EXHIBIT 1

TRANSCRIPT OF TAPE-RECORDED
HEARING IN THE MATTER OF
PARAMETRIC SOUND CORP., ET AL. VS. RAKAUSKAS, ET AL.
SEPTEMBER 1, 2015

CASE NUMBER 66689

Job Number: 265198

00:00:00 HON. HARDESTY: Uh, this is a, uh, writ proceeding Parametric Sound Corporation et al., versus, um, the Eighth Judicial District Court and, uh, Vitie Rakauskas, individually and behalf of others, uh, real parties and interest, case number 66689.

MR. HESS: Good afternoon], [inaudible], Your Honors --

HON. HARDESTY: Hold on just a sec --

MR. HESS: Oh. Sure. You bet.

HON. HARDESTY: -- just to let the courtroom clear, and, um --

MR. HESS: [inaudible] --

00:00:47 HON. HARDESTY: Okay. Would you begin by introducing the lawyers that are with you, and I'll ask, uh, Mr. Baron to do the same.

MR. HESS: Uh --

HON. HARDESTY: At your commencement of your argument.

MR. HESS: That would be my pleasure. I'm -- my name's Joshua Hess, uh, with me is, uh, John Stigi, counsel for the director defendants; Richard Gordon, uh, my co-counsel on behalf of the corporate defendants; and also Robert Cassity, on behalf of the directed defendants.

00:01:14 I'll be representing all the defendants, uh, here today, uh, at the argument.

May it please the court, this case concerns whether a minority shareholder can bring a claim for breach of fiduciary duties directly against the company's directors in connection with a transaction wherein they did not lose their interest in the company, nor did they suffer any harm, independent of the harm suffered by the company.

00:01:40 Under well-developed corporate law throughout the United States, and specifically this court's decision in Cohen against Mirage Resorts, Incorporated, the answer to that question is clearly no.

As both sides have argued, it is well established that claims that seek to vindicate corporate harms belong to the corporation itself. It must be pursued by company share -- it can only be pursued by company shareholders derivatively, if at all, and subject to specific demand requirements set forth by statute --

00:02:12 HON. GIBBONS: Well, you know, Cohen's a long, long case -- panel case; uh, three justices are no longer here on the courts. So maybe you can, uh, enlighten us on how you feel Cohen plays into your case, and explain the difference in this case between direct claims versus derivative claims, because they seem to be kind of murky here to me, you know, how you define them. So if you'd do

that, I'd appreciate that --
00:02:35 MR. HESS: Sure. And -- and -- and -- and -- and you're -- you're not alone in -- in having that -- that, uh, issue.
But -- but Cohen set forth a -- a clear standard, that while recognizing that the harms to the corporation belong to the -- to the company itself and should be vindicated by the company, a dissenting shareholder to a merger who alleges that there is flawed and invalid merger process, uh, and -- and -- and lost his shares in a cash-out merger -- had a direct claim.
00:03:04 And -- and that decision made a lot of sense because at that point when you have a dissenting shareholder who -- who loses his interest in the company, you know, as -- as -- as Cohen put it, lost his personal property -- his interest in the company.
At that point, you know, there's no surviving company. The harm -- what -- whatever harm is alleged has been -- has been monetized and is at the shareholder level at that time. The shareholder has no other remedy, other than a direct claim. And that's true, you know, candidly, in -- in -- in the major corporate jurisdictions elsewhere.
00:03:41 Here, you have a company that still exists. Here, you have plans to hold just as many shares in the

company that they had both before the transaction and afterwards. And when one's reality -- their -- their alleged harm -- is that their share -- their -- their -- their interest in the company has been diluted.

That -- in essence -- that as part of this transaction, too many shares have been issued to the other company's shareholders, in order to obtain the assets of VTBH.

00:04:15 HON. GIBBONS: Well, assuming dilution's true, doesn't that affect all the minority shareholders -- all of them have their claims diluted -- so is it an argument that it's a derivative case then, that -- that -- that multiple people are affected by, uh, by this act -- assuming it was wrong to do it?

MR. HESS: Well, I mean, I'd say the dilution not only affects the minority's shareholders, it affected all of Parametric's --

HON. GIBBONS: Mm-hmm.

00:04:37 MR. HESS: -- shareholders. Because the dilution claim itself undervalued the company. And that's how -- that's -- that's the dilution issue here, is that the company itself was undervalued. And as a consequence of that, all share just as pro rata as their -- you know, each share, their pro rata interest in the company itself suffered a dilution. All of them. All of them --

00:05:01 HON. HARDESTY: But isn't -- isn't Cohen saying that if that dilution occurs through the wrongful conduct of the directors, uh, either in affecting the price in the merger, or in, uh, getting a merger that somehow favored those officers and directors in a unique way; that that is a basis for a direct claim by the shareholders.

00:05:31 Uh, it -- it -- I -- I think the language in Cohen kind of waxes and wanes, but it -- one of the things that appears to be the case, from the decision, is that at the very beginning of the opinion, uh, the court says that direct -- that claims relating to lost profits, usurpation of corporate opportunities or mismanagement are derivative.

00:05:58 But it then says that you still have a direct claim if the merger is the product of wrongful conduct by the directors; correct? That way, all that changes is the measure of damages.

MR. HESS: So, there's -- there's -- there's a few things there that I -- I want to address --

HON. HARDESTY: Okay.

MR. HESS: -- um, Mr. Chief Justice. The first issue is on -- on, uh, whether or not, uh, well, just addressing the first point, is that Cohen was very clear that, again, the context of the case was a shareholder

who dissented in a cash-out merger --
00:06:37 HON. HARDESTY: Mm-hmm.
MR. HESS: Now, in terms of whether or not --
HON. PICKERING: But they didn't dissent; they didn't exercise dissenters' rights in Cohen.
MR. HESS: Correct. And -- and -- and by dissenting, you know, I -- I -- I think --
HON. PICKERING: You use it in the vernacular, not the technical [inaudible] --
MR. HESS: Correct, Your Honor. Right. Because that was an issue, certainly, in Cohen that --
HON. PICKERING: And --
MR. HESS: -- that remedy had passed Cohen by.
HON. HARDESTY: Mm-hmm.
00:06:57 MR. HESS: And so this is -- again -- just a -- a dissenter. And so the issue is, you know, when you're dissenting from a merger -- which, of course, you know, the plaintiffs did not really have an opportunity to do that here, because they were not part of the merger entity.
But in any event -- going back to your point -- Cohen did not deal with the dilution; it dealt with a cash-out merger. And -- and that's a distinction with an enormous difference.
Because there's no corporate law jurisdiction in the

United States that has held that a dilution claim -- a pure dilution claim -- is a direct claim, unless there's very specific instances involved.

00:07:31 Now, Delaware has set forth that the only instance in which a dilution case can be brought directly -- and this is the Supreme Court's holding in Gentile -- is where you have a controlling shareholder who then -- who does it in -- in -- a fraudulent expropriation. Neither of those things is alleged here; neither one of those things.

And to go beyond that -- to read Cohen, which is a cash-out merger case -- which under Delaware law, in a cash-out merger case; yes. There would be direct claim.

00:08:05 But to read Cohen then to say in a -- just a dilution case, which is what we have here -- absent a controlling shareholder, absent a fraudulent expropriation for minority shareholders -- would go way beyond where Delaware has gone, and any other corporate jurisdiction. That would be brand new law.

HON. SAITTA: So do we need to clarify Cohen?

00:08:27 MR. HESS: Well, I think -- I think for purposes of this case, Cohen answers the question, you know, in the affirmative that they have not been able to show that they lost any personal property. They did not lose their interest in the company --

HON. HARDESTY: Well, let's talk of that --

MR. HESS: [inaudible]

HON. HARDESTY: -- that language, if we might. In Cohen there is a use of that phrase.

Uh, it states, uh, a claim brought by a dissenting shareholder that questions the validity of a merger as a result of wrongful conduct on the part of majority shareholders or directors is properly classified as an individual or direct claim. This sentence, "A shareholder has lost unique personal property -- his or her interest -- in a specific corporation."

00:09:18 But what's interesting is that the citation to that sentence doesn't use that sentence at all. So the question that I think, uh, raised -- that is raised by the Cohen case is whether this requirement of the loss of unique personal property is really part of the test at all.

Isn't it simply a question of whether the claim is that the merger was the product of wrongful conduct?

00:09:49 MR. HESS: Well, the -- the problem with that is --

HON. HARDESTY: When you analyze what happened in the Delaware Supreme Court in Tooley and subsequent tests, and then some of the treatises, three tests seem to have evolved -- at least according to those treatises

-- one of which is the wrongful conduct test; isn't that right?

MR. HESS: Uh, I would -- I would submit that there -- there is no wrongful conduct test in terms of determining whether or not there's a direct and derivative claim, uh, at -- at all. That is not, in and of itself, the test.

The test is, if you take Tooley -- which is the governing law -- and I think you're grabbing that from Parnes, which is pre-Tooley -- but Tooley clarified what -- what the test, at least in Delaware, is. Which is, where was the harm --

00:10:32 HON. DOUGLAS: Counselor, you hit Delaware twice. There's a 2013 ruling in Delaware at the chancery court, uh, Carsanaro versus, uh, Bloodhound Tech, which seems to deviate a little bit more and, uh, Delaware seems to be moving in the direction that this case fits into. Why doesn't it?

MR. HESS: Well, again, in Carsanaro, which I would submit is -- is, you know, the [inaudible] is, again, there's -- there's a dispute even among the chancery court whether or not the Carsanaro was beyond the Supreme Court in Delaware's teaching in Gentile.

But let's take for a minute that Carsanaro is -- is good law and should -- should apply. In that case, the chancery court still recognized that there was a -- an expropriation; again, a -- a -- a corporate actor who had ability to, uh, influence and could pull the corporate levers as they -- as he put it.

00:11:25 Expropriated voting rights and economic rights from minority shareholders, and then, you know, prior to -- prior to -- prior to the -- the transaction at issue.

What is notable in this case is that there is no allegation that, you know, there's -- they conclude a lot of facts in their brief about what happened. But what's interesting is there's never any allegation that any of the directors of Parametric received a better deal. There's no -- no -- why -- why did they favor Parametric?

We're never told. They were never given a special deal. They were diluted as much as the minority shareholders that plaintiffs purport to represent. So, you know, there's no expropriation. And absent expropriation, it wouldn't even fit into Carsanaro.

00:12:11 HON. DOUGLAS: If that being the case --

HON. PICKERING: Then every merger case would be a direct claim, if you'd credit that reading. I mean, every single one if it's just wrongdoing on the part of the board that's alleged, then you would be -- it'd all be direct.

MR. HESS: Yeah. You -- you -- you -- I totally agree, Justice Pickering, that if you just basically say bad faith test, and which is kind of where -- you know, if you took -- took it off that far, which is well beyond Delaware -- the Tooley framework would disappear.

00:12:40 HON. PICKERING: Do you think it matters to Cohen that, um -- and I'm going to ask your opposing colleagues the same question -- that that plaintiff in Cohen, by virtue of the merger lost, he -- he would not have had standing to bring a derivative claim --

MR. HESS: [inaudible] --

HON. PICKERING: -- um, so he's procedurally out in the sidelines. Um, and I don't know -- I've read and re-read Cohen, and I'm not sure exactly what it means. But, um --

MR. HESS: Mr. Bice was here earlier; he may have helped.

