERT ZIMMERMAN, Plaintiff, v. KATHERINE D. CROTHALL, MICHAEL GAUSLING, PETER MOLINARO, ROBERT TONI, STEVE BRYANT, ORIGINATE ADHEZION A FUND, INC., a Delaware corporation, ORIGINATE ADHEZION Q FUND, INC., a Delaware corporation, ORIGINATE VENTURES, LLC, a Delaware limited liability company, LIBERTY VENTURES H, L.P., a Delaware limited partnership, LIBERTY ADVISORS, INC., a Delaware corporation, and THOMAS R. MORSE, Defendants, - and - ADHEZION BIOMEDICAL LLC, a Delaware limited liability company, Nominal Defendant.	)	C.A. No. 6001-VCP

MEMORANDUM OPINION

Submitted: November 17, 2011
Decided: March 5, 2012
Revised: March 27, 2012

Evan O. Williford, Esq., THE WILLIFORD FIRM LLC, Wilmington, Delaware; *Attorneys for Plaintiff*.

Richard A. Barkasy, Esq., SCHNADER HARRISON SEGAL & LEWIS LLP, Wilmington, Delaware; David Smith, Esq., Stephen A. Fogdall, Esq., Benjamin D. Wanger, Esq., SCHNADER HARRISON SEGAL & LEWIS LLP, Philadelphia, Pennsylvania; *Attorneys for Defendants*.

PARSONS, Vice Chancellor.

This case involves a challenge to certain issuances of preferred units and convertible debt by a start-up medical products company. The founder, former CEO, and current common member of the company challenges the issuances, claiming they were self-interested transactions designed to benefit the company's directors and venture capital sponsors by unfairly diluting its common members. The defendants have moved for summary judgment on all counts.

For the reasons stated in this Memorandum Opinion, I find the plaintiff has failed to adduce sufficient evidence to support a reasonable inference that the defendants' actions in approving the challenged issuances were grossly negligent or reckless. Therefore, I grant summary judgment to the defendants on the plaintiff's duty of care claims. As for the plaintiff's duty of loyalty claims, however, I find that the defendants have failed to establish that the transactions were not self-interested or that they warrant protection under the safe harbor provisions of the company's operating agreement. Therefore, I deny summary judgment on these claims. Finally, because I find the operating agreement ambiguous on the issue of whether the defendants were permitted to authorize additional common units or new series of units without approval by a majority vote of the common members, I deny summary judgment on the plaintiff's breach of contract claim under Count VI.

I. FACTUAL BACKGROUND

A. The Parties

Nominal Defendant, Adhezion, is a privately-held Delaware limited liability company with its principal place of business in Wyomissing, Pennsylvania. Adhezion is an early-stage medical products company engaged in the development and manufacture of adhesive and infection-prevention products for use in the closure and care of wounds in surgical and other medical applications. Adhezion is governed by an operating agreement. At the time of the issuance of Series B Preferred Units in February 2010 (the "February 2010 Transaction"), the Second Amended and Restated Limited Liability Operating Agreement of the Company (the "Second Operating Agreement") was amended and replaced by the Third Amended and Restated Limited Liability Operating Agreement (the "Third Operating Agreement"). As discussed *infra*, Plaintiff claims that the Third Operating Agreement is invalid. The Second and Third Operating Agreements contain essentially the same terms. The only substantive difference is that the Third Operating Agreement provides for Series B Preferred Units.[1]

Plaintiff, Robert Zimmerman, is the co-founder, former CEO, and a former director of Adhezion Biomedical LLC ("Adhezion" or the "Company"). Zimmerman currently owns 86,900 Class A Common Units and 40,000 Class B Common Units.

Defendant Peter Molinaro is Adhezion's current CEO and Chairman of Adhezion's board of directors (the "Board").

Defendant Steve Bryant is one of two outside Industry Directors on the Board. Defendant Robert Toni is the other Industry Director. Defendants contend that Toni is actually the director representative of the Class A Common Members (the "Common

[1] For simplicity, I use the term the "Operating Agreement" to denote the original agreement and the Second and Third Operating Agreements unless a distinction among the agreements is required. Capitalized terms not otherwise defined are given the meanings ascribed to them in the Operating Agreement.

Director"), but whether that is true is irrelevant for purposes of this motion. Therefore, I assume here that Toni is an Industry Director.

Defendant Katherine D. Crothall is an Adhezion director and a principal at Defendant Liberty Advisors, Inc., a venture capital firm that invested in Adhezion through its subsidiary, Defendant Liberty Ventures II, L.P. (together with Liberty Advisors, Inc. "Liberty"). Defendant Thomas R. Morse is a co-founder and principal of Liberty Advisors, Inc.

Defendant Michael Gausling is an Adhezion director and one of three managing partners of Originate Ventures, LLC, a venture capital firm that has invested in Adhezion through its affiliates, Defendants Originate Adhezion A Fund, Inc. and Originate Adhezion Q Fund, Inc. (together "Originate").

B. Facts[2]

Founded in 2001, Adhezion develops and manufactures various skin adhesives and sealants for use in the treatment and closure of wounds before and after surgery. Adhezion's primary products are SurgiSeal, a patented, FDA-approved skin adhesive alternative to sutures for closing wounds after surgery, and FloraSeal, a skin sealant used before surgery to seal in skin flora around a planned incision site and thus reduce the risk of infection.

[2] Unless otherwise noted, the facts set forth in this Memorandum Opinion are undisputed and taken from the verified pleadings, admissions, affidavits, and other evidence submitted to the Court.

As an early-stage medical products company, Adhezion has raised a large portion of its funding from venture capital sources, including its two largest unitholders, Liberty and Originate (together, the "VC Investors"). Originate first invested $3 million in Adhezion in March 2008 in exchange for 375,000 Series A Preferred Units at $8 per unit. That investment valued the Company at $8 million. Around the same time, Molinaro became the CEO and Chairman of Adhezion and Gausling was appointed to the Board as Originate's designated director.

Liberty invested $1,990,000 in October 2008. In exchange, Liberty received 281,917 Series A Preferred Units at approximately $7.05 per unit. This investment valued the Company at $10.5 million. Like Originate, Liberty also received the right to appoint a director to the Board. Crothall joined the Board as Liberty's designated director at this time. Zimmerman alleges that, as of 2008, the VC Investors controlled 66% of all voting units in Adhezion.[3]

a. The structure of the Adhezion Board

In addition to the two directors appointed by the VC Investors, there are four other directorships on the Board.[4] One seat is reserved for the CEO of Adhezion (the "CEO

---

3 Pl.'s Ans. Br. ("PAB") 5.

4 Plaintiff claims that the Board was in breach of the Operating Agreement and Delaware law, because it had only five directors at all times relevant to this dispute. *Id.* This argument, however, is not persuasive. Because Adhezion is an LLC, it is governed by the contractual terms of its Operating Agreement. *See Kuroda v. SPJS Hldgs., L.L.C.*, 971 A.2d 872, 880 (Del. Ch. 2009) ("Limited liability companies are creatures of contract, and the parties have broad discretion to use an LLC agreement to define the character of the company and the rights and obligations of its members."). The Operating Agreement expressly contemplates

Director").[5] The CEO Director can be removed from the Board by a majority vote of the other directors to remove him as CEO.[6] Molinaro is the current CEO Director.

The Common Director is elected by a majority vote of the Class A Common Units and can be removed without cause by a majority vote of the same.[7] As previously noted, I assume for purposes of the pending motion that there is currently no Common Director on the Board.

Finally, the Board has two non-Member Industry Directors, who possess "experience and knowledge relevant to the Company's industry."[8] The Industry Directors are appointed by a majority vote of the non-Industry Directors and may be removed without cause by a majority of the VC and Common Directors.[9] As noted, Toni and Bryant are the current Industry Directors.

---

the possibility that the Board may function at less than full capacity. For example, § 6.2(iii) of the Second Operating Agreement provides that then-CEO Zimmerman "shall remain a Director unless voted off the Board of Directors by (A) a majority of the Directors, if there are at least *five* Directors . . . comprising the total number of Directors." This language indicates that the Board was not required to have six directors at all times. Therefore, the record does not support Plaintiff's argument that the Company acted illegally by having only five directors.

5 Operating Agreement ("OA") § 6.2(iv).

6 *Id.* § 7.3.

7 *Id.* §§ 6.2(iii), 6.5.

8 *Id.* § 6.2(v).

9 *Id.* § 6.5.

b. Adhezion's capital structure

Before February 2010, the Company had three types of units outstanding: (1) Class A Common Units; (2) Class B Common Units; and (3) Series A Preferred Units. In February 2010, the Board issued a new series of preferred units, Series B, which participates *pari passu* with Series A and is senior to Class A and Class B Common Units.

