



IN THE COURT OF CHANCERY IN THE STATE OF DELAWARE

DAVID WOOD, Individually and)
On Behalf of All Others Similarly Situated)
)
Plaintiff,)
) C.A. No.
v.)
)
MICHAEL DONAHUE, BRADLEY)
NAYIN, DAVID ALTSCHUL, DANIEL)
STEIN, VIET DINH, JOEL STRAKA,)
NATHAN PECK and DIMENSIONAL)
ASSOCIATES, LLC,)
)
Defendants.)

VERIFIED CLASS ACTION COMPLAINT

Plaintiff David Wood, by his attorneys, for his complaint against defendants, alleges upon personal knowledge as to himself, and upon information and belief as to all other allegations herein, as follows:

NATURE OF THE ACTION

1. This is a class action on behalf of the former public common shareholders of The Orchard Enterprises, Inc. (“Orchard” or the “Company”) who owned Orchard common stock between March 16, 2010 and July 29, 2010 (the “Class Period”) seeking damages as a result of Orchard’s board of directors (the “Individual Defendants” herein) agreement to sell Orchard to its majority owner, Dimensional Associates, LLC (“Dimensional”) on terms that were unfair to the Company’s minority shareholders (the “Buyout”).

2. The underpriced Buyout was foisted on Orchard’s public shareholders because Dimensional, the Company’s largest shareholder, no longer wanted to hold shares in Orchard as a public Company. In late 2008, Dimensional informed the Board that it was interested in a sale of the Company or going private. From that point until the Buyout was announced Dimensional

inappropriately ran the process to sell the Company and refused to in good faith negotiate a fair value for its preferred shares to a third-party. As a result, the Company was strong-armed into accepting Dimensional's unfair price.

3. In order to justify this grossly unfair price, the Board, through a so-called "independent" special committee, retained a financial advisor that manipulated management projections in its Discounted Cash Flow ("DCF") calculation to come up with a scenario where it could show that the Buyout price was fair. The so-called "independent" special committee failed to adequately protect the Company's minority shareholders and instead allowed the flagrant manipulation of Company's financials to falsely justify the inadequate offer from its largest shareholder's.

4. In fact, this Court has determined that the Buyout price was unfair in a recently decided appraisal action. *See In re Orchard Enterprises, Inc.*, C.A. No. 5713-CS, 2012 WL 2923305 (Del.Ch., Jul. 18, 2012). The Court found that the Company's value was \$4.67 per share, *more than double* the Buyout price. This opinion provides further information about the Board's failure to protect the minority and instead allow its financial advisor to use inappropriate adjustments in its financial analysis to justify a price the majority shareholder chose to pay.

THE PARTIES

5. Plaintiff David Wood was an owner of shares of the common stock of Orchard prior to the Buyout during the Class Period.

6. Defendant Michael Donahue ("Donahue") was Chairman of the Board of Orchard. He has served as a member of Board since November 2007 and became Chairman of the Board in June 2008.

7. Defendant Bradley Navin (“Navin”) served as Chief Executive Officer and a member of the Board. He was Interim Chief Executive Officer, Executive Vice President, General Manager of Orchard effective October 27, 2009. He has been Executive Vice President and General Manager of the Company since April 2008.

8. Defendant David Altschul (“Altschul”) had been a director of the Company since 2006.

9. Defendant Daniel Stein (“Stein”) had been a director of the Company since 2009. Stein had also served as the interim CEO of Orchard from September 2009 through October 27, 2009. Defendant Stein also is the CEO of Dimensional.

10. Defendant Viet Dinh (“Dinh”) had been a director of the Company since 2007.

11. Defendant Joel Straka (“Straka”) had been a director of the Company since 2008.

12. Defendant Nathan Peck (“Peck”) had been a director of the Company since 2007.

13. Defendants Donahue, Navin, Altschul, Stein, Dinh, Straka and Peck are collectively referred to as the “Individual Defendants” and/or the “Orchard Board.” The Individual Defendants as officers and/or directors of Orchard, have a fiduciary relationship with Plaintiff and other former public shareholders of Orchard and owe them the highest obligations of good faith, fair dealing, loyalty and due care.

14. Defendant Dimensional is a New York limited liability company and is a private equity affiliate of JDS Capital, L.P. Dimensional was the controlling stockholder of Orchard owning approximately 42% of the Company’s outstanding common stock and 99% of the Company’s outstanding Series A Preferred Stock, representing an aggregate of approximately 53% of the Company’s voting stock.

CLASS ACTION ALLEGATIONS

15. Plaintiff brings this action on his own behalf and as a class action, pursuant to Rule 23 of the Rules of the Court of Chancery, on behalf of all former shareholders of the Company (except the defendants herein and any person, firm, trust, corporation, or other entity related to or affiliated with any of the defendants) and their successors in interest, who were injured as a result of defendants' actions as more fully described herein (the "Class").

16. This action is properly maintainable as a class action.

17. The Class is so numerous that joinder of all members is impracticable. There were approximately 2.5 million shares of Orchard common stock outstanding prior to the Buyout that were not owned by Dimensional.