HON. PICKERING: Yeah. Um, waxes and wanes is probably more articulate.

But if it's concern about a -- a specific interest or a specific shareholder tied up with the concept that, um, the wrong didn't run to every single shareholder equally, and this guy lost his stock particularly, and maybe others got some advantage?

00:13:30 MR. HESS: I -- I think that's -- that's exactly -- that's exactly the -- the point where I think you see the -- the -- the law emerge, where when you see a -- a -- the shareholders of one company, and there's a divergence of interests where one group -- usually a controller -- is getting one deal; and these minority shareholders are getting another worse deal. That's where you start seeing a direct claim.

Because all of a sudden it's -- it's --

HON. PICKERING: But aren't they alleging that here -- or are they trying to? Um, they're trying to --

MR. HESS: I don't think they -- I don't think they are alleging that here --

HON. PICKERING: Okay.

MR. HESS: -- because they can't allege that Potasher and the other directors got a worse deal. They haven't alleged that.

HON. PICKERING: They seem to allege that they're happier now than they were before.

MR. HESS: Right. Because -- because as they've also conceded, the company's now a new, cool, better company than it was before. So --

00:14:12 HON. PICKERING: I don't know that they've conceded that.

MR. HESS: Well. I -- I -- I have another two minutes left I'd like to [inaudible] --

HON. DOUGLAS: But counsel, could -- before you sit down --

MR. HESS: Yes, sir.

HON. HARDESTY: -- if you could deal with the issue that they're asserting, and that is the loss of unique personal property.

MR. HESS: I'm -- I'm sorry. I didn't catch that.

HON. HARDESTY: The loss of unique personal property. That's, in essence, what they're alleging, through this merger.

MR. HESS: All right. Well -- well -- well, I -- I think -- I think the -- the only loss that they've ever sought to advance in this litigation is a majority voting right, which they've abandoned, because it's just a disjointed group of minority public shareholders; they never had majority voting rights.

00:14:49 And then this other kind of ethereal concept that it's a new company; that somehow that -- that Parametric still exists, they never lost their shares, that somehow --

00:14:59 HON. PICKERING: Their -- their -- their allegation is, essentially, they've been marginalized by virtue of going from part of 100 percent to 20 percent.

MR. HESS: Right. Right. For 100 percent of a company that had a $270,000 profit to 20 percent of one that had a $63.7 million profit. So, yeah. And that's a dilution. And -- and you cannot find a case where all that is -- all you're alleging is that -- that kind of dilution.

Not in Delaware absent, again, expropriation, which is not alleged here. No court has ever found that's correct.

HON. HARDESTY: Okay. Mr. Baron?

00:15:37 MR. BARON: Good afternoon, Your Honor. My name is Randall Baron. I represent plaintiffs in this case. I am here with co-counsel Mr. David O'Mara; Mr. David Knott; Mr. Jonathan Stein; and Mr. Rick Atwood.

May it please the court, I -- I think, Justice Hardesty, you hit it -- the nail on the head with your question is, doesn't Cohen just cover this?

In fact, that's exactly what, uh, Judge Gonzalez asked Mr. Peek in the question, which was, are we here on a motion to dismiss or are we not? Yes.

The plaintiffs have alleged that they were harmed as a result of a merger. Did they not? Yes; they did. That is exactly what Cohen says is required to be pled to confer standing.

00:16:25 The rest is all going to be questions of fact that would have to be argued going forward whether or not it really was a merger. All of that goes forward.

And to really take Justice Hardesty's view a little further, if you --

HON. PICKERING: Okay. Wait. Is it your position that every complaint alleging misconduct by officers and directors in connection with the merger gives rise to a direct action at the pleading stage?

MR. BARON: Yes. That's what it says. If you read --

HON. PICKERING: You read Cohen to say that?

MR. BARON: -- if you read what Cohen says, and let me take a step back from what -- where Cohen was. Remember in Cohen what happened was the plaintiff in that action did not affect dissenter's rights. 00:17:06 They were given to him; he chose not to do so. At that time period, courts throughout the country were weighing the question of whether or not appraisal rights were exclusive.

And so that was the struggle that -- the real struggle, which is if you have -- were given those appraisal rights, and you didn't choose to do that, do you -- were you out of court?

And that -- and the court came down along the lines of what Delaware court did, which are there are two separate statutory schemes.

You can choose to proceed with one, or you can choose to proceed with the other, and both are viable. That was the bulk of -- of that opinion and it is lengthy.

00:17:43 The opinion on direct derivative is really the one paragraph that Justice Hardesty read. And the -- above that, it cites Parnes and a couple other cases, which simply stand for the proposition that a merger is a direct claim.

And that's what Parnes says, and that's why that section -- that one phrase that he read, which talks about the unique interest -- cites to Parnes.

Because what it really says, is if you read that quote, a claim brought by a dissenting shareholder that questions the validity of the merger -- which is what we plead -- as a result of wrongful conduct -- which we plead, and which, uh, Justice -- Judge Gonzalez found -- on the part of a majority shareholders or directors -- we pled that -- is properly classified as an individual or direct claim.

00:18:33 And then explaining that -- and that's all it really is, this middle sentence --

HON. DOUGLAS: Counsel, at the beginning of that, you put in the word, "Dissenting shareholder --"

MR. BARON: Yes. And I think --

HON. DOUGLAS: And is that not different from our situation here?

MR. BARON: Not at all. Because as -- as the Justice pointed out, Mr. Cohen wasn't a dissenting shareholder. If the -- the technical -- and she asked counsel that, and he said, yes; we're talking dissenting in the colloquial term.

Because under a technical stat -- under a statute for seeking to be a dissenter -- it's 92A.315 -- a dissenter must be someone who, "Has dissenter's right and is -- has perfected their dissenter's rights." 00:19:14 And we know Mr. Cohen didn't. We know that's the whole purpose of the case; and yet he was still a dissenter for the purposes of proceeding in that case --

HON. PICKERING: But what's the remedy that you're -- alleged you're entitled to, by virtue of what wrong?

MR. BARON: We are entitled to the difference in the value of what the Parametric shareholders really got -- what was left over -- their stub ownership of 20 percent, and what the real value was. Now we --

HON. PICKERING: That's a claim that every Parametric shareholder would have; correct? Every former Parametric shareholder, as of the date of this reverse triangular merger?

MR. BARON: It was a pseudo-reverse --

HON. PICKERING: Right. Right --

MR. BARON: -- triangular merger, actually --

HON. PICKERING: -- right. Whatever.

MR. BARON: -- which -- which --

00:19:55 HON. PICKERING: But you agree then, that claim would run in favor of every extant Parametric shareholder?

MR. BARON: Just like Mr. Cohen's. Just [inaudible] --

HON. PICKERING: The answer is yes.

MR. BARON: The answer is just -- yes, just like Mr. Cohen's. And I apologize for not directly answering. But yes, because every shareholder who was cashed out in Cohen got the same amount of cash.

So his position was identical. And that's why Parnes in Delaware did what it did, which said in a merger that is a unique personal interest.

00:20:29 And the reason -- and the court brought up Tooley. The reason the court sort of moved beyond that -- and I think counsel was honest when he said they clarified where they were under the special injury test -- is because, well, most derivative cases are obvious; you overpay somebody, it's obviously -- the money goes back to the corporations.

But in certain context, you have to worry about, if we are right, if the directors did, in fact, breach their fiduciary dues of loyalty and were disinterested, and did, in fact, give Turtle Beach 80 percent control of

this company -- take that away from the -- the shareholders who were 100 percent -- take away their power to vote different board members, etc.; if that was true and they were hurt, and you ultimately -- and the court ultimately awarded damages -- who does it go to?
00:21:21 And that's really where Tooley had the problem; right? Because in our situation, if we were to win the case, and we were to proceed derivatively, and we were to get -- let's say -- $30 million, if it were a derivative claim, the argument is that $30 million just popped back into the corporation that is 80 percent controlled by the people who got the benefit in the first place.

And that's wrong. That is not the way that corporate law is supposed to work. Corporate law is supposed to give the benefit of the -- of justice -- to the people who were wronged.

But if it -- if is stays in a derivative suit, then it, basically, goes to the wrong people, which is exactly why the two-part test of Tooley came about.
00:22:04 It doesn't really change whether there's a special injury. It just says; look, in a merger it's clear it would have to go to the people who were part of the merger and not whoever owns the company now and is running the company now -- in this case, Turtle Beach.

So I think that if you look down that line, and you realize that we're talking all about what happens in a merger -- and I do really want to emphasize the -- the sentence right after the question about the, um, loss to unique personal property.

00:22:38 Because Cohen not only tells you what the rule is, explains that it's like Parnes, which there's a special injury in a merger; it then says, "Therefore, if a complaint alleges damages resulting from an improper merger, it should be -- it should not be dismissed as a derivative claim."

So the court, in that one paragraph, tells you exactly what it is you need to plead.

HON. SAITTA: But it doesn't de- -- it doesn't define any personal property.

MR. BARON: No. Because -- because unique personal property was just a definition of what happens in a merger. And that's why -- that's why it's not this long dissertation on direct derivative. It is a dissertation on what happens to a shareholder in a merger.

00:23:22 And let's not be -- let's not fool ourselves with what Delaware courts in Gatts [ph] called the -- what is it called -- it's called the create -- or the creativity of lawyers, or the transactional creativity.

Because what the -- what the defendants did -- or what the lawyers who do this transaction -- they do a lot of different transactions. But at the end of the day we had two companies that became one.

We had the larger, private company that controlled the company; they ended up taking the voting rights mostly away from the Parametric shareholders.

All the assets were merged; all of the directors were merged -- the officers were the people who Turtle Beach wanted -- and the product lines were product lines that Turtle Beach wanted to promote.

00:24:08 As a result of that, they had to have SEC approval; there had to be shareholders who had to approve both the stock issuance and the fact that they were going to lose control in order for their -- to get approvals for the merger -- which was a merger agreement; and ultimately, for tax reasons and for accounting reasons, the defendants themselves have to acknowledge that Turtle Beach is the acquirer.

It's a merger. It's within Cohen. Now --

00:24:42 HON. HARDESTY: So let me ask you something that, with respect to what you must demonstrate in your complaint, returning to that paragraph we've been talking about; was the sentence, "The shareholder has lost unique personal property, his or her interest in a specific corporation," necessary in the opinion to demonstrate a direct claim --

MR. BARON: No.

HON. HARDESTY: -- versus a derivative claim?

MR. BARON: No. It is the definition -- and I think you -- you hit the nail on the head when you said the citation to it is to Parnes.

HON. HARDESTY: Mm-hmm.

MR. BARON: The reason the citation to that sentence is to Parnes is because what Parnes found -- and if you read Parnes in detail, what they said is, we understand we have the special injury test, we understand it's kind of confusing, but in a merger shareholders will lose an interest in the property.