The Preferred Members have the right to vote with the Class A Common Members as a single class on all matters on which the Members may vote.[10] They also have the right to vote as a separate class on certain corporate actions, including change of control transactions and the issuance or sale of units or derivative rights, other than Class B Common Units.[11] The VC Investors control a majority of the Company's Series A Preferred Units.

c. The challenged issuances

i. The 2009 Transactions

The controversy in this case relates to three issuances of preferred units between July 2009 and January 2011. Beginning in January 2009, Adhezion engaged in negotiations with 3M regarding an exclusive licensing and distribution agreement for SurgiSeal and FloraSeal. To satisfy the Company's working capital needs, the Board approved a bridge loan of $750,000 by unanimous written consent. Adhezion issued the

---

10 *Id.* § 3.2(a). Class B Common Units are non-voting "profit interests" in the Company.

11 *Id.* § 3.2(b).

first $525,000 of promissory notes (the "2009 Notes") under the bridge loan to Liberty, Originate, Crothall, Molinaro, and non-party William Graham on July 17, 2009. The 2009 Notes carried a 10% annual dividend, warrant coverage, a security interest in the Company's property, and an automatic conversion feature triggered by a financing transaction greater than $5 million. The 2009 Notes were convertible into 74,000 Series A Perferred Units at a price of approximately $7.05 per unit.[12] The investment valued the Company at $10.5 million, the same valuation used in the October 2008 issuance to Liberty.[13]

3M terminated negotiations with Adhezion in September 2009. Still in need of cash, the Company continued to pursue business opportunities and look for other sources of capital. During the fall of 2009, Adhezion communicated with other potential partners, including Medline Industries and Kensey Nash, but no deal materialized. Medline balked at the risk that SurgiSeal would be subject to patent infringement suits by competitor Johnson & Johnson. In addition, the Board rejected an offer from Kensey Nash to purchase the Company for $4 million upfront and a potential earn-out of $6 million. The Board advised Kensey Nash that it was not interested in selling the Company and, in any case, would have wanted $20 million upfront with a potential $30 million earn-out.

---

[12] Pl.'s App. B59-61.

[13] Defendants allege that the 2009 Transaction valued the Company at a higher incremental value than previous issuances. As discussed *infra* Part II.B.2.b.(iii)(a), however, I disagree with that assertion.

By December 2009, the Company urgently needed additional funding. In 2009, it lost $2.28 million on revenues of $127,000. As a result, on December 15, 2009, the Company issued additional 2009 Notes with a face amount of $315,000 to the same investors who participated in the 2009 issuance and on the same terms.

ii. The February 2010 Transaction

Two months later, on February 17, 2010, the Company authorized the issuance of up to 811,295 new Series B Preferred Units. Crothall, Molinaro, Gausling, the VC Investors, and Graham purchased 625,000 at $4 per unit. The Transaction valued the Company at $13 million. The Series B Preferred Units are entitled to, among other things, an annual dividend of 8% of the original purchase price and the right to purchase an additional Series B Preferred Unit for $4.[14] The Company also gave Class A Common Members the opportunity to purchase their pro rata share of the remaining Series B Preferred Units. Zimmerman did not participate in the February 2010 Transaction. The Second Operating Agreement was amended and replaced by the Third Operating Agreement, which described the terms of the new Series B Preferred Units.

iii. The January 2011 Transaction

In 2010, Adhezion lost more than $2 million on sales of $452,666. On January 10, 2011, the Board approved the issuance of up to $2.5 million in promissory notes convertible into Series B Preferred Units at $4 per unit. The transaction again valued the Company at $13 million. The January 2011 Notes were entitled to, among other things,

---

[14] Defs.' App. A726.

10% annually compounded interest, 20% warrant coverage to buy additional Series B Preferred Units, and a security interest in all of the Company's property.[15]

Similar to the February 2010 Transaction, already-existing Preferred Members were given the first opportunity to participate in the issuance. Crothall, Molinaro, Originate, and Graham each elected to participate, investing a total of $1,285,000. The Company offered the Class A Common Members the opportunity to purchase their pro rata share of the remaining $1,215,000 in promissory notes. Zimmerman again did not participate.

C. Procedural History

This action was filed on November 18, 2010. After seeking and obtaining leave from the Court, Plaintiff filed the operative Amended Complaint (the "Complaint") on May 19, 2011. Defendants moved for summary judgment on October 6, 2011, and a hearing on the motion was held on November 17, 2011.

D. Parties' Contentions

The Complaint asserts six counts individually and derivatively against Defendants. Count One accuses all Defendants, including the VC Investors, who allegedly constituted a controlling shareholder group, of breaching their fiduciary duty of loyalty. Plaintiff claims that the challenged transactions were self-dealing, bad faith transactions intended to benefit certain Board members and the VC Investors at the expense of all other Members.

---

15 Defs.' App. A863.

Count Two is a claim for breach of the fiduciary duty of care against Defendants Crothall, Molinaro, Gausling, Bryant, and Toni (the "Director Defendants"). Zimmerman avers that the Director Defendants acted recklessly and with gross negligence in approving the allegedly self-dealing issuances by written consent without first securing and considering all reasonably available information concerning the fairness of those transactions.

Counts Three and Four repeat the allegations made in Counts One and Two, but state them as breach of contract claims for violating the duties imposed by the Operating Agreement.

Count Five accuses the VC Investors of aiding and abetting the wrongs asserted in Counts One through Four and Count Six by participating in or causing their affiliates to participate in the challenged transactions.

Finally, Count Six asserts a claim for breach of contract against all Defendants for amending the Operating Agreement to authorize the Series B Preferred Units without prior approval by a majority vote of the Class A Common Units.

II. ANALYSIS

A. Standard for Summary Judgment

Under Delaware law, "[s]ummary judgment is granted if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."[16] When considering a motion for summary judgment, the evidence and the inferences drawn from the evidence are to be viewed in the light most favorable to the nonmoving party.[17] Furthermore, summary judgment will be denied when the legal question presented needs to be assessed in the "more highly textured factual setting of a trial."[18] The Court "maintains the discretion to deny summary judgment if it decides that a more thorough development of the record would clarify the law or its application."[19]

B. The Appropriate Standard of Review to be Applied to the Transactions

In deciding whether to grant summary judgment, I must determine the level of judicial scrutiny that should apply to the challenged transactions. This question often may be dispositive in the resolution of a summary judgment motion.

Because Adhezion is a limited liability company, the fiduciary duties owed by its directors are governed by the terms of its Operating Agreement. Under the Operating Agreement, the directors are required to "carry out their duties and exercise their powers . . . in good faith and in a manner reasonably believed by the Directors to be in the best

---

16 *Twin Bridges L.P. v. Draper*, 2007 WL 2744609, at *8 (Del. Ch. Sept. 14, 2007) (citing Ct. Ch. R. 56(c)).

17 *Judah v. Del. Trust Co.*, 378 A.2d 624, 632 (Del. 1977).

18 *Schick, Inc. v. Amalgamated Clothing & Textile Workers Union*, 533 A.2d 1235, 1239 n.3 (Del. Ch. 1987) (citing *Kennedy v. Silas Mason Co.*, 334 U.S. 249, 257 (1948)).

19 *Tunnell v. Stokley*, 2006 WL 452780, at *2 (Del. Ch. Feb. 15, 2006) (quoting *Cooke v. Oolie*, 2000 WL 710199, at *11 (Del. Ch. May 24, 2000)) (internal quotation marks omitted).

interests of the Company and its Members and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances."[20] This standard is similar to the common law, and no party has argued that the Operating Agreement should be interpreted differently.

To avoid the application of business judgment deference, the burden lies with the plaintiff "to establish a genuine issue of material fact as to whether the directors were independent, disinterested, informed, or acting in good faith."[21] Because this burden requires the plaintiff to show "that the directors' decision was either wholly-irrational or motivated by self-interest or bad faith on the part of the directors approving the transaction," it is often a difficult hurdle to overcome.[22] But, if a plaintiff meets this burden and the challenged transaction must be reviewed for entire fairness, the fact-intensive demands of such review may make it difficult for a defendant to prevail on summary judgment. As Vice Chancellor Glasscock noted in *Encite LLC v. Soni*, the application of entire fairness review

> is often of critical importance. Entire fairness is Delaware's most onerous standard, and it requires the Director Defendants to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. . . . Given the fact-intensive nature of this enhanced scrutiny, a party bearing the burden of proving fairness faces a difficult road when moving for summary judgment, where the court views

---

[20] OA § 6.15.

[21] *Encite LLC v. Soni*, 2011 WL 5920896, at *20 (Del. Ch. Nov. 28, 2011).

[22] *Brehm v. Eisner*, 746 A.2d 244, 264 n.66 (Del. 2000).

> the record in the light most favorable to the non-moving party.[23]

Here, Zimmerman claims that Defendants breached both their duty of loyalty and duty of care in approving each of the challenged transactions and that those transactions fail to satisfy the entire fairness standard.

