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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE MATCH GROUP, INC.
DERIVATIVE LITIGATION.

No. 368, 2022

Court Below: Court of Chancery
of the State of Delaware

CONSOLIDATED
C.A. No. 2020-0505-MTZ

**CORRECTED BRIEF OF *AMICUS CURIAE*
ALPHA VENTURE CAPITAL MANAGEMENT, LLC
IN SUPPORT OF APPELLANTS**

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IDENTITY AND INTEREST OF *AMICUS CURIAE*

Amicus curiae Alpha Venture Capital Management, LLC is an asset manager that, through its affiliated funds (collectively, “Alpha”), invests in publicly traded microcap companies—that is, companies with market capitalizations between \$50 million and \$300 million. Alpha has designated its founder and President to serve as a director on boards of Delaware-incorporated microcaps. Alpha has also brought stockholder litigation in the Delaware Court of Chancery, including most recently in *Alpha Venture Capital Partners LP v. Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch.), which presented a fact pattern that the Court of Chancery described as a “case of unmitigated greed.”¹ There, after its representative was forced off of CytoDyn, Inc.’s (“CytoDyn”) board, Alpha asserted claims for breach of fiduciary duty against, among others, the CEO of CytoDyn, who successfully co-opted perceptibly independent directors to award himself spring-loaded options. Having witnessed the ability of overweening insiders to secure independent director support for even the most obvious self-dealing, Alpha is concerned about the potential changes to the law that are contemplated by this Court’s May 30, 2023 order requesting supplemental briefing (the “Order”). Alpha respectfully submits this limited brief because it fears that the prospect of fewer guardrails against controller self-dealing will adversely

¹ *Alpha Venture Cap. P’rs LP v. Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Apr. 19, 2021), Transcript (Trans. ID 66565001) at 28.

affect microcap companies, and seeks to offer the perspective of an experienced microcap investor, which is not otherwise before the Court.

ARGUMENT

I. MICROCAP COMPANIES DRIVE INNOVATION

Microcaps are an arguably overlooked but crucial segment of Delaware’s corporate base and play an outsized role in driving innovation in the United States and world economies. Over 4,600 microcaps are listed on the major U.S. exchanges (*i.e.*, the New York Stock Exchange (“NYSE”) and NASDAQ),² more than half of which (approximately 59%) are incorporated in Delaware.³

Microcaps disproportionately operate in industries that provide for the common good. Approximately 30% of all microcaps operate in health care, of which approximately 57% are in the pharmaceutical industry and 24% are in biotechnology.⁴ Amgen and Celgene, for example, went public as microcaps.⁵ Indeed, “small biotech firms or research labs play the foundational role in innovation of drugs and vaccines. That innovation must benefit the society, evident from the

² Bloomberg Data (as of August 22, 2023).

³ See Annalisa Barret, *Microcap Board Governance*, IRRC INSTITUTE (Aug. 2018), <https://cpb-us-w2.wpmucdn.com/sites.udel.edu/dist/8/12944/files/2022/07/FINAL-MicroCap-Governance-Study-Aug-1-2018.pdf>, at 17.

⁴ *Id.* at 9.

⁵ *All Great Companies Started As Small Companies*, INTELLIGENT FANATICS CAP. MGMT., <https://if.capital/>; see also Stelios Papadopoulos, *Evolving Paradigms in Biotech IPO Valuations*, NATURE BIOTECHNOLOGY (June 2001), https://www.nature.com/articles/nbt0601supp_be18; Mike Huckman, *Celgene’s Success Story*, CNBC (Sept. 4, 2008), <https://www.cnbc.com/2008/09/04/celgenes-success-story.html>.

progress in healthcare, physical well being, and increasing longevity of human beings over the last century.”⁶ Alpha itself has invested in companies that have either developed or sought to develop applications for HIV,⁷ cancer,⁸ COVID-19,⁹ severe respiratory illness,¹⁰ ADHD,¹¹ infertility,¹² and congenital hyperinsulinism.¹³

Many microcaps are “pre-revenue,” meaning they have yet to generate sales.¹⁴ For health care microcaps, that is often because their products have yet to receive approval from the United States Food and Drug Administration (FDA). As one market commentator recently noted, “When you buy a biotech stock, you are taking a risk that your company will fail to execute and the biotech’s drugs will not receive approval from the [FDA], or otherwise fail to make any money.”¹⁵

⁶ Vijay Govindarajan et al., *The Rapid Rise and Fall of Biotech Stocks Adversely Impacts The Society*, CALIF. MGMT. REV. (Mar. 15, 2022), <https://cmr.berkeley.edu/2022/03/the-rapid-rise-and-fall-of-biotech-stocks-adversely-impacts-the-society/>.