00:25:33 HON. HARDESTY: So as far as your position and your argument is that if this sentence had been deleted from the opinion, uh, you would have a direct claim as long as you could demonstrate that the validity of the merger was -- at issue because of wrongful conduct, uh, by a majority shareholders or directors?

MR. BARON: Yes.

HON. HARDESTY: And the measure of your damages would be something that would be determined at trial, uh, based upon the effect of that wrongful conduct?

MR. BARON: That is correct.

HON. HARDESTY: Okay. I think I understand your position.

MR. BARON: Excuse me?

HON. HARDESTY: I said, I think I understand your position.

00:26:07 MR. BARON: And the interesting thing about following the case -- or the rules just in the case -- which is, if we allege a merger, and we allege that it was an improper merger, and we allege that the director breached their fiduciary duties in bringing it about, and we allege that shareholders were damaged by that, we have to prove it. If we prove it, that money goes to shareholders.

We don't -- it doesn't make sense to say, "We don't get the day in court to prove that claim." And defendants' arguments -- I'm trying to say, we don't -- is sort of this sky-is-falling approach.

00:26:46 They're saying, if you go down the approach of allowing this merger to proceed derivatively, then all sorts of horribles will happen. And they -- then in various places in their --

HON. PICKERING: But what -- how would you distinguish, um, I mean, let's say they sold the major asset for inadequate consideration?

MR. BARON: May I ask you a question; was there a merger?

HON. PICKERING: No.

MR. BARON: Then -- then -- then Cohen wouldn't apply, and it would be derivative. Next question? That's my point. That's --

HON. PICKERING: So your point is, anytime there's any kind of stock acquisition as opposed to dollars changing hands, that that automatically makes it into a direct as opposed to a derivative claim?

MR. BARON: No. I'm saying if there is a merger, which means that there are two companies that combine into one; one takes over, one doesn't -- they can even be mergers in influence --

00:27:33 HON. PICKERING: So that's the litmus test, in your mind. And then you define merger expansively and --

MR. BARON: Well, I don't even think you need to define merger expansively. I don't think there is a question -- the defendants ultimately concede from the second paragraph of their brief that this was a merger.

And -- and there is no question that since they concede that the -- that it's treated as though Turtle Beach was the acquirer and Parametrics was the acquiree [sic] for accounting purposes, that's exactly what happened. So I don't think it's that expansive. And a merger between companies is pursuant to a merger agreement and --

00:28:09 HON. PICKERING: But analytically, what's the difference?

MR. BARON: Between a merger and a non-merger?

HON. PICKERING: No. Let's say they divested the -- they sold some very valuable asset and made a misjudgment and took, you know, stock from the company that they sold it to as the consideration for it --

MR. BARON: They didn't lose --

HON. PICKERING: -- and that -- that would be, in your estimation, a derivative claim?

MR. BARON: In this -- in that situation, where again, the shareholders didn't have what happened here, which is they lost from 80 -- 80 to 100 percent voting control the ability to vote in and out officers and directors, the ability to proxy contests, the ability to control this -- the --

00:28:50 HON. PICKERING: Did they have that before?

MR. BARON: Did they?

HON. PICKERING: They were minority shareholders before and after; right?

MR. BARON: Not in this case. No. They were majority. They -- they were -- the -- the public shareholders, the people who was the class of shareholders that we represent, constituted a majority of ownership.

They had about 80 percent ownership of that company;

that other 20 percent was with officers and directors. They had -- they had control as a public shareholder body, and the way that Delaware talks about control and lack of control --

HON. PICKERING: So your clients were the majority, is what you're saying?

MR. BARON: The class as a whole was. Not my clients in particular. My clients --

00:29:29 HON. PICKERING: And the majority voted and approved this transaction?

MR. BARON: The majority that voted to approve this transaction was the public shareholders -- they were not -- they were not necessarily officers and directors -- and they voted to approve that based upon what we have alleged was misleading -- misleading information --

HON. PICKERING: Misinformation. Yeah.

MR. BARON: -- and coercion. But again, defendants aren't challenging Judge Gonzalez's view of that.

So looking at that sky is falling, the answer is -- to your question -- if there's not a challenge to a merger, then it's going to likely be derivative.

00:30:01 If there is a dilution claim in which there is not an expropriation by a, uh, fiduciary -- and just so that you're clear, we've cited in our briefs -- also Nine Systems as well as Carsanaro -- both of which say that an expropriation that is brought about by a majority of interested directors is also a direct claim. And that's what --

HON. PICKERING: Right. But that's not this case; right?

MR. BARON: It could be this case.

HON. PICKERING: But that's not what's alleged.

MR. BARON: That's not what's alleged.

HON. PICKERING: Yeah.

00:30:34 MR. BARON: It -- it -- it isn't. Because we allege a merger, because we allege specifically into what the Supreme Court of this state has said -- said you must. If you send it back can we allege a claim exactly like, um, Nine Systems? Yes. We can do that. But in this state we have a merger.

And we have a clear rule from Cohen that says if you are challenging the validity of a merger, then that is a direct claim. That's all we need to plead; that's what we did plead.

HON. PICKERING: May I ask a question?

00:31:06 HON. HARDESTY: Yes. Of course.

HON. PICKERING: Why would you analytically -- explain to me the rationale, um, in -- in simple terms for saying it's a direct claim in this sort of merger context, versus the selling the major asset too cheap context. Philosophically, why should that be the law?

MR. BARON: Philosophically, because you are -- if there is a business judgment decision by the board of directors -- the board of directors manage the assets of the company as a whole.

00:31:41 And if you are just simply selling off an asset of the company, you are acting as the company as a whole and therefore the company itself needs to -- needs to recover that.

And let's sort of break that down -- and note Justice Hardesty did the work that he did in Americo. But remember, there's -- it -- when you choose to bring a derivative claim, you can bring it either demand futility or demand refute.

You could just tell the board, I want you to go back, and I want you to go after the person who wrongfully gave up corporate money. And then what it does is it puts people back into the exact same situation they were.

00:32:18 So for example, if I sold an asset to my brother-in-law -- and I'm sorry I'm going [inaudible], but I'm hoping it's okay with the court -- if I sold the asset to my brother-in-law for way too cheap, and I've hurt that company as a whole -- I haven't really just hurt the shareholders, I've just hurt the company as a whole -- if I go back and I sue -- sue my -- the person who sold us -- the brother-in-law -- and get that money back, then the corporation is in exactly the same position --

HON. PICKERING: But that's a classic derivative claim. Why isn't that the case in this case?

00:32:48 MR. BARON: Because what happened here --

HON. PICKERING: Other than the label merger. But I mean --

MR. BARON: Because as a result of the merger, Turtle Beach now owns 80 percent of the company. If you were to go forward and get the money back that the Turtle -- that was overpaid for Turtle Beach asset and -- in the divestment of that 80 percent ownership interest, then what do you do with it?

You put it back in a corporation, but that corporation is 80 percent owned by Turtle Beach, so that money goes back to Turtle Beach, and you are not remedying the wrong and giving the people who were hurt what they deserve --

00:33:23 HON. PICKERING: Unless you did rescission.

MR. BARON: But that's not -- that's not --

HON. PICKERING: Yeah.

MR. BARON: -- damages, and that's not Cohen, either. And yes, you're right, rescission. But to tell

you the truth, rescinding publically paid --
HON. PICKERING: Yeah. That's --
MR. BARON: -- mergers --
HON. PICKERING: Yeah. No. You can't --
MR. BARON: -- is a nightmare. All right. If there's any other questions? I'll sit down.
HON. HARDESTY: I don't think so.
MR. BARON: Thank you.
HON. HARDESTY: All right. Mr. Hess, we'll give you two minutes.
MR. HESS: Yes. The -- so the issue is what is -- is talismanic; is it a merger or not a merger? And, again, focusing on the language from [inaudible] --
00:33:55 HON. HARDESTY: But not necessarily. Let's follow up on the discussion that Justice Pickering and Mr. Baron were just having. It's not talismanic; it really has to do with who receives the damages caused by the improper conduct of the office's directors.
If it is a merger, then the shareholders who are merged out, uh, would be the recipient of the damages from the alleged wrongful conduct; correct?
00:34:23 MR. HESS: You -- you are right. But that case is different from this case, because the shareholders were not merged out. And that's the -- that's -- that's -- that's --

HON. HARDESTY: Well, not entirely. Because one of the points that Justice Becker made in the Cohen case -- earlier in the opinion -- is that there may be an impact on value.

Let's take the example that, uh, Mr. Baron and Justice Pickering were commenting about. He sells or -- a -- an asset, uh, to his brother-in-law at an understated price; the company is harmed; a merger occurs.

The value at the merger time is going to be affected by the, uh, asset that has been sold at an understated price. Who should receive the benefit? The merger might have been a different price, if that had been still at asset of the company; correct?

00:35:10 MR. HESS: Well, so there's -- there's -- there's -- there's two issues. One, again is, you know, you have kind of an expropriation issue, um, first and foremost --

HON. HARDESTY: Mm-hmm.

MR. HESS: -- which is -- which is -- which is different there. But here we're talking about the whole -- they're selling the whole company. Uh, and -- and so the issue here is, you know -- you know, Mr. Baron's made much about this -- kind of this bad guys theory; but that's been rejected in JP Morgan shareholders' litigation.

Because again, you know, this is not a pass-through remedy. If the $30 million Mr. Baron hypothetically gets, it's not going to be distributed out, like, right through the company -- it goes in the company -- the share -- the share price might not move one cent; right?

It just -- it just -- this is the -- they own this part of this company; if it was undervalued the -- the -- the bad actors are going to be out $30 million, and their benefit is going to be, you know -- hard to -- it's hard to monetize it; right?

00:35:59 And -- and focusing just on the Parnes part in just the part is it merger/not merger, Delaware in Dieterich v. Harrer hit this perfectly, in focusing on the language we've been talking about says, that language in "Parnes might be read as suggesting that all shareholder claims for breach of fiduciary duty are direct if they involve the merger. That is not, of course, the law. Even after Tooley, a claim is not direct simply because it is pleaded that way. And mentioning a merger does not talismanically [sic] create a direct action."

00:36:30 So you need to go through, at a minimum, Tooley in Delaware, and under Cohen you need to allege the loss of the personal, unique property. That's where --

HON. HARDESTY: Is there any case that you have found that uses the sentence that Judge Becker used in this opinion? That was the paragraph that we're talking about?

MR. HESS: Those exact -- those exact words?

HON. HARDESTY: Anything close to it.

MR. HESS: Anything close to it? Well, I mean, there is -- you know, again, if you look at the acknowledgement of the various change in control cases, they don't just assume there's a change in control. They go through -- they -- an analysis.

00:37:02 If it was just simply, oh, there's a change in control; this is an easy one. They wouldn't have had to wrestle with it if it was that easy; but they wrestle with it. And as a consequence they go through and figure out, where was the harm?

Here, there's no divergence between the directors and all of the shareholders of Parametric because they got the exact same deal.

There's no -- no allegation that Turtle Beach sought to influence and gave someone a better side deal that impacted the value of the merger as a whole. None of that.

00:37:32 And as a consequence, in Delaware under Tooley it's a corporate harm if any harm at all; and that remedy still exists, as a derivative action here, unlike in

Cohen.