1. Duty of Care Claims

Plaintiff claims that the Director Defendants breached their duty of care by acting "recklessly and with gross negligence by approving[] the Transactions."[24] According to Zimmerman, the Director Defendants approved the transactions without deliberation and did not consider all reasonably available information concerning Adhezion's value. Plaintiff further argues that the Director Defendants failed to negotiate any material economic terms for the transactions other than the amount of funding needed. As a result, Plaintiff claims that the Director Defendants breached their duty of care and Adhezion received an inadequate price for its equity.[25] In response, the Director Defendants argue that § 6.16 exculpates them from any liability for violations of the duty of care and that, in any case, the challenged conduct did not amount to "gross negligence" or "recklessness."

---

23 2011 WL 5920896, at *20 (Del. Ch. Nov. 28, 2011).

24 Compl. ¶¶ 83, 92. This standard is similar to the common law and no party has argued that the Operating Agreement should be interpreted differently.

25 Compl. ¶ 93.

a. Are the Director Defendants exculpated from liability for duty of care violations?

As an initial matter, I must determine whether the Operating Agreement exclusively limits the Director Defendants' potential liability to violations of the duty of loyalty. Section 6.16 limits a director's personal liability and exposure to monetary damages to behavior that constitutes "self-dealing, willful misconduct, recklessness or a criminal violation."[26] The Director Defendants argue that each of these terms implicates the duty of loyalty and that "recklessness" should be interpreted in the context of this clause as the "intentional dereliction of duty or conscious disregard of one's responsibilities . . . ."[27] In contrast, Zimmerman argues that "recklessness" is "a word the Delaware courts have traditionally used to describe the Delaware duty of care and its gross negligence standard" and that its use, therefore, preserves the possibility of director liability for violations of the duty of care.[28]

Having considered these arguments and the language of the Operating Agreement, I find that "recklessness" as used in § 6.16 is equivalent to "gross negligence" and,

---

26 OA § 6.16. Section 6.16 provides: "No member, Director or officer shall be personally liable, responsible, accountable in monetary damages or otherwise to the Company or any Member for any act or failure to act or for any mistakes of judgment unless such Member, Director or officer has breached or failed to perform the duties of his, her or its office under the Act or this Agreement and the breach or failure to perform constitutes self-dealing, willful misconduct, recklessness or a criminal violation."

27 Defs.' Reply Br. ("DRB") 18 (quoting *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008)).

28 PAB 30.

therefore, implicates the duty of care. Plaintiff is correct that the term "recklessness" often is conflated with "gross negligence" in describing the standard for breach of the duty of care under Delaware corporate law. As this Court stated in *In re Lear Corp. Shareholder Litigation*, "the definition [of gross negligence] is so strict that it imports the concept of recklessness into the gross negligence standard, thus conflating two standards that are distinct when used in the criminal law concept."[29] Likewise, in *Albert v. Alex. Brown Management Services, Inc.*, this Court found that "[g]ross negligence has a stringent meaning under Delaware corporate (and partnership) law, one which involves a devil-may-care attitude *or indifference to duty amounting to recklessness*."[30]

Rather than challenge these precedents, the Director Defendants argue that here, as a contractual term, "recklessness" should be interpreted under the precept of *noscitur a sociis*, which requires that ambiguous contractual terms be interpreted in the context of the words surrounding them.[31] Relying on this precept and *McPadden v. Sidhu*,[32] the Director Defendants contend that because the rest of the words used in the exculpatory

---

[29] 967 A.2d 640, 652 n.45 (Del. Ch. 2008).

[30] 2005 WL 2130607, at *4 (Del. Ch. Aug. 26, 2005) (emphasis added); *see also McPadden*, 964 A.2d at 1274 ("Delaware's current understanding of gross negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason.").

[31] *See Gutierrez v. Ada*, 528 U.S. 250, 255 (2000) (describing the interpretive rule of *noscitur a sociis* as one in which "words and people are known by their companions").

[32] 964 A.2d 1262 (Del. Ch. 2008).

clause of § 6.16 implicate the duty of loyalty, "recklessness" should be interpreted in the same manner.

This argument fails for at least two reasons. First, the doctrine of *noscitur a sociis* only applies where a contractual term is ambiguous. The Director Defendants, however, have not produced any independent facts or argument that the term "recklessness" in this context is ambiguous other than their circular assertion that under the precept of *noscitur a sociis* "recklessness" as used in § 6.16 may be ambiguous. This contention provides no reasonable support for finding ambiguity in the contractual language.

Second, the Director Defendants erroneously rely on *McPadden* to support their interpretation of "recklessness." The full language of the section of *McPadden* from which the Director Defendants selectively quote reads:

> Thus, from the sphere of actions that was once classified as grossly negligent conduct that gives rise to a violation of the duty of care, the Court has carved out one specific type of conduct—the intentional dereliction of duty or the conscious disregard for one's responsibilities—and redefined it as bad faith conduct, which results in a breach of the duty of loyalty. *Therefore, Delaware's current understanding of gross negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason*.[33]

Fairly read, this statement in *McPadden* undermines the Director Defendants' assertion that "recklessness" constitutes an intentional dereliction of a known duty. To the contrary, *McPadden*'s definition of "gross negligence" as "conduct that constitutes reckless indifference" reaffirms the Delaware case law holding that "recklessness" is

[33] *Id.* at 1274 (emphasis added).

conduct similar or equal to "gross negligence."[34] Therefore, I conclude that "recklessness" as it is used in § 6.16 is unambiguous and that, under the plain meaning of that term, the section does not exculpate the Director Defendants from liability for breaches of the duty of care.[35]

b. Defendants' conduct did not amount to gross negligence

Although § 6.16 does not exculpate the Director Defendants from liability for violations of the duty of care, Zimmerman has failed to adduce evidence from which this Court reasonably could infer that those Defendants were grossly negligent or reckless in approving the transactions. Thus, I hold that the Director Defendants are entitled to summary judgment on Plaintiff's duty of care claims.

Under the business judgment rule, scrutiny of a board's actions begins with the presumption that the directors "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[36] In

---

34 This conclusion comports with the similar legal definitions of the two terms. "Gross negligence" is defined as "[a] conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party . . . ." *Black's Law Dictionary* 480 (3d ed. 2006). Similarly, "recklessness" is defined as "[c]onduct whereby the actor does not desire harmful consequence but nonetheless foresees the possibility and consciously takes the risk. [] Recklessness involves a greater degree of fault than negligence but a lesser degree of fault than intentional wrongdoing." *Id.* at 597.

35 In contrast, in the corporate context, 8 *Del. C.* § 102(b)(7) has been held to exculpate directors for breaches of the duty of care. *See Ryan v. Lyondell Chem. Co.*, 2008 WL 4174038, at *3 (Del. Ch. Aug. 29, 2008). Notably, § 102(b)(7) makes no reference to "recklessness" in its list of nonexculpated actions.

36 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

determining whether the Board was reasonably informed in making a business decision, "the standard for judging the informational component of the directors' decisionmaking does not mean that the Board must be informed of *every* fact," but instead, "[t]he Board is responsible for considering only *material* facts that are *reasonably available*" at the time of the decision.[37]

Furthermore, to rebut the presumptions of the business judgment rule, it is not enough for a plaintiff simply to second-guess the reasonableness or prudence of a business judgment.[38] Instead, to avoid application of the rule, a plaintiff must allege that the process applied by a board in making a business decision was so egregious as to constitute "reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason."[39] This is an onerous

---

37 *Brehm*, 746 A.2d at 259.

38 *McMillan v. Intercargo Corp.*, 768 A.2d 492, 505 n.56 (Del. Ch. 2000) ("Second-guessing about whether a board's strategy was 'reasonable' or 'appropriate' may be sufficient in a front-end injunction action under the *Revlon* standard, but it does little to assist a plaintiff in meeting its obligation to set forth facts from which one could infer that the defendants' lack of care was so egregious as to meet Delaware's onerous gross negligence standard.").

39 *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008) (quoting *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 192 (Del. 2005) (internal quotation marks omitted); *see also In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 749-50 (Del. Ch. 2005) ("[C]ompliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith or rationality of the process employed. . . . [Instead,] whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational,' provides no ground for director liability, so long as the court determines that the

standard,[40] requiring the plaintiff to allege "facts that suggest a *wide* disparity between the process the directors used . . . and that which would have been rational."[41]

It is undisputed that, beginning in 2009, Adhezion urgently needed capital. To address this concern, the Board contacted over forty potential investors between July 2009 and February 2010 and entered into serious discussions with a few of these investors, including 3M, Medline, and Kensey Nash. Through these discussions, the Board considered a range of funding options, such as licensing deals, direct investment, and even a possible sale of the Company. Despite their efforts, however, the Board was unable to negotiate a transaction that they believed would be in the best interests of the Company. As a result, they decided to raise interim capital from their existing investors.