⁷ CytoDyn, Inc., Form 10-K (Aug. 15, 2022) at 4.

⁸ *Id.* at 5.

⁹ *Id.* at 4-5.

¹⁰ Aytu Biopharma, Inc., Form 10-K (Sept. 27, 2022) at 10.

¹¹ *Id.* at 7, 9.

¹² Aytu Biopharma, Inc., Form 10-K (Sept. 6, 2018) at 1.

¹³ Rezolute, Inc. (formerly AntriaBio, Inc.), Form 10-K (Sept. 15, 2022) at 1.

¹⁴ Taylor Carmichael, *This Risky Micro-Cap Could Pay Off Big*, THE MOTLEY FOOL / NASDAQ (June 30, 2021), <https://www.nasdaq.com/articles/this-risky-micro-cap-could-pay-off-big-2021-06-30>.

¹⁵ *Id.*

Investing in microcaps thus entails tremendous risk, but also extraordinary opportunity—both for investors and for society as a whole.

II. MICROCAPS ARE RIPE FOR SELF-DEALING AND OTHER ABUSES BY CORPORATE INSIDERS

As noted above, from a pure economic perspective, microcaps are risky investments. Those risks multiply, however, and substantially so, when combined with the governance profile of a typical microcap.

Though only 4% of microcaps qualify as “controlled” under NYSE and NASDAQ standards—*i.e.*, 50% of the company’s voting power is held by a single stockholder or group¹⁶—far more are subject to *de facto* control or are otherwise dominated by influential founders and corporate insiders.¹⁷ Indeed, roughly 14% of microcap CEOs founded the company.¹⁸

Board governance at microcap companies is also frequently problematic. Microcaps “often find it difficult to attract experienced director talent.”¹⁹ This is due to a variety of factors, including “limited financial resources (and often without the benefits of institutional-investor backing).”²⁰ On average, directors of microcaps are

¹⁶ Barret, *Microcap Board Governance*, *supra* note 3, at 19.

¹⁷ *Id.* at 18, 45.

¹⁸ *Id.* at 5.

¹⁹ Lawrence J. Trautman, *The Matrix: The Board’s Responsibility for Director Selection and Recruitment*, 11 FLA. ST. U. BUS. REV. 75, 89 (2012).

²⁰ *Id.*

less experienced, and receive substantially lower compensation for their service, than their counterparts at larger, better-established corporations.²¹

In addition, because microcaps frequently trade “over-the-counter” through broker-dealer networks, where fewer public disclosures are required,²² microcaps are often subject to less market scrutiny. Indeed, many microcaps are not covered by a single analyst.²³ Combined, these dynamics create fertile ground for abuse.

Two of Alpha’s experiences bear mentioning as illustrative examples of rampant self-dealing that obtained approval of nominally “independent” directors at microcap companies. In 2014, Alpha invested in Rezolute, Inc. (f/k/a AntriaBio, Inc.) (“AntriaBio”), a pre-revenue biopharma company that was developing novel diabetes treatments. In 2016, a purportedly majority-independent board approved a management-proposed equity compensation plan that awarded officers of the company *nearly half of the company’s equity* (including 14% to the company’s CEO)—and did so by written consent (without any meetings) and without retaining

²¹ See Barret, *Microcap Board Governance*, *supra* note 3, at 7 (noting median 2016 director compensation of \$75,000 at microcaps compared to nearly \$180,000 at a Russell 3000 company).