HON. HARDESTY: Okay. Thank you very much, Mr. Hess. Any questions from the court?

All right. Can you please stand submitted?

I, Chris Naaden, a transcriber, hereby declare under penalty of perjury that to the best of my ability the above 35 pages contain a full, true and correct transcription of the tape-recording that I received regarding the event listed on the caption on page 1.

I further declare that I have no interest in the event of the action.

September 11, 2015
Chris Naaden

(Parametric Sound Corp., et al. vs. Rakauskas, et al.

hearing, 9-1-15)

IN THE SUPREME COURT OF THE STATE OF NEVADA

PARAMETRIC SOUND CORPORATION, VTB HOLDINGS, INC., KENNETH POTASHNER; ELWOOD NORRIS; SETH PUTTERMAN; ROBERT KAPLAN; ANDREW WOLFE; and JAMES HONORE

Petitioners,

v.

THE EIGHTH JUDICIAL DISTRICT COURT, in and for the County of Clark, State of Nevada, and THE ELIZABETH GONZALEZ, District Judge

Respondents,

and

VITIE RAKAUSKAS, individually and on behalf of all others similarly situated, and Intervening Plaintiffs RAYMOND BOYTIM and GRANT OAKES,

Real parties in interest.

Case No. 66689

Electronically Filed
Sep 18 2015 02:54 p.m.
Tracie K. Lindeman
Clerk of Supreme Court

District Court No. A-13-686890-B
Dept. No. XI

PETITIONERS' SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS, OR, IN THE ALTERNATIVE, WRIT OF PROHIBITION

Docket 66689 Document 2015-28375

RICHARD C GORDON, ESQ.
Nevada Bar No. 9036
KELLY H. DOVE, ESQ.
Nevada Bar No. 10569
SNELL & WILMER L.L.P.
3883 Howard Hughes Parkway, Suite 1100
Las Vegas, Nevada 89169
Telephone: (702) 784-5200
E-mail: rgordon@swlaw.com
kdove@swlaw.com

NEIL A. STEINER, ESQ. (*Admitted Pro Hac Vice*)
DECHERT LLP
1095 Avenue of the Americas
New York, NY 10036
Telephone: (212) 698-3822
E-mail: Neil.steiner@dechert.com

JOSHUA D. N. HESS, ESQ. (*Admitted Pro Hac Vice*)
DECHERT LLP
One Bush Street, Suite 1600
San Francisco, CA 94104
Telephone: (415) 262-4583
E-mail: Joshua.Hess@dechert.com

Attorneys for Petitioners Turtle Beach Corporation and VTB Holdings Inc.

J. STEPHEN PEEK, ESQ.
Nevada Bar No. 1758
ROBERT J. CASSITY, ESQ.
Nevada Bar No. 9779
HOLLAND & HART L.L.P.
955 Hillwood Drive, 2d Floor
Las Vegas, Nevada 89134
Telephone: (702) 669-4600
E-mail: speek@hollandhart.com
bcassity@hollandhart.com

JOHN P. STIGI III, ESQ. (*Admitted Pro Hac Vice*)
SHEPPARD, MULLIN, RICHTER, & HAMPTON LLP
1901 Avenue of the Stars, Suite 1600
Los Angeles, CA 90067
Telephone: (310) 228-3700
E-mail: jstigi@sheppardmullin.com

Attorneys for Petitioners Kenneth Potashner, Elwood Norris, Seth Putterman, Robert Kaplan, Andrew Wolfe, James Honoré

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page

Federal Cases

State Cases

TABLE OF AUTHORITIES
(Continued)

Page

TABLE OF AUTHORITIES
(Continued)

Page

State Statutes

Other Authorities

TABLE OF AUTHORITIES
(Continued)

Page

Introduction

This Court has requested the parties to provide supplemental briefing on two issues relevant to the determination of whether Real-Parties-In-Interest ("Plaintiffs") may directly challenge a stock issuance provided as consideration for a merger between two entities in which Plaintiffs did not own, let alone lose, any shares. First, this Court has asked the parties to consider three tests courts have used to distinguish direct suits from derivative suits—Direct Harm, Special Injury, and Duty Owed—and to recommend which test Nevada should use going forward to replace or clarify the standard previously set in *Cohen v. Mirage Resorts, Inc.*, 119 Nev. 1, 19, 62 P.3d 720 (2003). Although the District Court's order denying Petitioners' motion to dismiss should be reversed under *any* of these tests because none of them reach the unprecedented conclusion advanced by the District Court that *every* challenge to *every* merger is *always* a direct claim, Defendants maintain that the Direct Harm test—already used by New York, Delaware, and most other states—is the most appropriate test.

Second, the Court also asked the parties to consider whether share dilution cases—like the present case—can be brought directly or derivatively. Share dilution cases are unequivocally derivative under all three tests. The <u>only</u> recognized exception to this general rule applies in cases involving allegations of misappropriation of corporate assets by controlling shareholders. Notably, Plaintiffs conceded at oral argument that they have not alleged that such an exception applies here. Exhibit 1, Tr. of Oral Arg., *In re Parametric Sound Corp.*, Case No. 66689 (Nev. Sept. 30, 2015) ("Hr'g Tr.") at 18:12-19:9; 28:4-8.[1]

Because the transaction at issue resulted only in a dilution of the Parametric shareholders' shares, the claims are necessarily derivative and the District Court's order should be reversed.

SUMMARY OF THE TRANSACTION AT ISSUE

Plaintiffs are shareholders of a company formerly known as Parametric Sound Corp. ("Parametric"). By the end of 2013, Parametric was a nearly bankrupt company that had failed to bring to market its only potentially marketable asset – audio technology known as Hypersound. VTBH Inc. ("VTBH") was and is a successful developer and marketer of audio components, particularly headsets used in interactive gaming. In the fiscal year of 2013, VTBH had revenues of $202 million and a profit of $63.7 million. In August 2013, Parametric and VTBH agreed to the transaction that has given rise to the claims asserted in this case.

In the first part of the transaction, Parametric formed a subsidiary entity, Paris Acquisition Corp. ("Paris"), which VTBH merged into and remained as the surviving

[1] The transcript of the September 1, 2015, oral argument was professionally transcribed by Litigation Services from this Court's certified compact disc of the same for ease of citation in the instant brief.

entity. VTBH's shareholders lost their shares in VTBH and Parametric became the sole owner of VTBH. Because Parametric was *not* one of the merging entities, none of Parametric's voting shareholders were entitled to vote on the merger.

The second part of the transaction provided the consideration to the VTBH shareholders in exchange for their lost shares in VTBH. Instead of providing them with cash for their lost shares (which Parametric did not have), Parametric issued new Parametric stock such that the VTBH shareholders ultimately owned 80% of Parametric. This stock issuance was voted upon and overwhelmingly approved by Parametric's shareholders. No Parametric shareholder was asked to sell his or her shares as part of this transaction.

<u>ARGUMENT</u>

I. QUESTION 1

A. In Shareholder Suits, Direct Claims Are The Exception To The Rule That Corporations Control Litigation Over Corporate Harms.

As a preliminary matter, suits that seek relief for breaches of duties owed by company directors and officers normally belong to the company itself and must be brought either by the company or derivatively by shareholders, if at all.[2] This rule

[2] *See, e.g.*, *Gray v. Bicknell*, 86 F.3d 1472, 1488 (8th Cir. 1996) ("The general rule . . . in breach of fiduciary duty suits" is that "individual shareholders must sue corporate directors and officers derivatively. Only under specific circumstances may an individual pursue such an action directly."); *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893, 896 (5th Cir. 1968) (direct action is the "exception" and "[t]hat exception to the general rule does not arise . . . merely because the acts complained of resulted

follows from the "cardinal precept" of American corporate law "that directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) (citing Del. Code Ann. tit. 8 § 141(a)), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).
In other words, when a court allows a shareholder to assert a direct claim against a company's directors or officers for breaches of duties to carefully and loyally manage the company, it does so as a narrow exception to the general rule favoring derivative claims, regardless of which test it applies. To do otherwise would ignore the corporate form and usurp claims belonging to the corporation by vesting those claims with individual shareholders who owe no duties whatsoever to the company or the entire body of its shareholders.

In this case, none of the tests identified by the Court would deviate from the general rule that a claim alleging that a stock dilution that diminished *the company's* value, and thus incidentally the *pro rata* value of each share of stock, belongs to the company. Indeed, this is true even in the case of a dilution associated with a merger. *See In re J.P. Morgan Chase & Co. S'holder Litig.*, ("*J.P. Morgan I*") 906 A.2d 808, 812 (Del. Ch. 2005), *aff'd*, ("*J.P. Morgan II*") 906 A.2d 766 (Del. 2006). The

---

in damage both to the corporation and to the stockholder"); *Miller v. Up In Smoke, Inc.*, 738 F. Supp. 2d 878, 884 (N.D. Ind. 2010) (shareholder asserting direct claim must "overcome the presumption in favor of derivative actions"); *accord Cole v. Ford Motor Co.*, 566 F. Supp. 558, 568-69 (W.D. Pa. 1983); *Judice's Sunshine Pontiac, Inc. v. Gen. Motors Corp.*, 418 F. Supp. 1212, 1222 n.26 (D.N.J. 1976).

universality of this conclusion is underscored by the fact that Plaintiffs here are forced to assert a talismanic "merger" standard that is virtually unknown in the jurisprudence of corporate law and has not been adopted by any State.

B. The "Direct Harm," "Special Injury," And "Duty Owed" Tests All Require Dismissal Of Plaintiffs' Claims.

The three "primary tests" this Court has identified to determine whether a claim by a shareholder is derivative or direct all conclude that Plaintiffs' claims here are derivative. Doc. #15-26806 at 2. The "Direct Harm" test requires consideration of whether the shareholder alleges a wholly independent injury or if the shareholder alleges an injury that is merely incidental to some corporate harm. The "Duty Owed" test essentially asks the same question, but determines whether an injury was to the stockholder or the corporation by asking whether the duty breached was owed to the stockholder or the corporation. The "Special Injury" test requires consideration of whether the alleged injury applied equally to every shareholder or if specific shareholders suffered unique harms.

Instead of adhering to these three recognized tests, Plaintiffs have fabricated a fourth, previously unrecognized "Challenging a Merger" test, which forgoes all of these considerations and allows any challenge to a "merger" (however defined) to proceed directly without any additional analysis whatsoever.

1. Plaintiffs' Claims Are Derivative Under The Direct Harm Test (And The Related Duty Owed Test)

a. The Direct Harm Test

A claim is derivative under the Direct Harm test if the harm from the alleged wrongdoing flows first to the company, and is direct only when the alleged injury to the shareholder is not secondary to the company's loss. As Delaware courts have explained, "[f]or a plaintiff to have standing to bring an individual action, he must be injured *directly* or *independently* of the corporation." *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348, 351 (Del. 1988) (emphasis in original). In other words, "the inquiry should focus on whether an injury is suffered by the shareholder that is not dependent on a prior injury to the corporation." *Agostino v. Hicks*, 845 A.2d 1110, 1122 (Del. Ch. 2004). New York has also adopted this test as a "common sense approach." *Yudell v. Gilbert*, 99 A.D.3d 108, 114 (N.Y. App. Div. 2012). In addition to Delaware and New York,[3] more jurisdictions employ a "Direct Harm" test than any other test.[4]

---

[3] As recognized in *Cohen*, this Court "relies on Delaware and New York case law in interpreting Nevada's corporate merger law." *Cohen*, 119 Nev. at 26.