Zimmerman complains that (1) the Board did not formally deliberate on the transactions, (2) the transactions were approved by written consent, (3) the Board failed to negotiate any material terms other than the amount of the offerings, and (4) the Board did not do enough to obtain other reasonably available information concerning Adhezion's value.

The Operating Agreement does not require the Board to hold an official meeting to deliberate on proposed actions. Section 6.11(b) explicitly permits Board action to be

---

process employed was either rational or employed in *a good faith* effort to advance corporate interests."), *aff'd*, 906 A.2d 27 (Del. 2006).

40 *McMillan*, 768 A.2d at 505 n.56.

41 *Guttman v. Huang*, 823 A.2d 492, 507 (Del. Ch. 2003).

taken by written consent in lieu of a meeting. Therefore, neither of the first two items enumerated above suggests a care violation.

Moreover, to the extent that Zimmerman is claiming that the Board was uninformed because they did not deliberate on the transactions, the evidence is to the contrary. The record shows that the Board consistently received updates on the financial condition of the Company, the development of its business, and efforts to obtain additional outside funding. The evidence also demonstrates that the Board discussed and deliberated upon possible financing transactions, including the challenged transactions.

For example, the minutes of the October 14, 2010 Board meeting note that the Board reviewed the Company's third quarter financial statements, received a presentation on the Company's cash position and possible outside investments, and discussed a strategy for raising an additional $1 million for working capital.[42] The minutes also report that the Board requested that Molinaro provide the other directors with pro forma financial statements for the Company.[43] The minutes of the November 11, 2011 Board meeting state that there was an "extensive discussion by the board regarding the scope and structure of the proposed extended round financing."[44] These minutes support a finding that the Board was reasonably informed about the Company's condition and value before the January 2011 Transaction and that the Director Defendants deliberated

---

42 Defs.' App. A642-44.

43 *Id.*

44 *Id.* at A646.

on possible terms for that transaction. Having also considered the record as to each of the other challenged transactions, I find that Zimmerman similarly has failed to provide any reasonable basis to rebut the presumption that the Director Defendants were reasonably informed when they approved those transactions, as well.

I also find unpersuasive Zimmerman's argument that Bryant and Toni failed to negotiate any other material terms for the transactions. The full participation of the Board in negotiating the transactions was not required to satisfy the Board's duty of care or their contractual duties under the Operating Agreement. Moreover, to the extent Plaintiff suggests that Molinaro, Crothall, and Gausling were conflicted in negotiating the transactions, that concern relates more to a duty of loyalty claim for self-dealing and is addressed in that context *infra*.

Finally, Zimmerman's contention that the Board failed to make additional efforts to obtain reasonably available information in light of buyout offers that Adhezion received is conclusory and unconvincing. Plaintiff has not identified what additional information the Board should have obtained and it is unclear why those particular offers should have prompted the Board to seek additional valuation information.

Adhezion received buyout offers from Kensey Nash and Arteriocyte after the 2009 Transactions were approved; therefore, those offers could not have affected the Board's consideration of the 2009 Transactions. Although the Kensey Nash offer came shortly before the February 2010 Transaction, the offer valued the Company at $10 million, with only $4 million guaranteed. In contrast, the February 2010 Transaction valued the Company at approximately $13 million. Furthermore, the fact that the Company advised

Kensey Nash that it would only consider a significantly higher offer, around $20 million in guaranteed money and an earn-out of up to $30 million, does not demonstrate that the Board's February 2010 and January 2011 Transactions were reckless. At a time when it appears that the Board was not interested in selling the Company, but rather was responding to an offer they considered inadequate, the fact that the Board responded by suggesting a much higher value is not a reliable indicator of their actual valuation of the Company. Moreover, the challenged transactions were not for the sale of the Company, but to raise needed capital, and the price set by the Board significantly exceeded the Kensey Nash proposal. In that context, Plaintiffs' evidence provides no basis to conclude that the Board's actions were "without the bounds of reason." [45]

To the extent Zimmerman is asserting that the Company should have obtained a fairness opinion for each of the challenged issuances, that objection alone is not enough to overcome the presumption of due care. The Board was under no obligation to hire financial advisors,[46] and the Company's limited cash position likely would have made it reluctant to incur such an expense. To overcome the business judgment rule, Plaintiff must do more than argue that the process used by the Board was suboptimal or even negligent. Instead, Plaintiff must show that the process used by the Board was irrational or "without the bounds of reason." As this Court noted in *Savin Business Machines*

---

45 *McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008).

46 *See Chesapeake Corp. v. Shore*, 771 A.2d 293, 331 (Del. Ch. 2000) ("There is no legal requirement that a board consult outside advisors, so long as the board has adequate information to make an informed judgment.").

Corp. v. Rapifax Corp., "[w]here a corporation in financial distress issues stock as a means to raise needed capital, its directors are given considerable latitude in fixing the price for the issuance."[47] In each of the transactions, the Board negotiated terms that were consistent with previous, similar transactions and that bore a reasonable relationship to previous valuations of the Company.[48]

In summary, viewing the evidence in the light most favorable to Zimmerman, as I must, I find that the record does not support a reasonable inference that the Board's process was reckless. Therefore, I grant summary judgment on Plaintiff's duty of care claims under Counts II and IV.

2. Duty of Loyalty Claims

Turning to Plaintiff's duty of loyalty claims, Zimmerman asserts that Defendants approved self-dealing transactions in bad faith. Primarily, Plaintiff argues that a majority of the directors, as well as the allegedly controlling VC Investors, stood on both sides of the transactions and received an exclusive benefit at the expense of the Common Members. Zimmerman also asserts that, by approving the interested transactions,

---

47 1978 WL 2498, at *5 (Del. Ch. Feb. 15, 1978).

48 To the extent Zimmerman claims that the price was so unreasonable that it appears inexplicable on any other ground than bad faith, *see Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1246 (Del. 1999), I find that he has not produced sufficient evidence to survive Defendants' motion for summary judgment on such a claim. Plaintiff failed to present any expert opinion on valuation, for example. He attempted to excuse that omission by asserting that the parties agreed to forego expert discovery on price until after the summary judgment stage, but such an agreement would not absolve Plaintiff of his duty to respond to a properly supported motion for summary judgment by "set[ting] forth specific facts showing that there is a genuine issue for trial." Ct. Ch. R. 56(e).

Defendants exhibited a conscious disregard for their duty to act in the best interests of the Company. As a result, he argues that the transactions should be reviewed under the entire fairness standard.

a. Bad faith

Plaintiff claims that the Director Defendants acted in bad faith by "intentionally fail[ing] to act in the face of a known duty to act, demonstrating a conscious disregard for [their] duties."[49] Specifically, Zimmerman argues that Crothall and Gausling acted in bad faith by causing the Company to accept the transactions in lieu of other potential offers and that Toni, Bryant, and Molinaro acted in bad faith by approving the transactions without materially negotiating their terms.[50]

"To prevail on . . . a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests."[51] For the reasons discussed in Part II.B.1.b *supra*, I find that Zimmerman has not shown that the Board's decisions to approve the transactions were so "egregious or irrational" as to constitute bad faith. Furthermore, to the extent Plaintiff is claiming that

---

49 PAB 26 (quoting *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006)).

50 Plaintiff also asserts that Toni and Molinaro participated in a "scheme" to trick the Class A Common Members into voting for a representative that did not own any Class A interests. Plaintiff has failed, however, to aver any specific facts supporting the existence of the alleged "scheme"; therefore, I reject this claim outright.

51 *White v. Panic*, 783 A.2d 543, 554 n.36 (Del. 2001).

the Director Defendants acted in conscious disregard of their known duties, I likewise find those claims deficient for the reasons discussed *supra*. The intentional dereliction of a known duty is a higher standard of wrongdoing than gross negligence or recklessness.[52] Because I already have found that the Director Defendants' actions in approving the transactions were not grossly negligent or reckless, I also necessarily find that their actions did not constitute an intentional dereliction of a known duty. Accordingly, I grant summary judgment in favor of Defendants on Plaintiff's bad faith claims.

b. Self-dealing

Entire fairness review will apply where a transaction is approved by a majority of directors or a controlling stockholder "stand[ing] on both sides of the transaction, dictat[ing] its terms, and obtain[ing] a benefit not received by all stockholders generally . . . ."[53] Here, Zimmerman alleges that each of the challenged transactions constituted self-dealing because they were approved by a majority of directors who stood on both sides of the transactions and who received additional equity interests in the Company as a result of the transactions. Plaintiff further claims that the transactions were self-dealing because the VC Investors formed a controlling shareholder group that stood on both sides of the transactions.