²² *Microcap Stock: A Guide for Investors*, SEC (Sept. 18, 2012), <https://www.sec.gov/reportspubs/investor-publications/investorpubsmicrocapstock>; True Tamplin, *Microcap Stock: Definition, How It Works, Pros, Cons & Strategies*, NASDAQ (July 18, 2023), <https://www.nasdaq.com/articles/microcap-stock-definition-how-it-works-pros-cons-strategies>.

²³ Barret, *Microcap Board Governance*, *supra* note 3, at 4.

a compensation consultant.²⁴ Only after Alpha sued for breach of fiduciary duty in the Delaware Court of Chancery did AntriaBio's then-CEO and other officers and directors agree to return a majority of the awards.²⁵

In 2013, Alpha invested in CytoDyn, a pre-revenue biotechnology company dedicated to the development and commercialization of a single drug with potential applications as a treatment for both cancer and HIV.²⁶ CytoDyn's board included an Alpha designee.²⁷ In what the Court of Chancery would later describe as a “a case of unmitigated greed,”²⁸ in 2019, CytoDyn's CEO orchestrated the removal of Alpha's board representative (and two other directors, one of them independent) in order to secure board approval of a massive grant of spring-loaded stock options to CytoDyn's CEO and other members of management.²⁹ As with AntriaBio, Alpha

²⁴ AntriaBio, Inc., Form 8-K (Nov. 4, 2016); *Alpha Venture Cap. P'rs, L.P. v. Elam*, C.A. No. 2017-0239-AGB (Del. Ch. June 28, 2017), Order Voluntarily Dismissing Action (Trans. ID 60784966) at 2; *Elam*, C.A. No. 2017-0239-AGB (Del. Ch. Mar. 31, 2017), Complaint (Trans. ID 60411171) at ¶ 34.

²⁵ *See Elam*, C.A. No. 2017-0239-AGB (Del. Ch. June 28, 2017), Order Voluntarily Dismissing Action (Trans. ID 60784966) at 2.

²⁶ *Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Apr. 29, 2020), Public Complaint (Trans. ID 65607273) at ¶¶ 17, 34.

²⁷ *Id.* ¶ 17.

²⁸ *Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Apr. 19, 2021), Transcript (Trans. ID 66565001) at 28.

²⁹ *Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Apr. 29, 2020), Public Complaint (Trans. ID 65607273) at ¶¶ 78, 90-97, 109, 119-20, 127-33.

was forced to assert claims in the Court of Chancery, resulting in a settlement under which approximately 80% of the challenged awards were rescinded.³⁰

³⁰ See *Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Apr. 29, 2020), Public Complaint (Trans. ID 65607273); *Pourhassan*, C.A. No. 2020-0307-PAF (Del. Ch. Jan. 27, 2021), Stipulation and Agreement of Compromise, Settlement, and Release (Trans. ID 66288552).

III. THE CHANGES TO DELAWARE LAW CONTEMPLATED BY THE ORDER WOULD NEGATIVELY IMPACT MICROCAPS AND THEIR MINORITY INVESTORS

As an experienced microcap investor (and former litigant in the Court of Chancery), Alpha harbors serious concerns regarding any change in the law that would potentially grant business-judgment deference to transactions involving controllers that have *not* been approved by *both* a committee of independent directors and a majority of fully-informed, disinterested stockholders.³¹ As explained above, microcaps are especially susceptible to unfair self-dealing by insiders, including because they frequently lack effective independent director oversight, and are often subject to little, if any, market scrutiny. Yet, the changes to Delaware law contemplated by the Order would potentially allow controllers of microcaps—*i.e.*, the proverbial “800-pound gorilla”³²—to evade judicial review of self-interested transactions with the mere blessing of supposedly independent directors but minimal disclosure to stockholders (*e.g.*, a Form 8-K).³³

To the extent these proposed changes become law in Delaware, Alpha will reconsider investing in microcap companies. And Alpha is concerned that investor hesitation stemming from these proposed changes to Delaware law will hurt the

³¹ Order at 3.

³² *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002).