[4] *See, e.g.*, *Schuster v. Gardner*, 25 Cal. Rptr. 3d 468, 474 (Cal. Ct. App. 2005) ("An individual cause of action exists only if damages of the shareholders were not incidental to damages of the corporation") (emphasis in original); *Hill v. Ofalt*, 85 A.3d 540, 548 (Pa. Super. Ct. 2014) ("[A] shareholder must allege a direct, personal injury – that is independent of an injury to the corporation – and the shareholder must be entitled to receive the benefit of any recovery"); *accord Beninati v. Borghi*, 2014 WL 4639447, at *24 (Mass. Supp. July 9, 2014); *Perry v. Cohen*, 285 S.W.3d 137, 144 (Tex. Ct. App. 2009); *Lightner v. Lightner*, 266 P.3d 539 (Kan. Ct. App. 2011); *Sabey v. Howard Johnson & Co.*, 5 P.3d 730, 735 (Wash. Ct. App. 2000); *Griffin v. Jones*, 2015 WL 4776300, at *5 n.2 (Ky. Ct. App. Aug. 14, 2015).

The current, prevailing articulation of this test was stated in Delaware in 2004 in *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d. 1031(Del. 2004). After a thorough review of over 50 years of caselaw, the Delaware Supreme Court affirmed the Chancery Court's analysis in *Agostino* and arrived at the following articulation of the "Direct Harm" standard:

> [A] court should look to the nature of the wrong and to whom the relief should go. The stockholder's claimed direct injury *must be independent* of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail *without showing an injury to the corporation*.

Tooley, 845 A.2d at 1038-39 (emphasis added). The Court summarized this standard in a two-part test: "(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Id.* at 1033. The second prong should "logically follow" the first. *Id*. at 1036.

In applying the Direct Harm test, courts do not simply accept a complaint's conclusory allegation of direct harm. *See, e.g., Feldman v. Cutaia*, ("*Feldman I*") 956 A.2d 644, 659-60 (Del. Ch. 2007), *aff'd* ("*Feldman II*") 951 A.2d 727, 733 (Del. 2008) (recasting a derivative claim as direct is "disfavored by Delaware courts"). Rather, the focus is on the essential nature of the plaintiff's claim. Here, the only form of damages that Plaintiffs request is a "top-up" of the value of the Parametric shares they continue to hold. *See* Hr'g Tr. at 18:14-17 (Plaintiffs seek "the difference in the value [between] what the Parametric shareholders really got . . . and what the real value was"); PA 548 ("here, it is axiomatic that a damages computation 'may include the difference, if any, between the merger price and the fair value of the shares'"). But corporate shares have no value independent from the value of the corporation itself. *See, e.g.*, *Windsor Shirt Co. v. N.J. Nat'l. Bank*, 793 F. Supp. 589, 595-96 (E.D. Pa. 1992) ("To a businessperson, the market capitalization of a company's stock is the company's market value"). The shares are only undervalued if *the corporation* is undervalued. As a result, Plaintiffs' claim that the value of their shares has been harmed fundamentally seeks to remedy a corporate harm. *Agostino*, 845 A.2d at 1122 ("the inquiry should focus on whether an injury is suffered by the shareholder that is not dependent on a prior injury to the corporation.").

This principle has been squarely addressed in substantially similar circumstances in *J.P. Morgan I*. In that case, the Delaware Chancery Court addressed a transaction like the present one that involved a merger in which a dilutive stock issuance was offered as consideration for the merger. The stockholder plaintiffs, like the plaintiffs in this case, sued the board of directors for breach of fiduciary duty by claiming that the "issuance of stock to consummate the merger" diluted their collective ownership. *J.P. Morgan I*, 906 A.2d at 812. Addressing *Tooley*'s first prong, the court observed that, distilled to its essence, plaintiffs' claim alleged that J.P. Morgan "overpaid for Bank One." *Id.* at 818. It also noted that, "[i]f [J.P. Morgan] had paid cash for Bank One, the plaintiffs' claim would clearly be derivative," as "[t]he only harm to the stockholders would have been the natural and foreseeable consequences of the harm to [J.P. Morgan]." *Id.* That the transaction's consideration took the form of a dilutive stock issuance did not produce a different outcome: "To the extent that any alleged decrease in the asset value and voting power of plaintiffs' shares . . . results from the issuance of new equity to a third party . . . , plaintiffs' dilution theory as a basis for a direct claim fails and any individual claim for dilution must be dismissed." *Id.* (internal citations omitted). As for the second prong, the Court held that because only J.P. Morgan suffered an alleged injury for the dilution resulting from the alleged "overpayment" for Bank One, "[a]ny remedy from the alleged harm would necessarily accrue to [the company] and not to a subset of stockholders." *Id.* at 818-19. The same conclusion is warranted here.

Applying the Direct Harm test to this case demonstrates the derivative nature of Plaintiffs' claims. Plaintiffs take the position that Parametric's directors caused Parametric to overpay the former shareholders of VTBH in exchange for VTBH's assets. In Plaintiffs' view, the former VTBH shareholders should have received something less than the 80% ownership interest in Parametric that they acquired. However, it was Parametric, not the individual Plaintiffs, that issued the new shares and if some portion of those shares (or their monetary value) should now be returned, it is inconceivable that they would be returned to any entity other than the one that issued them in the first place: Parametric. If the Defendants caused Parametric to overpay, then Parametric was harmed and Parametric should receive the remedy, with Parametric's shareholders enjoying the *pro rata* benefit of that remedy based on their respective ownership interests. The Direct Harm test does not permit Plaintiffs to personally and directly recover for *Parametric's* alleged overpayment. Such a claim can only be asserted derivatively.

b. The Duty Owed Test

The Duty Owed test is effectively an alternative approach to the same inquiry as the Direct Harm test. *Tooley*, applying the Direct Harm test, stated that a "stockholder must demonstrate that the duty breached was owed to the stockholder." *Tooley*, 845 A.2d at 1039. This makes sense. If a director breaches a duty owed directly to the stockholder, then the injury will be direct to the stockholder. Under the Duty Owed Test, "a direct action may be brought when it is based upon a primary or personal right belonging to the plaintiff-stockholder." *See G&N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 235 (Ind. 2001) (internal quotation omitted). A claim is "derivative when the action is based upon a primary right of the corporation[,]" but direct claims are narrowly based on "[t]he rights of a shareholder" that "may be derived from the articles of incorporation and bylaws, state corporate law, or agreements among the shareholders or between the corporation and its shareholders." *Id.*

The Duty Owed test is based on the notion, already recognized in Nevada, that the fiduciary obligations a director owes a corporation are different from the obligations owed to the individual stockholders. *See Smith v. Gray*, 250 P. 369, 373 (Nev. 1926) (noting that the "trust relation . . . between the stockholder and the directors" is "confined to the shares of stock held by the stockholders"). Typically, directors owe only limited duties, such as those regarding voting rights or disclosure obligations, directly to stockholders. *See, e.g., Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 372 (Del. 1993) (discussing the "duty of disclosure owed to shareholders"). Although Plaintiffs have attempted to implicate some duty owed to the stockholders by arguing that they lost a supposedly majority interest in the company following the issuance of stock, Plaintiffs concede they never held such an interest in the first place. Hr'g Tr. 27:5-8.[5] In contrast, duties related the value of the corporation—*i.e.*, the value of a stockholder's *pro rata* ownership—are duties that run to the corporation. *See, e.g., Elsman v. Standard Fed. Bankcorporation*, 1999 WL 33453645, at *2

[5] To the extent that Plaintiff argues that *all* the unaffiliated public shareholders, in the aggregate, controlled Parametric through their combined majority ownership, it is well-settled that hypothetical control cannot be established by aggregation. *See, e.g., Amadeus Global Travel Distribution, S.A. v. Ortiz, LLC*, 302 F.Supp. 2d 329 (D. Del. 2004) ("It is axiomatic that any conceivable majority of shareholders in the aggregate holds the hypothetical power to control the corporate entity" but the law "require[s] that control be actual"); *Gatz. v. Ponsoldt*, 2004 WL 3029868 at * 9 (Del. Ch. 2004) ("an aggregate of outstanding shares held by the public does not translate into a right to a control premium"). In addition, as Plaintiffs conceded at oral argument, a majority of stockholders voted in favor of the merger and stock issuance, effectively eviscerating any such claim. Hr'g Tr. 27:9-15.

(Mich. Ct. App. Mar. 26, 1999) (holding that a claim by former shareholders that "they received less money for their shares after the merger" implicated solely a duty to the corporation and gave rise solely to derivative claims).

As with the Direct Harm test, Plaintiffs' claims would be derivative under the Duty Owed test. The damages sought here are based exclusively on the notion that Parametric received insufficient consideration for the 80% equity position it granted VTBH. This implicates only a duty to the corporation and not any duty to the shareholders, thus potentially giving rise only to a derivative claim.

2. The Special Injury Test

Whereas the Direct Harm test considered whether the shareholders claimed an injury that was wholly independent from any harm to the company, the Special Injury test asks whether any shareholder claims an injury that is wholly independent from any harm to *any other shareholder*.[6] Although the Special Injury test has recently fallen out of favor in some States, the test nevertheless remains good law today in many States and even Delaware continues to consider whether all shareholders have alleged the "same" injury to the extent that this inquiry informs the analysis under

---

[6] *See, e.g.*, *Ring v. Kaplan*, 2012 WL 763582, at *4 (Minn. Ct. App. Mar. 9, 2012) ("[t]he determinative question is whether the injury was separate and distinct from the injury to other persons in a similar situation as the plaintiff.") (internal quotation marks omitted); *accord Landstrom v. Shaver*, 561 N.W.2d 1, 12 (S.D. 1997); *APA Excelsior III, L.P. v. Windley*, 329 F. Supp. 2d 1328, 1360 (N.D. Ga. 2004); *Altrust Fin. Serv., Inc. v. Adams*, 76 So.3d 228, 247 (Ala. 2011).

Tooley's Direct Harm test. *See, e.g, Tooley*, 845 A.2d at 1035; *see also Dinuro Invs., LLC v. Camacho*, 141 So.3d 731, 737 (Fla. 3d DCA 2014) ("[T]his test can be . . . difficult to apply, as the 'special' nature of the injury can be a nebulous inquiry that is often not readily apparent."); *cf. Feldman I*, 956 A.2d at 655 (post-*Tooley* analysis considering whether the harm "falls upon all shareholders equally"). Plaintiffs conceded at oral argument that the only alleged injury in this case is one that applies equally to all shareholders. Hr'g Tr. 19:2-19:11. Accordingly, if this test is applied here, it is indisputably fatal to Plaintiffs' ability to bring the alleged claims directly.

3. No State, Including Nevada, Finds All Claims Involving A Merger To Be Direct.

a. Plaintiffs' "Challenging A Merger" Test Cannot Be Reconciled With Any Of The Recognized Tests.