In opposition, Defendants argue that a majority of the directors were not interested in the transactions, that the VC Investors did not constitute a controlling shareholder

52 *See In re Walt Disney Co. Deriv. Litig.*, 906 A.2d at 67 ("[T]he legislature has also recognized this intermediate category of fiduciary misconduct, which ranks between conduct involving subjective bad faith and gross negligence.").

53 *Gilbert v. El Paso Co.*, 1988 WL 124325, at *7 (Del. Ch. Nov. 21, 1988).

group, and that, in any case, the transactions did not confer an exclusive benefit on Defendants. They further contend that because the transactions were approved by independent and disinterested directors, the transactions must be evaluated under the business judgment rule pursuant to § 6.13 of the Operating Agreement.

i. Are the VC Investors controlling shareholders?

A shareholder will be considered "controlling" if it either (1) owns a majority interest in the company[54] or (2) exercises "actual control over the board of directors during the course of a particular transaction."[55] "Actual control" under the second test will be found where a shareholder, or shareholder group,[56] wields such "formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control."[57] As this Court noted in *In re PNB Holding Co.*

---

54 *In re W. Nat'l Corp. S'holders Litig.*, 2000 WL 710192, at *20 (Del. Ch. May 22, 2000).

55 *Kahn v. Lynch Commc'ns Sys., Inc.*, 638 A.2d 1110, 1113 (Del. 1994) (quoting *Ivanhoe P'rs v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987)) (internal quotation marks omitted).

56 *See Dubroff v. Wren Hldgs., LLC*, 2009 WL 1478697, at *3 (Del. Ch. May 22, 2009) ("Although a controlling shareholder is often a single entity or actor, Delaware case law has recognized that a number of shareholders, each of whom individually cannot exert control over the corporation (either through majority ownership or significant voting power coupled with formidable managerial power), can collectively form a control group where those shareholders are connected in some legally significant way–*e.g.*, by contract, common ownership, agreement, or other arrangement–to work together toward a shared goal.").

57 *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006).

Shareholders Litigation, this test "is not an easy one to satisfy and stockholders with very potent clout have been deemed, in thoughtful decisions, to fall short of the mark."[58]

In considering whether Liberty and Originate are controlling shareholders of Adhezion, I begin by noting that, although neither Liberty nor Originate owns a majority interest, the VC Investors collectively own more than 66% of the Company's voting shares and control at least two of the five directors on the Board. They are also the two largest investors in the Company, collectively having invested more than $5 million since 2008. Moreover, as early-stage venture capital investors, Liberty and Originate likely have similar economic interests vis-a-vis their investments in the Company. Although parallel interests alone are "insufficient as a matter of law to support the inference that the shareholders were part of a control group,"[59] the VC Investors' parallel interests, in addition to other facts alleged by Plaintiff, support a reasonable, but not necessarily conclusive, inference that the VC Investors acted as a controlling shareholder group here.[60]

Additionally, Plaintiff has identified multiple communications among Defendants that would support a reasonable inference that the VC Investors exercised actual control over Adhezion's capital raising efforts. For example, in a September 2009 email regarding preparation for an investor conference, Molinaro stated that the amount of

---

58 *Id.*

59 *Dubroff*, 2009 WL 1478697, at *3.

60 *But see PNB Hldg. Co.*, 2006 WL 2403999, at *1 (holding that a group of twenty family members with varying economic interests did not constitute a controlling shareholder group).

money he would be looking to raise from other investors was "a sensitive issue as Liberty & Originate both would like to see [the investment as] a smaller number."[61] In addition, certain contemporaneous Board meeting minutes reflect that Liberty and Originate had advised that they "would continue to temporarily satisfy Adhezion's operating cash requirements" until the Company concluded various ongoing negotiations with other potential partners.[62] Bryant similarly testified that Gausling had communicated to Molinaro that the VC Investors did not "want [Molinaro] to continue trying to raise venture capital funding or funding outside of the company because [the VC Investors] want[ed] [Molinaro] to focus on running the business and that [the VC] investors and so forth would continue to fund the business."[63] These communications support not only Zimmerman's allegations that the VC Investors had a pervasive influence in directing the Company's capital-raising activities, but also his averment that the VC Investors acted in concert.

Based on this and the other available evidence, I find that there is a genuine issue of material fact as to whether the VC Investors together exerted actual control over the Company in relation to the challenged transactions. Therefore, I deny Defendants' motion for a summary judgment declaring that the VC Investors were not controlling

---

[61] Pl.'s App. B127.

[62] *Id*. at B124.

[63] Bryant Dep. 56.

stockholders. If Plaintiff carries his burden on this issue at trial, then the transactions will be reviewed for entire fairness.

ii. A majority of the Board was either interested or not independent when they approved each of the challenged transactions

Even if the VC Investors are not controlling shareholders, however, Zimmerman contends that the challenged offerings were interested transactions because a majority of the Board was interested in the approval of each transaction as either direct participants or representatives of participants in the transactions.

Crothall and Gausling were both interested and non-independent.[64] Crothall participated in each of the transactions and was affiliated with Liberty, which received units in the first two transactions. Although Gausling did not participate personally in any of the transactions, he served as a managing partner of Originate, which did participate in each of the transactions. Thus, Zimmerman ultimately could succeed in proving that Gausling was interested and lacked independence.[65]

---

64 Although Defendants stated in their Opening Brief that, for the purposes of this motion, they "do not concede that Crothall or Gausling [were] interested or lacked independence," Defs.' Opening Br. 20 n.9, they failed to present sufficient evidence to rebut conclusively Zimmerman's allegations to the contrary.

65 *See Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 174-75 (Del. Ch. 2005) ("[A] director who is not independent is dominated or otherwise controlled by an individual or entity interested in the transaction. Control over individual directors is established by facts demonstrating that through personal or other relationships the directors are beholden to the controlling person or so under their influence that their discretion would be sterilized." (internal quotation marks and footnotes omitted)).

Molinaro participated in each of the transactions. Defendants dispute that Molinaro was interested in the transactions because the 16,671 Series B Preferred Units that he received ostensibly represented an immaterial benefit to him compared to the dilution the transactions caused to his 259,710 Class B Common Units.[66] Regardless of whether the receipt of preferred units was material to Molinaro, our law provides that "whenever a director stands on both sides of the challenged transaction he is deemed interested and allegations of materiality have not been required."[67] Molinaro also received Series A Preferred Units in the 2009 Transactions, and Defendants made no effort to explain why the receipt of these units was immaterial to Molinaro. In any case, it is reasonable to infer from the evidence that the receipt of preferred units was material to Molinaro. Class B Common Units are nonvoting profit interests. Therefore, the only dilution Molinaro would have experienced from the challenged transactions was dilution of the economic interest those shares represented. If there were insufficient assets to pay off the Preferred Members in a liquidation, however, Molinaro's receipt of preferred units would have increased the likelihood that he would receive at least some proceeds, even if he received nothing for his Class B Common Units. Given the Company's precarious financial condition at the time of the transactions, it would be reasonable to infer that Molinaro viewed the receipt of preferred units as a material benefit. Therefore, for purposes of the pending motion, I find that Molinaro was interested in the transactions.

---

[66] Defs.' App. A726.

[67] *Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

Finally, Zimmerman challenges Toni and Bryant's independence on two bases. First, he argues that the VC Investors controlled Toni and Bryant because they could remove them from the Board at any time. Even if true, however, it is well-settled that "[i]n most circumstances Delaware law routinely rejects the notion that a director's interest in maintaining his office, by itself, is a debilitating factor."[68]

Second, Plaintiff alleges that Toni and Bryant are not independent of Molinaro because they were both friends and former colleagues of Molinaro. As to Bryant, Plaintiff alleges that Molinaro and Bryant were good friends, that their families socialized, and that the two had worked closely together on previous occasions, including in founding a start-up company. As to Toni, Zimmerman avers that Molinaro and Toni worked together in the past and, on one occasion, went to a professional football game together.

These allegations indicate that Molinaro had a relationship with both Toni and Bryant, but they do not provide a sufficient basis for questioning the independence of either director. As Defendants correctly point out, "[a]llegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director's independence."[69] To rebut the presumption of director independence, a plaintiff must allege more than that the directors "moved in the same social circles, attended the same weddings, developed business relationships before

---

68 *Solomon v. Armstrong,* 747 A.2d 1098, 1126-27 (Del. Ch. 1999).

69 *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004).

joining the board, and described each other as 'friends.'"[70] Instead, to support an inference that a particular relationship jeopardized a director's ability to exercise his own independent and objective judgment in considering a corporate transaction, a plaintiff must make specific factual allegations of such material connections as "financial ties, familial affinity, a particularly close or intimate personal or business affinity or . . . evidence that in the past the relationship caused the director to act non-independently vis-à-vis an interested director."[71] Here, Zimmerman's allegations of mere friendship and shared work experiences likely fall short of what is necessary to call into question the independence of Toni or Bryant. Therefore, drawing all reasonable inferences in Zimmerman's favor, I consider Toni and Bryant to be disinterested and independent directors for purposes of Defendants' summary judgment motion.

iii. Did Defendants receive an exclusive benefit?