³³ Order at 3.

ability of microcap companies to obtain the capital necessary to fuel innovations that improve society.³⁴ Even outside the microcap context, scholars have shown that, for example, perceptibly independent compensation committees rarely comply with “optimal contracting because directors are captured or subject to influence by management, sympathetic to management, or simply ineffectual in overseeing compensation.”³⁵ Indeed, nominally independent compensation committees should be viewed skeptically given “the pervasive influence of management, particularly the CEO, on all facets of the pay-setting process,” “management influence over director appointment,” and that “[t]he board can satisfy its procedural duties by reading some materials and asking some questions.”³⁶ This pervasive influence of insiders is even more oppressive when a CEO or his or her ally is a controlling stockholder. These concerns are particularly acute in the microcap context because

³⁴ Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 788 (2003) (“A significant body of scholarship links capital market development and public shareholder protection.”).

³⁵ Lucian Arye Bebchuk et. al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 754 (2002).

³⁶ *Id.* at 766, 781; *see also* Martin J. Conyon, *Executive Compensation and Board Governance in US Firms*, 124 ECON. J. 574, F63 (Feb. 2014) (“[D]irectors may owe their current board position to the incumbent CEO; the directors might be fearful of not having their board positions renewed if they lowball the CEO’s pay package; the outside directors might be as executives elsewhere; directors might rely too much on information supplied CEO and the firm”); *id.* at F61 (quoting Warren Buffett as saying of public companies, “They don’t look for Dobermans on [the compensation committee], they look for Chihuahuas - Chihuahuas that have been sedated”).

of director inexperience and the lack of meaningful market scrutiny, as discussed *supra*.

To be clear, these concerns extend far beyond compensation matters. If the Court were to change Delaware law to provide business judgment deference to transactions approved by nominally independent committees, microcap CEOs, founders, and other insiders could potentially avoid judicial review of even the most egregious types of self-dealing conduct. This Court is familiar with various forms of “tunneling,” where “[m]anagers and controlling shareholders (insiders) . . . extract (tunnel) wealth” from the firms they manage.³⁷ Tunneling can include, for instance: selling products or assets to the company at inflated prices; purchasing products or assets from the company at below-market prices; obtaining above-market compensation, consulting agreements, and/or service agreements; arranging investments in affiliates on terms that could not be obtainable from third parties; and arranging dilutive equity offerings, recapitalizations, and selective sales and repurchases of equity that uniquely benefit the insider or controller.³⁸

Indeed, as noted above, Alpha has historically invested principally in Delaware corporations given the protections Delaware law affords minority

³⁷ Vladimir Atanasov et al., *Law and Tunneling*, 37 J. CORP. L. 1, 2 (2011).

³⁸ *See id.* at 5-8; Vladimir Atanasov et al., *Unbundling and Measuring Tunneling*, 2014 U. ILL. L. REV. 1697, 1703-08 (2014).

investors. If tunneling and other types of corporate misconduct can avoid judicial review merely by obtaining the approval of a facially independent committee, microcap investments will become even more risky than they already are, and minority investors in microcaps will lose critical protections they have relied upon for decades.

Finally, to the extent this Court is concerned about the potential costs imposed on corporations by a vote requirement, Alpha notes that corporations have the option of soliciting votes in connection with their annual meetings.³⁹ And to the extent the Court is seeking to limit the number of challenges to controlled transactions that stockholders assert in Delaware, Alpha notes that the non-squeeze-out transactions that the Order addresses most often give rise to only derivative claims, and thus would be subject to a demand requirement that is itself a substantial barrier to litigation. Companies can generally avoid litigation over such transactions simply by ensuring that a majority of their directors are truly independent and disinterested.

³⁹ Another possibility would be to permit microcaps to solicit majority-of-the-minority stockholder approval in a potentially ratifying vote post-transaction, which, if successful, would trigger business judgment deference if a committee of independent directors also approved the subject transaction. While Alpha does not advocate that such a change in the law should apply to large, well-funded corporations who engage in controller transactions, this “ratification” approach may make sense for pre-revenue microcap companies that may not be able to delay the closing of a transaction.

CONCLUSION

This Court should confirm, consistent with the Court of Chancery, that application of the full *MFW* protections is the only way to obtain business judgment review of conflicted controller transactions and thus answer the question posed by the Order in the negative.

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