Importantly, the District Court did not apply *any* of the recognized tests in ruling that the claims asserted in this case were direct claims. Instead, the Court adopted Plaintiffs' incorrect assertion that the "question is simply one of is it a merger or is it a dilution" and "*Cohen* makes it very clear that a merger is a direct claim." PA 611, 613, 617-18. Again, at oral argument before this Court, Plaintiffs took the same stance that *any* challenge to *any* merger would be a direct claim. Hr'g Tr. 16:2-6 ("Q. Is it your position that every complaint alleging misconduct by officers and directors in connection with the merger gives rise to a direct action at the pleading stage? A. Yes.").

Plaintiffs were asked how this case would differ from a hypothetical case in which a company sold a "major asset for inadequate consideration" – an apt comparison considering that Parametric owned only one marketable asset at the time of the transaction. Plaintiffs provided the following facile response:

> **Mr. Baron**: May I ask you a question? Was there a merger?
> **Justice Pickering:** No.
> **Mr. Baron**: [T]hen *Cohen* wouldn't apply and it would be derivative. Next question?

Hr'g Tr. 24:23-24:3. Plaintiffs conceded at oral argument that selling a major asset for inadequate consideration (even to a related party) would give rise only to a derivative claim because "if you are just simply selling off an asset of the company . . . the company . . . itself needs to . . . recover that." *Id.* at 29:6-9. Plaintiffs offer no satisfactory explanation for this absurd distinction in which the subset of shareholders they represent should recover directly if the company issued equity for less than its fair market value, but only Parametric (not the shareholders directly) could recover if instead the company sold its primary asset (on which the equity is based) for below market value.[7] In both situations, if Parametric received inadequate consideration in the sale then it is Parametric that is owed compensation.

---

[7] Plaintiffs attempt to argue that it would be somehow unfair for Parametric to recover here because, following the transaction, the former VTBH shareholders now own 80% of Parametric and thus the money would not go "to the people who were wronged." But Parametric is not a pass-through entity and damages in a derivative case would <u>not</u> be paid to the former VTBH shareholders. Instead, any remedy would go to Parametric and every shareholder would benefit in the same way they

Plaintiffs' suggestion that merely alleging that a merger occurred—even between entities in which they never owned any shares—is sufficient to state a direct claim cannot be reconciled with the law of any jurisdiction. It requires no analysis whatsoever of the type of harm alleged, as required by both the Direct Harm and Special Injury tests, nor does it consider the type of duty that has allegedly been breached, as required by the Duty Owed test. Plaintiffs obviously favor their illusory "Challenging a Merger" test because it is the *only* standard that could possibly allow the purported class to directly assert claims based on a diminution of stock value—a harm that is nothing more than a reflection of a diminution of *corporate* value and that Plaintiffs concede would apply equally to every shareholder. The duty owed and injury alleged are simply *irrelevant* under Plaintiffs' favored test, thus converting it into a fail-safe test that would always conclude that every challenge to a merger was direct, even though that notion has been discredited and rejected by the principal corporate law jurisdictions in the United States.

At oral argument and in the briefing, Plaintiffs relied exclusively on *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1245 (Del. 1999) in an attempt to suggest

---

have allegedly been harmed – derivatively. Again, if the former VTBH stockholders failed to provide sufficient value for their 80% position in Parametric, then it was Parametric that suffered the harm arising from the undercapitalization. *See, e.g., J.P. Morgan I,* 906 A.2d at 819 (where company allegedly overpaid for a merger by issuing too many shares, "any remedy from the alleged harm would necessarily accrue to the company and not to the subset of stockholders" even though there were new shareholders following the merger).

that Delaware has endorsed the "Challenging a Merger" test. Although *Parnes* did recognize that there may be a direct claim when shareholders received inadequate consideration for their lost shares in a stock-for-stock merger because of an unfair merger process, it did not do so without qualification. The court instead recognized that the "problem" with finding such claims direct is that "it is often difficult to determine whether a stockholder is challenging the merger itself, or alleged wrongs associated with the merger." *Id*. The Intervening Complaint challenges only wrongs "associated with the merger" because Plaintiffs indisputably never owned shares in either merging entity and thus had no right to challenge any merger. Rather, as in *In re J.P. Morgan,* Plaintiffs merely challenge the exchange ratio of the "associated" dilutive stock issuance to the former VTBH shareholders.

Moreover, "Delaware Courts have interpreted the *Parnes* exception very narrowly." *In re Nymex S'holder Litig.*, 2009 WL 3206051, at *10 (Del. Ch. Sept. 30, 2009). Delaware has cautioned against the error the District Court made here, stating "*Parnes* might be read as suggesting that all shareholder claims for breach of fiduciary duty are direct if they involve a merger. That is not, of course, the law." *Dieterich v. Harrer*, 857 A.2d 1017, 1027 (Del. Ch. 2004).[8] Instead, "[e]ven after *Tooley,* a claim

[8] Indeed, Delaware has long recognized that "[a] complaint that 'directly challenges the fairness of the process and the price' of a merger . . . suggests that *the corporation suffered harm* . . . and that the harm suffered by stockholders is only a natural and foreseeable consequence of the harm to the corporation." *In re J.P. Morgan I,* 906 A.2d at 812 (emphasis added).

is not 'direct' simply because it is pleaded that way and mentioning a merger does not talismanically create a direct action." *Id.* *Dietrich* specifically recognized that it would be highly unlikely for a direct claim to exist when, as here, the "ultimate merger partner was a third party." *Id.* at 1029. No court endorses a test as broad as the one Plaintiffs assert here, which would allow shareholders who suffered no independent harm to directly challenge a merger between two entities in which they never owned shares in the first place.

b. The *Cohen* Test Is Closest To The Direct Harm Test.

Cohen contains references to each of the above tests, but ultimately provides a standard closest to the Direct Harm test. *See Cohen*, 119 Nev. at 19, 62 P.3d at 732 ("shareholder . . . ha[s] standing to seek relief for direct injuries *that are independent of any injury suffered by the corporation*.") (emphasis added). In explaining its holding, *Cohen* provided the following language that caused the District Court's confusion: "A claim brought by a dissenting shareholder that questions the validity of a merger as a result of wrongful conduct on the part of majority shareholders or directors is properly classified as an individual or direct claim. The shareholder has lost unique personal property—his or her interest in a specific corporation." *Id.*

Plaintiffs attempt to read the first sentence in *Cohen*'s test in a vacuum to support their unprecedented "Challenging a Merger" test. But this Court's further requirement that a plaintiff plead a loss of "unique personal property—his or her interest in a specific corporation" such that the plaintiff is "entitled to relief that [is] independent of any injury suffered by the corporation" is no accident. 119 Nev. at 19, 62 P.3d at 732. This requirement *is* the Direct Harm test. Unsurprisingly, Plaintiffs request that this Court ignore this language in the *Cohen* test, effectively removing the Direct Harm test from Nevada jurisprudence. Hr'g Tr. at 23:13-19. Contrary to Plaintiffs' request, this Court should affirm the Direct Harm standard and clarify that *Cohen* does not create a new, unprecedented standard under which every challenge to every merger will be a direct claim.

Without question, the adoption of Plaintiffs' test would turn Nevada into the most permissive jurisdiction in the United States for activist shareholders seeking to challenge mergers. Approximately 93% of all public mergers are challenged in court,[9] and the same law firms that file suits over virtually every corporate acquisition are actively seeking jurisdictions that are most likely to confer standing to assert direct claims.[10] If Nevada adopts a test that would confer standing on individual stockholders without requiring even minimal scrutiny of the economic realities of

[9] *See* Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2014 M&A Litigation*, at 1, available at https://www.cornerstone.com/GetAttachment/897c61ef-bfde-46e6-a2b8-5f94906c6ee2/Shareholder-Litigation-Involving-Acquisitions-2014-Review.pdf

[10] McCormick, *et. al.*, *Fleeing the Homeland: The Aggressive Pursuit of Merger Litigation Outside of Delaware*, *available at* http://www.tklaw.com/files/Publication/dab6e344-3c66-4b19-983c-964af1a313ef/Presentation/PublicationAttachment/46e0d0d7-c5e1-415c-b886-a4f47d9258c1/AgressivePursuitofMergerLit.pdf

their claims, based simply on the existence of a merger (no matter how broadly defined) and some vague reference to wrongful conduct, then Nevada will become a haven for such lawsuits. Every shareholder claim related to a corporate "merger" could potentially meet Plaintiffs' proffered standard and leave directors and officers of Nevada corporations open to wide-ranging personal liability under direct claims brought by shareholders who have no duty to act in the company's best interests. Corporations would, thus, favor virtually any other jurisdiction where their directors and officers would not be exposed to such unprecedented risk of personal liability for every corporate transaction. Such a result would undermine Nevada's unique legislative policy to treat change in control transactions (such as mergers) with the same deference provided to any other business decision adopted by a corporation's board of directors. *See* NRS 78.139(1).

II. QUESTION 2

A. The General Rule: Dilution Claims Are Derivative Only

Shares of corporate stock represent an asset of a corporation. A corporation, by resolution of its board of directors, can issue additional shares of stock for a variety of business purposes. A corporation can issue new shares of stock and sell them on the public market to raise capital. A corporation can issue new shares of stock to employees as part of their incentive compensation. A corporation also can issue new shares of stock for purposes of acquiring an asset from (or consummating a business transaction with) a third party. "Stock is a form of currency that can be exchanged for other forms of currency (such as cash) or used for a variety of corporate purposes, including paying off debts, acquiring tangible or intangible assets, compensating employees, or acquiring other entities." *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 655 (Del. Ch. 2013).

A share dilution claim arises when a corporation issues stock "at below market value, thereby depriving the corporation of income and depressing the price of the shareholders' stock as a general matter." *Sweeney v. Harbin Elec., Inc.*, 2011 U.S. Dist. LEXIS 82872, at *6 (D. Nev. July 27, 2011); *see also Gentile v. Rossette*, 906 A.2d 91, 96-97 (Del. 2006) (identifying a dilution claim as arising where a company "authorizes the issuance of stock for no or grossly inadequate consideration"). "A claim for wrongful equity dilution is premised on the notion that the corporation, by issuing additional equity for insufficient consideration, made the complaining stockholder's stake less valuable." *Feldman I*, 956 A.2d at 655. As such, a dilution claim is fundamentally a claim for corporate waste because the directors are alleged to have "wasted" corporate assets (*i.e.*, the corporation's newly issued shares of stock) by exchanging those assets for money or other assets of lesser value. *See, e.g.*, *J.P. Morgan II*, 906 A.2d at 771.

Because equity dilution claims are essentially claims for corporate waste, it is the general rule that such claims are "not normally regarded as direct" because any injury is only to the corporation itself. *See Feldman II*, 951 A.2d at 732 (citing *Gentile*, 906 A.2d at 99). "[A]ny dilution in value of the corporation's stock is merely the unavoidable result (from an accounting standpoint) of the reduction in the value of the entire corporate entity, of which each share of equity represents an equal fraction." *Id.* "[S]uch equal injury to the [company's] shares resulting from corporate overpayment is not viewed as, or equated with, harm to specific shareholders individually." *Id.* Rather, a wrongful dilution claim is "essentially [a claim] for mismanagement of corporate assets," which causes a corporate harm. *Id.* at 734.