In addition to showing that a controlling shareholder or a majority of the Board was interested, Plaintiff must show that the transactions conferred an exclusive benefit on those interested fiduciaries to prove self-dealing.[72] Defendants argue that they did not

---

70 *Id.*

71 *Telxon Corp. v. Meyerson*, 802 A.2d 257, 264 (Del. 2003).

72 *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983); *Gilbert v. El Paso Co.*, 1988 WL 124325, at *7 (Del. Ch. Nov. 21, 1988); *see also Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) ("First, [the] protections [of the business judgment rule] can only be claimed by disinterested directors whose conduct otherwise meets the tests of business judgment. From the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, *as opposed to a*

receive an exclusive benefit and, therefore, did not engage in self-dealing, regardless of whether they stood on both sides of the transactions. Because the 2009 Transactions were materially different in structure from the February 2010 and January 2011 Transactions, I first consider whether Defendants received an exclusive benefit in the 2009 Transactions.

(a) The 2009 Transactions

The 2009 Transactions were not open to all Members. Defendants nevertheless assert that those transactions did not confer a "benefit" on them because the offering price of the 2009 Transactions was consistent with the prices in other relatively contemporaneous transactions and was, in fact, approved by Zimmerman himself. They further argue that, in any case, Zimmerman's claims must fail because he is trying to bring dual derivative and direct claims under the framework of *Gentile v. Rossette*,[73] but has failed to allege facts sufficient to state a claim under that framework. Thus, Defendants contend that Plaintiff has failed to "articulate[e] any coherent theory of liability at all."[74]

Defendants misunderstand both the essential holding of *Gentile* as well as Plaintiff's claims in this case. *Gentile* stands for the proposition that certain corporate transactions can give rise to direct, as well as derivative, claims for breach of fiduciary

---

benefit which devolves upon the corporation or all stockholders generally." (emphasis added)).

73 906 A.2d 91 (Del. 2006).

74 DRB 2.

duty against a controlling shareholder. Specifically, *Gentile*-type direct claims will arise where:

> 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 . . . 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.[75]

In *Gentile*, the controlling shareholder of a corporation allegedly caused the corporation to issue him an excessive number of shares in exchange for forgiveness of an outstanding debt. The minority shareholders challenged the transaction, claiming that the value of the issued shares exceeded the forgiven debt, thereby diluting the value of the company.[76]

The central question in *Gentile* was whether the minority shareholders could bring their fiduciary duty claims directly.[77] The Delaware Supreme Court held that the plaintiffs could bring direct claims against the controlling shareholder because the transaction had expropriated both economic value and voting power directly from the minority shareholders to the controlling shareholder. In coming to this conclusion, the Supreme Court found that "the harm resulting from the overpayment [was] not confined to an equal dilution of the economic value and voting power of each of the corporation's

---

[75] *Gentile*, 906 A.2d at 100.

[76] *Id.* at 93.

[77] *Id.* at 96.

outstanding shares,"[78] but rather that such harm also was, at least in part, individual in nature.

The essential teaching of *Gentile* is that in situations where a corporation issues excessive shares to a controlling shareholder in exchange for an asset of lesser value, minority shareholders can bring *both* direct and derivative claims. Defendants, however, appear to interpret *Gentile* as recognizing a "dual derivative-and-direct" cause of action that can be proven only upon a showing that a transaction (1) resulted in a decrease in the value of the company as a whole and (2) caused dilution of the economic value and voting power of the minority shareholders.[79] This interpretation is incorrect. Rather, *Gentile* confirms that two types of actions, derivative and direct, can be brought based on the same transaction. Moreover, the requirements Defendants assert as being essential to bringing a *Gentile*-type claim constitute only the requirements for bringing a direct claim for breach of fiduciary duty under *Gentile*. To bring a derivative action on behalf of the corporation, plaintiffs do not need to allege that the transaction resulted in "a redistribution to the controlling shareholder[] of a portion of the economic value and voting power embodied in the minority interest."[80] Instead, they only need to allege that an overpayment occurred, diluting the overall value of the Company.[81]

---

78 *Id.* at 100.

79 DRB 4.

80 *Gentile*, 906 A.2d at 100.

81 *Id.*

Applying this understanding of *Gentile*, I find that Plaintiff has articulated a sufficient theory of liability. Zimmerman is claiming that the 2009 Transactions resulted in the issuance of preferred units at an improperly low price and that, therefore, the overall value of the Company was diluted. Thus, Plaintiff properly has brought this fiduciary duty claim regarding the alleged overpayment by the Company on at least a derivative basis.[82] Furthermore, in relation to this claim, Plaintiff has made a sufficient showing to support a reasonable inference that the transaction conferred an exclusive benefit on Defendants, namely the opportunity to buy equity in the Company at a price that allegedly is unfair.

Finally, to the extent Defendants argue that the transaction was entirely fair, that issue cannot be resolved on summary judgment. Entire fairness requires Defendants to prove both fair dealing and fair price.[83] In considering whether a transaction was entirely fair, "the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness."[84] The aspects of the transaction the Court will consider when determining entire fairness include "when the transaction was timed, how it was initiated, structured,

---

82 For purposes of Defendants' summary judgment, I further find that he also may have asserted a claim for direct relief. That issue, however, cannot be decided on the current record and will have to be addressed at trial. *See Tunnell v. Stokley*, 2006 WL 452780, at *2 (Del. Ch. Feb. 15, 2006) (holding that the Court maintains the discretion to deny summary judgment if it decides that a more thorough development of the record would clarify the law or its application).

83 *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

84 *Id.*

negotiated, disclosed to the directors, and how the approvals of the directors . . . were obtained."[85] In addition, when considering whether the transaction was done at a fair price, the Court will consider whether it was "substantively fair by examining the economic and financial considerations."[86]

There are genuine questions of fact as to whether the 2009 Transactions, as well as the other transactions, involved fair dealing and were at a fair price. Because no expert valuation of the Company has been presented by either side, I cannot find conclusively that $7.05 was a fair price per share. Furthermore, there are genuine issues of material fact as to Defendants' assertion that the 2009 Transactions placed a higher value on the Company, thereby immunizing them from *Gentile*-type claims. The pre-transaction value of the Company for the 2009 Transactions was $10.5 million, the same valuation used in October 2008, with the only "increase" in value coming from the additional cash received from the note issuance itself.[87] Therefore, according to Defendants, the promissory notes convertible into Series A Preferred Units at $7.05 per unit that were issued under the bridge loan in connection with the 2009 Transactions were not executed at a higher valuation than the previous transaction. Nevertheless, it is possible that the transactions were executed on worse terms for the Company because the promissory notes included, among other things, the right to interest payments and a security interest in the

---

85 *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 746 (Del. Ch. 2007).

86 *Id*. 921 A.2d at 746.

87 *See* DRB 4 n.2 ("The July and December bridge note transaction implied that Adhezion's value had increased by an additional approximately $860,000.").

Company's intellectual property, in addition to the conversion rights. Moreover, Zimmerman has presented evidence, such as the FDA approval of SurgiSeal in December 2008 and the addition of a "number of strong distributors outside the U.S.,"[88] that arguably supports a reasonable inference that the value of the Company increased during that period. Consequently, Defendants may not be able to prove that the 2009 Transactions were entirely fair. Therefore, I deny summary judgment on Plaintiff's duty of loyalty claims relating to the 2009 Transactions.

(b) The February 2010 and January 2011 Transactions

The February 2010 and January 2011 Transactions did not offer equal terms for all shareholders and, therefore, conferred an exclusive benefit on Defendants. As a result, those transactions also may be the product of self-dealing and be subject to entire fairness review.

Both transactions were structured as two-step offerings. In the first step, the Preferred Members, including Defendants, were given the opportunity to purchase all of the securities offered. In the second step, the offering was opened to the Common Members to participate up to their pro rata interest of the remaining securities. In the February 2010 Transaction, for example, the offering was opened first to the Series A Preferred Members, who purchased 625,000 of the 811,295 newly created units for $2.5 million.[89] A month later, the Company sent an offering memorandum to the Company's

---

88 Defs.' App. A721.

89 *Id*. at A723.

Class A Common Members, providing them with the opportunity to purchase their pro rata share of the remaining 186,295 Series B Preferred Units that were authorized for sale at a value of $745,180.[90] Significantly, the Class A Common Members were permitted to participate on a pro rata basis only in the remaining authorized shares; they were not given the opportunity to maintain their pro rata interest in Adhezion overall. Moreover, the offering was not open to Class B Common Members, and the Class A Common Members' pro rata allocation was determined without regard to any Class B Common Units they may have owned.[91]

The Board conducted the January 2011 Transaction on similar terms. On January 11, 2011, the Preferred Members were invited to purchase up to $2.5 million in promissory notes convertible into Series B Preferred Units. The Preferred Members purchased $1,285,000 of this total. Then, on February 11, a month after the initial offering, the Company sent an offering memorandum to its Common Members, providing them with the opportunity to purchase their pro rata share of the remaining $1,215,000 in promissory notes. Again, the offering was not open to Class B Common

90 *Id.*

91 *Id.* ("Your pro rata share will be equal to your pro rata portion of the currently outstanding Class A Common Units . . . ."). Although the offering was not open to Class B Common Members as such, none of them were excluded because they all were also Class A Common Members. By not including Class B ownership in the Members' pro rata allocation, however, the offering arguably diluted the value of any Class B interests. According to the Membership Schedule from January 2011, Molinaro, Rafael Ruiz, and Zimmerman were the only Members that owned Class B Common Units. *Id*. at A811.

Members[92] and Class B ownership was excluded from the calculation of "pro rata" ownership.[93]

The two-step nature of the two transactions conferred an exclusive benefit on Defendants by providing them with the opportunity to participate first and fully in the offerings. Because nothing in the record indicates that the Preferred Members were limited in the number of units they could purchase, the Common Members bore a risk in each offering that they could be shut out if the first-step of the transactions were subscribed fully. The Company acknowledged this unequal treatment of its Members and the possibility that the Common Members might not be able to participate in the offerings, stating in both offering memoranda that "*[e]ven though the Company is not required to do so*, the Company now is offering . . . Common Members . . . the right to purchase their pro rata share of the remaining [value] . . . ."[94]

Although here, as Defendants emphasize, the Common Members were able to participate in the challenged transactions, there is no evidence that they were afforded an equal opportunity to participate in the entire offering amount. Instead, the Common Members received the option to participate only in whatever value remained after the Preferred Members had participated. Thus, under the terms of the offerings, if the Preferred Members purchased more units than their collective pro rata interest in the

92 *Id*. at A751.

93 *Id*. at A809-10.

94 *Id*. at A723 (emphasis added).

Company, the transactions by definition would be dilutive for the Common Members, even if they participated to the fullest extent possible. While there is no inherent right against dilution under Delaware law,[95] the fact that the Preferred Members could subscribe to as much of both the February 2010 and January 2011 Transactions as they chose and, thereby, potentially dilute the Common Members means that the Preferred Members enjoyed an exclusive benefit under those transactions that was not available to the unitholders generally. Therefore, I conclude that the transactions were self-dealing and are subject to entire fairness review.[96]

---

95 *See Savin Bus. Mach. Corp. v. Rapifax Corp.*, 1978 WL 2498, at *6 (Del. Ch. Feb. 15, 1978) ("In the first place 8 *Del. C.* § 102(b)(3) provides that no stockholder of a Delaware corporation shall have any preemptive right to subscribe to additional issues of stock unless the certificate of incorporation expressly so provides."); *id.* at *8 (holding that there is no "minority right to be frozen into the board of directors where stock ownership interests do not otherwise support it" and that "the fiduciary obligation of the majority to the minority would not seem to be affected by the mere act of increasing the already existing control of the corporate machinery which gives rise to that obligation").

96 *Cf. Sinclair v. Levien*, 280 A.2d 717, 721-22 (Del. 1971) (approving the application of business judgment deference to a decision by a company to issue a dividend in excess of its earnings because the controlling shareholder causing the issuance "received nothing from [the company] to the exclusion of its minority stockholders"); *Gilbert v. El Paso Co.*, 1988 WL 124325, at *8 (Del. Ch. Nov. 21, 1988) (finding that the fact that a revised tender offer negotiated by the board of the target company was open to all shareholders, including the defendant directors, on the same terms, precluded any finding of self-dealing that would implicate entire fairness review); *see also Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) ("First, [the] protections [of the business judgment rule] can only be claimed by disinterested directors whose conduct otherwise meets the tests of business judgment. From the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, *as opposed to a benefit which devolves upon the corporation or all stockholders generally*." (emphasis added)).

iv. Does § 6.13 of the Operating Agreement provide a safe harbor from entire fairness review?

Having found that each of the challenged transactions were self-dealing transactions warranting entire fairness review, I next consider whether the approval of the transactions by allegedly disinterested and independent directors nevertheless enables Defendants to claim the benefit of business judgment deference.

Section 6.13 of the Operating Agreement states, in part:

> [n]o transaction between the Company or its Subsidiaries and one or more of its Members, Directors or officers or between the Company or its Subsidiaries and any other business entity in which one or more of its Members, Directors or officers have an interest, shall be void or voidable solely for this reason, or solely because the Director or officer is present at or participates in the meeting of the Directors that authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if (a) the material facts as to the transaction are disclosed or are known to the disinterested Directors and the contract or transaction is approved in good faith by the vote or written consent of the disinterested Directors; or (b) the transaction is fair to the Company or its Subsidiary as of the time it is authorized, approved or ratified by the Board of Directors or the Members.

Both parties agree that this contractual provision closely tracks the language of 8 *Del. C.* § 144. In particular, § 144(a)(1) similarly provides:

> [n]o contract or transaction between a corporation and 1 or more of its directors or officers . . . shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because any such director's or officer's votes are counted for such purpose, if . . . . [t]he material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or

> committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum.

Although the parties agree that § 6.13 of the Operating Agreement should be interpreted similarly to § 144,[97] they disagree as to the legal effect that satisfaction of § 6.13's requirements should have on the review of the transactions. Defendants contend that satisfaction of the requirements of § 6.13 of the Operating Agreement entitles them to a presumption that the challenged transactions are subject to the presumption of the business judgment rule. In contrast, Zimmerman asserts that "Section 6.13, like Section 144, does not address monetary damages, but only renders a transaction itself not void or voidable solely because it is an interested-director transaction."[98] In this regard, I adopt Plaintiff's construction of § 6.13 as more reasonable. As the Delaware Supreme Court observed in *Fliegler v. Lawrence*, § 144 "merely removes an interested director cloud when its terms are met and provides against invalidation of an agreement soley because such a director . . . is involved."[99] That is, the statute only addresses the void or voidable issue presented by the common law before the 1967 amendments to the Delaware

---

97 Because the parties agree that § 6.13 should be interpreted similarly to § 144, I have looked to the case law governing § 144 in interpreting § 6.13 except where a party claims that the contractual language materially deviates from the statute.

98 Pl.'s Ans. Br. 32 n.20.

99 361 A.2d. 218, 221-22 (Del. 1976) (internal quotation marks omitted).

General Corporation Law.[100] Thus, it does not appear that either 8 *Del. C.* § 144 or § 6.13 of the Operating Agreement, which is based on § 144, was intended to address the common law rules for liability for breach of fiduciary duty. Therefore, even if Defendants have complied with § 6.13, that would not operate as a safe harbor against review of the challenged transactions under the entire fairness standard.

In addition, however, Zimmerman also argues that Defendants have not satisfied § 6.13 in the first place. Specifically, Plaintiff claims that the requirements of § 6.13 have not been met here because (1) the VC Investors control Adhezion, (2) the transactions were approved without due care and in bad faith, (3) the insider issuances were not comparable to third-party transactions, (4) Bryant and Toni did not know material facts and were not disinterested and independent, (5) no arm's length negotiations occurred, (6) there was no quorum, and (7) § 6.13 does not apply to contracts.

---

[100] *See In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 614-15 (Del. Ch. 2005) ("I must hasten to add that § 144 has been interpreted as dealing solely with the problem of per se invalidity; that is, as addressing only the common law principle that interested transactions were entirely invalid and providing a road map for transactional planners to avoid that fate. The somewhat different question of when an interested transaction might give rise to a claim for breach of fiduciary duty—i.e., to a claim in equity—was left to the common law of corporations to answer. Mere compliance with § 144 did not necessarily suffice.") (footnotes omitted); *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 114 (Del. Ch. 1999) ("[S]atisfaction of §§ 144(a)(1) or (a)(2) simply protects against invalidation of the transaction 'solely' because it is an interested one. As such, § 144 is best seen as establishing a floor for board conduct but not a ceiling.") (citations omitted); *see generally* Blake Rohrbacher, et al., *Finding Safe Harbor: Clarifying the Limited Application of Section 144*, 33 Del. J. Corp. L. 719 (2008) (discussing the sometimes conflicting or confusing application of § 144 in the cases).

For the reasons discussed *supra*, I have concluded that the question of whether the VC Investors are, in fact, controlling shareholders cannot be resolved on summary judgment. Hence, the first of Plaintiff's additional arguments also is not ripe for summary judgment. Furthermore, for the reasons discussed in Part II.B.1.b *supra*, I find that Plaintiff's claim that the transactions were not approved in good faith and with due care must be dismissed.