Under a *Tooley* analysis, "the alleged injury is to the corporation because it falls upon all shareholders equally and falls only upon the individual shareholder in relation to his proportionate share of stock as a result of the direct injury being done to the corporation." *Feldman I*, 956 A.2d at 655 (internal quotations omitted). In other words, share dilution in the form of a *pro rata* diminution in value of all the corporation's shares is not a separate, independent injury to individual or classes of stockholders. Hence, under *Tooley*, the corporation — and only the corporation — is injured by the receipt of inadequate consideration in exchange for the new, dilutive share issuance. As described above, this understanding of *Tooley* was confirmed in *J.P. Morgan I*, 906 A.2d 808. Upon review, the Delaware Supreme Court recognized that "[b]ecause claims of waste are classically derivative, the Vice Chancellor's conclusion [*i.e.*, dismissing the share dilution claim under *Tooley*] is correct." *J.P. Morgan II*, 906 A.2d at 771.

The Delaware Supreme Court has reaffirmed under *Tooley* that equity dilution claims typically fall within the classic pattern of a derivative corporate waste claim. *See Gentile*, 906 A.2d at 99 ("In the typical corporate overpayment case, a claim against the corporation's fiduciaries for redress is regarded as exclusively derivative, irrespective of whether the currency or form of overpayment is cash or the corporation's stock."); *see also Gatz v. Ponsoldt*, 925 A.2d 1265, 1278 (Del. 2007) (approving of *Gentile* and finding that a claim of "over-issuance" of shares is generally derivative); *Feldman II*, 951 A.2d at 733 (finding dilution claim derivative and holding that "[w]here all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock solely because they are stockholders, then the claim is derivative in nature.").

This basic legal principle is not unique to Delaware. *See, e.g.*, *Schuster*, 25 Cal. Rptr. 3d 468, 473 ("Under California law, 'a shareholder cannot bring a direct action for damages against management on the theory their alleged wrongdoing decreased the value of his or her stock (*e.g.*, by reducing corporate assets and net worth) . . . . [The claim] was for "diminution of stock value [and] was incidental to the injury to [the company]" and was, therefore, derivative"); *May v. Coffey*, 967 A.2d 495, 499-502 (Conn. 2009) (dilution claims are derivative because "individual stockholders cannot sue the officers . . . on the theory that they are entitled to damages because mismanagement has rendered their stock of less value, since the injury is generally not to the shareholder individually, but to the corporation — to the shareholders collectively."); *Potter v. Janus Inv. Fund*, 483 F. Supp. 2d 692, 700 (S.D. Ill. 2007) ("[T]he injury alleged by Plaintiffs, specifically, dilution of share value due to market-timing arbitrage, obviously is derivative in nature."); *Danielewicz v. Arnold*, 769 A.2d 274, 279, 283 (Md. App. 2006) (where plaintiff asserts "breach[es] of trust which depreciated the capital stock or rendered it valueless," directors are liable to the corporation, "not to its creditors or stockholders, and any damages recovered are assets of the corporation"); *accord Sw. Health & Wellness, LLC v. Work*, 639 S.E.2d 570, 576-77 (Ga. Ct. App. 2006).[11] The common thread running through these authorities is that a shareholder's claim that the corporation issued stock for

[11] Older New York precedents historically treated share dilution claims as direct claims. But these cases were decided before New York amended its Business Corporation Law in 1998 to eliminate a presumption of "preemptive rights," which, under the former New York law, provided stockholders with a personal contractual right to maintain their percentage ownership in the corporation upon the issuance of new shares. *See, e.g.*, *Witherbee v. Bowles*, 95 N.E. 27, 28 (N.Y. 1911) (wrongful dilution was direct because it deprived plaintiff of his position as the majority stockholder and "depriv[ed] him of his relative position as a stockholder"); *cf.* N.Y. Bus. Corp. Law § 622 (McKinney 2015). A different result may portend in New York going forward. *See* Renee L. Crean, *Has New York Effectively Challenged Delaware's Market Dominance With Recent Amendments to the New York Business Corporation Law?*, 72 ST. JOHN'S L. REV. 695, 706 (1998) (discussing New York's elimination of the presumption of preemptive rights).

insufficient consideration is fundamentally a claim for corporate waste, which must be brought, if at all, derivatively.

In the only reported decision considering the issue under Nevada law, the United States District Court for the District of Nevada held that Nevada law follows the general rule that dilution claims are derivative. *See Sweeney*, 2011 U.S. Dist. LEXIS 82872, at *5-6. Nevada law should continue to adhere to the general rule, particularly as all standing "tests" used to distinguish direct suits from derivative suits, including the test in Delaware established in *Tooley*, reinforce the general rule in dilution cases.

B. The Delaware And Utah Supreme Courts Recognize A Narrow Exception To The General Rule That Dilution Claims Are Derivative Only Where a Controlling Stockholder Expropriates Value From Public Stockholders

Delaware recognizes a narrow exception to the general rule that equity dilution claims are derivative where, unlike here, a majority or controlling stockholder uses its control to issue stock to itself for inadequate consideration. In such circumstances, Delaware views the minority stockholders' rights as impaired relative to those of the controlling stockholder. This injury is viewed as unique to the minority and separate from the corporation's waste-type injury. *See Gentile*, 906 A.2d at 100. Importantly, unlike a typical dilution claim, the injury in this instance results from a conflict between groups or classes of stockholders.

In *Gentile*, the CEO/controlling stockholder forgave certain debt the corporation owed him in exchange for being issued stock. *See id.* at 93. The plaintiffs, public stockholders, sued directly, claiming the value of the issued stock exceeded the value of the retired debt. *Id.* After the Court of Chancery dismissed the claims as derivative, the Delaware Supreme Court reversed, holding that the plaintiffs' claims were both direct and derivative. *Id.* Applying *Tooley*, it held that minority shareholders suffer direct harm independent from the company in a stock dilution *only* when two conditions are present and pleaded: "(1) a stockholder having majority or effective control causes the corporation to issue 'excessive' shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders." *Gentile*, 906 A.2d at 100. According to *Gentile*, the injury under such circumstances is not, as here, *pro rata* as to all shares but instead affects only the minority shareholders as a result of "an improper transfer — or expropriation — of economic value and voting power from the public shareholders to the majority or controlling stockholder." *Id.*[12]

[12] The *Gentile* exception has not gained much traction outside of Delaware. Only Utah has adopted it. *See Torain v. Craig*, 289 P.3d 479, 485 (Utah 2012). Other states expressly reject the exception. *See, e.g., May*, 967 A.2d at 506 ("we fail to see how the company's receipt of less than fair value for its new shares of stock becomes a separate and distinct harm to individual shareholders merely because a

The Delaware Supreme Court also found the conditions for "expropriation" identified in *Gentile* present in *Gatz*. There, a minority stockholder using entities owned or controlled by him, exercised *de facto* control over the corporation. *Gatz*, 925 A.2d at 1268. Pursuant to a two-step transaction, he first exercised that control to "expropriate, for [his] benefit, economic value and voting power from the public shareholders" (*see id.* at 1281) by issuing himself new shares and then, in the second step, cashed-out his improperly gained stake in the company by selling it to a third party. *See id.* at 1271-73. The Delaware Supreme Court held that even though the stockholder "[did] not retain the direct benefit from the expropriation" but, instead, transferred it to a third party, the controlling stockholder nevertheless expropriated value. *Id.* at 1281. Hence, the plaintiffs were entitled to bring their dilution claims directly.

Notably, the Delaware Supreme Court has since confirmed that *Gentile*'s exception is a narrow one. In *Feldman II*, the Delaware Supreme Court emphasized that an exception to the general rule that dilution claims are derivative exists only when a controlling stockholder benefits from the expropriation. 951 A.2d at 732 ("In the absence of a controlling stockholder, such equal 'injury' to the [company's] shares resulting from a corporate overpayment is not viewed as, or equated with, harm to

---

controlling shareholder, rather than an independent third party, acquires the offsetting benefits.").

specific shareholders individually.") (internal quotation marks omitted). The Supreme Court also reaffirmed that, in the dilution context, "[w]here all of a corporation's stockholders are harmed and would recover pro rata in proportion with their ownership of the corporation's stock solely because they are stockholders, then the claim is derivative in nature." *Id.* at 733.

Plaintiffs do not allege that there was any controlling shareholder prior to the transaction, let alone a misappropriation by such a shareholder. Instead, Plaintiffs concede that *every* former Parametric shareholder was allegedly harmed equally. Hr'g Tr. 19:2-19:11. Accordingly, the factual predicate for applying the *Gentile* exception is entirely absent here, and Plaintiffs' claims are derivative.

C. This Court Should Decline To Adopt The Delaware Chancery Court's Overbroad *Carsanaro* Exception.

The Delaware Chancery Court in *Carsanaro*, 65 A.3d 618, and *In re Nine Sys. Corp. S'holders Litig.*, ("*Nine Sys.*") 2014 Del. Ch. LEXIS 171 (Del. Ch. Sept. 4, 2014), posited a further exception to the general rule that dilution claims are exclusively derivative. This exception extends *Gentile*'s "expropriation" concept beyond controlling stockholders to directors who, acting disloyally, issue dilutive stock to themselves or their third-party affiliates. Importantly, *Plaintiff concedes that no such claim has been alleged here*. Hr'g Tr. at 28:4-8.[13] Accordingly, this Court

[13] Plaintiffs' self-serving argument that they "could" assert a misappropriation claim if this case were remanded is baseless, as the claim has not been pleaded. Hr'g Tr.

need not consider whether to adopt the *Carsanaro* exception but, even if this Court does adopt the exception, it cannot possibly apply to the facts of this case where no expropriation by a director is alleged.

The exception's value as precedent is highly uncertain as it conflicts with the Delaware Supreme Court's insistence in *Feldman* that any expropriation-based theory of direct liability rest upon facts showing a controlling shareholder shifted economic value and voting power to itself. Moreover, the *Carsanaro* exception, if adopted and applied broadly, risks swallowing the general rule that dilution claims are presumptively derivative.

In *Carsanaro*, plaintiffs were founders of the corporation and held its common stock. 65 A.3d at 628. As a result of initial financing rounds, several venture capital firms received preferred stock, secured board seats for their designees, and obtained control of the board. *See id.* at 628-34. Thereafter, these firms caused the corporation to issue additional classes of preferred stock *to themselves* and other investors for inadequate consideration, resulting in the dilution of plaintiffs' ownership to less than 1%. *Id.* Plaintiffs sued the directors who approved the dilutive financings for breach of fiduciary duty, and sued their respective funds as aiders and abettors. *Id.*

28:6. Notably, the complaint in this case has already been amended twice and *none* of the three complaints have ever suggested a misappropriation claim, nor could they.