Zimmerman further argues that the transactions were approved without a quorum. The express terms of the Operating Agreement, however, do not support that assertion. Section 6.11(a) expressly provides that "[a]t all meetings of the Board of Directors, the presence of a majority of the Directors in office shall constitute a quorum . . . ." This provision makes no distinction between interested or disinterested directors and Plaintiff has failed to point to any other provision in the Operating Agreement that suggests that interested directors cannot be counted toward a quorum. Furthermore, the fact that § 6.13, unlike 8 *Del. C.* § 144, does not expressly provide that interested directors may be counted for purposes of a quorum is of no moment because the Operating Agreement sets forth the quorum requirement in § 6.11(a) and it need not be restated under § 6.13.

Likewise, I reject Plaintiff's contention that § 6.13 does not apply to "contracts." In a three-sentence argument, Zimmerman suggests that § 6.13 only applies to "simple one-time exchanges of goods or services for payments that d[o] not further obligate Adhezion" in a long-term relationship.[101] In asserting such a strained interpretation of

[101] PAB 35.

§ 6.13, Plaintiff has gone beyond the "kitchen sink" and thrown in the plumbing. His selective focus on the absence of the word "contract" at the beginning of a sentence in § 6.13 ignores the remaining text and plain meaning of the full sentence, which reads, in pertinent part:

> [n]o transaction between the Company or its subsidiaries and any other business entity in which one or more of its Members, Directors or officers have an interest, shall be void or voidable solely for this reason, or solely because the Director or officer is present at or participates in the meeting of the Directors that authorizes *the contract or transaction*, or solely because his or their votes are counted for such purpose . . . .[102]

The express language of this sentence makes clear that § 6.13 applies to both contracts and transactions. Therefore, Plaintiff's argument to the contrary is unpersuasive.

Finally, as to the parties' arguments regarding whether the applicability of § 6.13 here depends on whether the transactions in question were comparable to third-party transactions, I conclude that the language of § 6.13 on that point is ambiguous. Therefore, the issue cannot be resolved on summary judgment.

C. Aiding and Abetting Claims

To succeed on an aiding and abetting claim, a plaintiff first must prove that there has been a "cognizable breach of fiduciary duty."[103] Therefore, because I grant summary

---

102 OA § 6.13 (emphasis added).

103 *See Related Westpac LLC v. JER Snowmass LLC*, 2010 WL 2929708, at *8 (Del. Ch. July 23, 2010) ("Furthermore, because the breach of fiduciary duty claim is dismissed, the aiding and abetting claim must also be dismissed. Because 'no cognizable breach of fiduciary duty claim is stated,' the aiding and abetting claim also fails.").

judgment on Plaintiff's duty of care claims, I likewise grant summary judgment on his claim for aiding and abetting a breach of the duty of care. I grant Defendants' motion for summary judgment as to Zimmerman's claims for aiding and abetting a breach of contract under Count VI, because there is no cause of action under Delaware law for aiding and abetting a breach of contract.[104] Finally, having found that Plaintiff possibly could prevail on his duty of loyalty claims, I deny summary judgment on his corresponding aiding and abetting claims regarding those alleged wrongs.

D. Was a Vote of the Class A Common Units Required to Amend the Operating Agreement to Issue Class B Preferred Units?

Finally, Plaintiff asserts that Defendants breached the Second Operating Agreement by amending it to include Series B Preferred Units without approval by a majority vote of the Class A Common Units. This claim arises from Zimmerman's interpretation of certain provisions of the Second Operating Agreement governing Adhezion. Thus, to prevail on this aspect of their motion for summary judgment, Defendants must show that the plain language of the Second Operating Agreement unambiguously provides that the Board could amend it to include new Series B Preferred Units without a majority vote of the Class A Common Units. Because I conclude that the relevant provisions of the Second Operating Agreement are ambiguous in this regard, I deny Defendants' motion for summary judgment on this claim.[105]

---

104 *Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 817 A.2d 160, 172 (Del. 2002).

105 Zimmerman's Complaint also alleges that Defendants breached their fiduciary duty by authorizing the amendment of the Second Operating Agreement. Compl.

Section 15.11 of the Second Operating Agreement provides that

> *[e]xcept as otherwise provided in Section 3.8 hereof with respect to the issuance of additional Units*, this Agreement and any term hereof may be amended and the observance of any term hereof may be waived . . . with the written consent or vote of (a) a Required Interest of the Preferred Members, voting together as a single, separate class, and (b) a Majority-in-Interest of the Common Members, voting together as a single, separate class . . . .[106]

In other words, with the exception of the issuance of additional units under § 3.8, § 15.11 requires that both the Preferred and Common Members vote on any amendment of the Operating Agreement.

Section 3.8 provides that:

> [s]ubject to the provisions of Section 3.2 hereof, the Board of Directors may, at any time and from time to time, issue additional Units (including, without limitation, Class B Common Units pursuant to Section 3.3(b) hereof) *or create additional Classes or Series of Units having such relative rights, powers and duties as the Board of Directors may establish, including rights, powers and duties senior to existing classes of Units*.[107]

¶ 57. Where a breach of fiduciary duty claim "overlap[s] completely" with a contractual claim "and arise[s] from the same nucleus of operative facts," however, the contractual claim will control and courts generally dismiss the fiduciary duty claim. *See Related Westpac LLC*, 2010 WL 2929708, at *8 n.45 (quoting *Grunstein v. Silva*, 2009 WL 4698541, at *6 (Del. Ch. Dec. 8, 2009)). That is the situation here. Therefore, I will consider Plaintiff's claims regarding the allegedly unauthorized amendment of the Second Operating Agreement solely as a breach of contract claim as stated in Count VI.

[106] OA § 15.11 (emphasis added).

[107] *Id.* § 3.8 (emphasis added).

Section 3.2 requires, in relevant part, that the Series A Preferred Members must vote on any Board action seeking to "create, authorize or reserve any Units or Derivative Rights."[108]

The dispute between the parties as to the proper interpretation of these provisions principally revolves around the reference to "issuance of additional Units" in § 15.11 and its relation to the fact that § 3.8 deals with both the issuance of additional Units and the "creat[ion] of additional Classes or Series of Units." A subsidiary issue requires consideration of the difference between the "creation" of Classes or Series of Units and the "authorization" of such Units. Defendants appear to suggest that § 3.8 provides the Board with "blank check authority" to create, authorize, and issue new units. Zimmerman argues that "create" should be construed more narrowly, allowing only for the Board to assign "rights, powers and duties" to new Classes or Series of Units, but prohibiting the Board from actually authorizing such units without a vote by the Common Members. More importantly, perhaps, Zimmerman contends that the introductory phrase to § 15.11 only carves out as an exception to that section the issuance of additional units under § 3.8, and not the creation of new Classes or Series of Units.

In considering these competing interpretations, I acknowledge that the language of the Operating Agreement reasonably could be read to mean, as Plaintiff urges, that only the issuance of Units under § 3.8 is exempted from the requirement under § 15.11 that a majority of the Class A Common Members must approve amendments to the Operating

---

108 *Id.* § 3.2(v).

Agreement. When § 15.11 is considered in the context of the Operating Agreement as a whole, however, the proposed construction advanced by Defendants also seems reasonable: *i.e.*, that § 15.11's reference to "issuance of additional Units" with regard to § 3.8 was meant as a shorthand reference to § 3.8 as a whole, inclusive of the provision regarding the creation of new securities.

Similarly, I cannot dismiss as unreasonable Zimmerman's more narrow interpretation of "create" in § 3.8. The use of both the terms "create" and "authorize" in § 3.2 suggests that "create" was intended to carry a meaning distinct from "authorize." Furthermore, if the two terms are distinct, one reasonably could infer that the use of "create" in, and the omission of "authorize" from, § 3.8 was purposeful. As a practical matter, however, such an interpretation would be cumbersome in that it would require three separate steps of (1) creating, (2) authorizing, and (3) issuing units of a new class or series of units, with the various steps having different voting requirements. An alternative, reasonable inference is that the parties intended the term "create" in § 3.8 to include the power to "authorize."

In all events, I agree with Plaintiff that, at the very least, the language of the Operating Agreement is ambiguous on these issues. Furthermore, the factual record regarding these issues and their relation to the challenged transactions that would be affected is spotty at best. Therefore, the Court would benefit from greater development of the factual and legal record on these matters. Accordingly, I deny summary judgment on Count VI.

III. CONCLUSION

For the reasons stated in this Memorandum Opinion, I grant Defendants' motion for summary judgment on Counts II and IV and on Count V as it relates to aiding and abetting violations of the duty of care under Counts II and IV or a breach of contract under Count VI. For Counts I, III, VI, and the remaining aiding and abetting claims under Count V, Defendants' motion is denied.

IT IS SO ORDERED.