The Chancery Court acknowledged the need to interpret Delaware Supreme Court precedents in a manner that did not undercut the traditional characterization of stock dilution claims as exclusively derivative. *Id.* at 657-58. And while accepting the need for a "line in the sand," it chose not to "limit *Gentile*'s expropriation principle to cases involving a majority stockholder." *Id.* at 658. Instead, based on the belief that" the directors *could be said* to have expropriated value from the common stockholders in the manner contemplated by *Gentile*," the Chancery Court proposed the following director-expropriation exception:

> In my view, the Delaware Supreme Court's decisions preserve stockholder standing to pursue individual challenges to self-interested stock issuances when the facts alleged support an actionable claim for breach of the duty of loyalty. *Standing will exist if a controlling stockholder stood on both sides of the transaction*. Standing will also exist if the board that effectuated the transaction lacked a disinterested and independent majority.

Id. (emphasis added). However, the Chancery Court was careful to add the qualification that "[s]tanding will not exist if there is no reason to infer disloyal expropriation[,]" – such as when "stock is issued to an unaffiliated third party" or "as part of an employee compensation plan" or "when a majority of disinterested and independent directors approves the terms." *Id.*[14] But here, there is concededly no allegation of any disloyal expropriation. Hr'g Tr. at 28:4-8.

---

[14] In *Nine Systems*, a case involving an allegedly dilutive recapitalization by self-interested directors, the Chancery Court determined similarly that a stockholder

Here, it does not matter if this Court adopts the *Carsanaro* exception because Plaintiffs concede that no misappropriation claim has been asserted and, accordingly, the exception would not apply even if adopted. For this reason, this Court does not need to decide if *Carsanaro* will apply in Nevada. However, to the extent this Court is inclined to address that question—and even though it has no bearing on this case—Defendants respectfully submit that it does not serve as an efficient test in Nevada for accurately discerning direct claims from derivative-only claims. The *Carsanaro* exception is highly problematic and cannot be reconciled with any of the primary tests, addressed *supra*. It purports to find a direct expropriation claim even when the claim in question concerns no majority stockholder using its power to expropriate additional shares to itself. The exception requires no consideration of whether the corporation has been harmed, as required by the Direct Harm test, and it requires no consideration of precisely which duties have been breached, as required by the Duty Owed test. And, in the absence of a majority stockholder who commits the expropriation, every shareholder is equally harmed by the dilutive issuance, which mandates that any claim be asserted derivatively under the Special Injury test. Because this exception is blind to the primary tests previously articulated, the use of

---

could plead a direct dilution claim against directors based upon an expropriation theory even though there was no controlling stockholder. *See Nine Sys.*, 2014 Del. Ch. LEXIS 171, at *83-85. The Court applied *Carsanaro*, but it conceded that "*Carsanaro* may also exceed what the Delaware Supreme Court intends in this area of Delaware law." *Id.* at *85.

this exception in cases where, unlike here, some misappropriation has been alleged would threaten to "swallow the general rule that equity dilution claims are solely derivative." *See*, *e.g.*, *Feldman I*, 956 A.2d at 657. At a minimum, the possibility of litigation harassment and abuse would be high.

Defendants submit that there is no sound policy reason, let alone legal basis, to depart from the general rule that dilution claims by public shareholders are derivative when the directors have been diluted in the exact proportion as the public shareholders. Accordingly, if this Court were to adopt the *Carsanaro* exception (for future cases in which it may be applicable), this Court should, at minimum, make clear that such an exception is limited to instances where the defendant directors are alleged to have caused the corporation to issue new stock *to themselves* for inadequate consideration. In such cases, the directors could be said to have participated in the allegedly wrongful dilutive action in their capacity as shareholders to the detriment of other shareholders, thus causing the kind of "shareholder versus shareholder" conflict that motivated the Delaware courts to establish the narrow exceptions to the general rule in the first place. But no expropriation is even alleged here so there is no basis, even under *Carsanaro*, to depart from the general rule that Plaintiffs' equity dilution claims are derivative.

CONCLUSION

Under any of the "primary tests," the District Court's ruling should be overruled because Plaintiffs' equity dilution claims are derivative.

September 18, 2015

SNELL & WILMER L.L.P.

By: *__/s/ Kelly H. Dove__*
RICHARD C. GORDON, ESQ.
KELLY H. DOVE, ESQ.
3883 Howard Hughes Parkway
Suite 1100
Las Vegas, Nevada 89169

NEIL A. STEINER, ESQ.
(Pro Hac Vice)
DECHERT LLP
1095 Avenue of the Americas
New York, NY 10036

JOSHUA D. N. HESS, ESQ.
(Pro Hac Vice)
DECHERT LLP
One Bush Street, Suite 1600
San Francisco, CA 94104

Attorneys for Petitioners Turtle Beach Corporation and VTB Holdings Inc.

J. STEPHEN PEEK, ESQ.
ROBERT J. CASSITY, ESQ.
HOLLAND & HART L.L.P.
955 Hillwood Drive, 2d Floor
Las Vegas, Nevada 89134

JOHN P. STIGI III, ESQ.
(Pro Hac Vice)
SHEPPARD, MULLIN, RICHTER, &
HAMPTON LLP
1901 Avenue of the Stars, Suite 1600
Los Angeles, CA 90067

Attorneys for Petitioners Kenneth Potashner, Elwood Norris, Seth Putterman, Robert Kaplan, Andrew Wolfe, James Honoré

CERTIFICATE OF COMPLIANCE

1. I certify that this brief complies with the formatting requirements of NRAP 32(a)(4), the type-face requirements of NRAP 32(a)(5), and the type-style requirements of NRAP 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman, 14 point. This brief contains approximately 8,300 words.

2. I certify that I have read this appellate brief, and to the best of my knowledge, information, and belief, it is not frivolous or interposed for any improper purpose. I further certify that this brief complies with all applicable Nevada Rules of Appellate Procedure, in particular NRAP 28(e)(1), which requires every assertion in the brief regarding matters in the record to be supported by a reference to the page and volume number, if any, of the transcript or appendix where the matter relied on is to be found. I understand that I may be subject to sanctions in the event that the accompanying brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

September 18, 2015. *_/s/ Kelly H. Dove_*

Kelly H. Dove

Nevada Bar No. 10569

CERTIFICATE OF SERVICE

I, the undersigned, declare under penalty of perjury, that I am over the age of eighteen (18) years, and I am not a party to, nor interested in, this action. On September 18, 2015, I caused to be served a true and correct copy of the foregoing **PETITIONERS' SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS OR, IN THE ALTERNATIVE, WRIT OF PROHIBITION** by the method indicated:

☐ **BY FAX:** by transmitting via facsimile the document(s) listed above to the fax number(s) set forth below on this date before 5:00 p.m. pursuant to EDCR Rule 7.26(a). A printed transmission record is attached to the file copy of this document(s).

☒ **BY EMAIL:** by emailing a PDF of the document(s) listed above to the email addresses of the individual(s) listed below:

Name	**Party**	**E-mail Address**
David C. O'Mara, Esq.	Plaintiffs	david@omaralaw.net
Valerie Weis (assistant)	Plaintiffs	val@omaralaw.net
David Knotts	Plaintiffs	DKnotts@rgrdlaw.com
Randall Baron	Plaintiffs	RandyB@rgrdlaw.com
Jamie Meske (paralegal)	Plaintiffs	JaimeM@rgrdlaw.com
Adam Warden	Plaintiffs	awarden@saxenawhite.com
Jonathan Stein	Plaintiffs	jstein@saxenawhite.com
Mark Albright	Plaintiffs	gma@albrightstoddard.com
Loren Ryan (paralegal)	Plaintiffs	e-file@saxenawhite.com
Steve Peek	Defendants	speek@hollandhart.com
Bob Cassity	Defendants	bcassity@hollandhart.com
Alejandro Moreno	Defendants	amoreno@sheppardmullin.com
John P. Stigi III	Defendants	JStigi@sheppardmullin.com
Tina Jakus (assistant)	Defendants	tjakus@sheppardmullin.com
Valerie Larsen (assistant)	Defendants	VLLarsen@hollandhart.com
Neil Steiner	Defendants	neil.steiner@dechert.com
Joshua Hess	Defendants	Joshua.Hess@dechert.com
Brian Raphel	Defendants	Brian.Raphel@dechert.com
Reginald Zeigler (assistant)	Defendants	Reginald.Zeigler@dechert.com

☐ **BY OVERNIGHT MAIL:** by causing document(s) to be picked up by an overnight delivery service company for delivery to the addressee(s) on the next business day.

☒ **BY U.S. MAIL:** by placing the document(s) listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Las Vegas, Nevada addressed as set forth below:

Honorable Elizabeth Gonzalez
Eighth Judicial District Court
Regional Justice Center
200 Lewis Avenue
Las Vegas, NV 89155

☒ **BY ELECTRONIC SUBMISSION:** submitted to the above-entitled Court for electronic filing and service upon the Court's Service List for the above-referenced case and the following list:

ALBRIGHT STODDARD WARNICK & ALBRIGHT G. Mark Albright, Esq. 801 South Rancho Drive, Suite D-4 Las Vegas, NV 89106 Email: gma@albrightstoddard.com SAXENA WHITE P.A. Jonathan M. Stein, Esq. Adam Warden, Esq. 5200 Town Center Circle, Suite 601 Boca Raton, FL 33486 (*Pro Hac Vice* pending) Email: jstein@saxenawhite.com awarden@saxenawhite.com e-file@saxenawhite.com *Attorneys for Kearney IRRV Trust*	HOLLAND & HART LLP J. Stephen Peek, Esq. Robert J. Cassity, Esq. 9555 Hillwood Drive, 2nd Floor Las Vegas, NV 89134 Email: speek@hollandhart.com bcassity@hollandhart.com VLLarsen@hollandhart.com SHEPPARD MULLIN RICHTER & HAMPTON LLP John P. Stigi III, Esq. Alejandro Moreno, Esq. 1901 Avenue of the Stars, Suite 1600 Los Angeles, CA 90067 (*Pro Hac Vice* pending) Email: jstigi@sheppardmullin.com amoreno@sheppardmullin.com tjackus@sheppardmullin.com *Attorneys for Kenneth Potashner, Elwood Norris, Seth Putterman, Robert Kaplan, Andrew Wolfe and James Honore*
O'MARA LAW FIRM, P.C. David C. O'Mara, Esq. 311 E. Liberty Street Reno, NV 89501 Email: david@omaralaw.net val@omaralaw.net ROBBINS GELLER RUDMAN & DOWD LLP Randall Baron, Esq. David Knotts, Esq. 655 West Broadway, Suite 1900 San Diego, CA 92101 Email: DKnotts@rgrdlaw.com randyb@rgrdlaw.com JamieM@rgrdlaw.com *Counsel for Intervening Plaintiffs/California Plaintiffs*	DECHERT L.L.P. Neil A. Steiner, Esq 1095 Avenue of the Americas New York, NY 10036 Email: neil.steiner@dechert.com Joshua D. N. Hess, Esq Brian Raphel, Esq. One Bush Street, Suite 1600 San Francisco, CA 94104 Email: Joshua.hess@dechert.com Brian.Raphel@dechert.com Reginald.Zeigler@dechert.com *Attorneys for Defendants Parametric Sound Corporation, VTB Holdings, Inc. and Paris Acquisition Corp*

22570214

/s/ Ruby Lengsavath

An Employee of Snell & Wilmer L.L.P.