18. There are questions of law and fact which are common to the Class including, *inter alia*, whether defendants have breached their fiduciary and other common law duties owed by them to plaintiff and other members of the Class.

19. Plaintiff is committed to prosecuting this action and has retained competent counsel experienced in litigation of this nature. Plaintiff's claims are typical of the claims of the other members of the Class and Plaintiff has the same interests as the other members of the Class. Accordingly, Plaintiff is an adequate representative of the Class and will fairly and adequately protect the interests of the Class.

20. The prosecution of separate actions by individual members of the Class would create a risk of inconsistent or varying adjudications with respect to individual members of the Class, which would establish incompatible standards of conduct for defendants, or adjudications with respect to individual members of the Class which would, as a practical matter, be

dispositive of the interests of other members or substantially impair or impede their ability to protect their interests.

THE BUYOUT

21. Orchard controlled and distributed digital music and video programming through hundreds of digital stores (e.g., Amazon, eMusic, Hulu, iTunes, Rhapsody, YouTube) and mobile carriers (e.g., China Mobile, Orange, Telefonica, Verizon) worldwide.

22. Orchard's capital structure before the Buyout consisted of (i) common stock, which was 42.5% owned by Dimensional, and (ii) preferred stock, which was essentially wholly owned by Dimensional. Dimensional had 53% of the voting power of Orchard's outstanding capital stock, because the preferred stock could vote on an as-converted basis. As such, Dimensional had control over the Company.

23. Therefore, when Dimensional determined that it was time to divest of its investment, despite growth opportunities for the minority shareholders, the Company agreed to a Buyout at a grossly unfair price of \$2.05 per share.

24. On March 16, 2010, the Company announced that it had entered into a merger agreement with Dimensional, stating:

New York- March 16, 2010 - The Orchard, a global leader in music and video distribution and comprehensive digital strategy, announced today that it has entered into a definitive merger agreement with Dimensional Associates, LLC, a private equity affiliate of JDS Capital, L.P. Dimensional currently owns approximately 42% of the Company's outstanding common stock and 99% of the Company's outstanding Series A Preferred Stock, representing an aggregate of approximately 53% of the Company's voting securities.

Following the unanimous recommendation and approval of a Special Committee of independent and disinterested directors, the Board of Directors of The Orchard (other than Daniel C. Stein, who abstained from voting on the matter due to his position as an executive of Dimensional Associates) has approved the merger agreement and is recommending to The Orchard's stockholders that they adopt and approve the merger agreement. Under the terms of the merger agreement,

Dimensional Associates will acquire all of the common stock of The Orchard not currently owned by it or its affiliates for \$2.05 per share and stockholders will also receive a contingent right to receive additional consideration, under certain circumstances post-closing if Dimensional Associates or any of its affiliates enters into a commitment to sell at least 80% of The Orchard's voting securities or assets within six months of the consummation of the merger.

25. The offer price of \$2.05 per share undervalued the Company.

26. On November 12, 2008, Stein, who is Dimensional's CEO and also a member of Orchard's board, contacted Donahue to inform him that Dimensional wanted to solicit parties interested in either acquiring Orchard or participating in the acquisition by Dimensional of all of the outstanding common stock not then owned by Dimensional.

27. As a result of this discussion, the Board decided to appoint a special committee consisting of four so-called "independent" directors: Donahue, Dinh, Peck and Straka. The special committee held its first meeting on November 25, 2008 wherein it engaged Patterson Belknap Webb & Tyler LLP to act as its legal adviser and appointed Donahue to serve as its Chairman.

28. Despite the formation of this special committee, the Board inappropriately allowed Dimensional to run the potential sale process.

29. Between November 2008 and March 2009, Dimensional contacted 53 potential strategic and financial buyers. The Company entered into non-disclosure agreements with eleven of the 53 contacted potential buyers, and the Company's management conducted eight face-to-face business diligence meetings. However, without further explanation, the Company disclosed that this process resulted in no "credible" offers.

30. Because the Company allowed Dimensional to run the process, it is unclear what Dimensional determined to be a "credible" offer and what premium Dimensional was requiring of the potential bidders to cash Dimensional out of its preferred shares.

31. On October 9, 2009, Stein, who was now serving as the CEO of both Orchard and Dimensional, contacted Donahue, Altschul, Dinh, Peck and Straka individually to inform them that, as part of its regular, ongoing review of its investments, Dimensional was considering making a proposal to buy the outstanding shares of capital stock of Orchard not already owned by Dimensional.

32. On October 19, 2009, the board of directors decided to form a new special committee to review and evaluate the Dimensional proposal comprised of the so-called “independent” directors. The special committee now consisted of Donahue, Altschul, Straka, Dinh and Peck.

33. The special committee held its first meeting on October 22, 2009 and resolved to engage Patterson Belknap as its legal adviser and to appoint Donahue to serve as its Chairman.

34. On October 28, 2009, the special committee engaged Fesnak and Associates, LLP (“Fesnak”), to be the financial advisor to the special committee. Fesnak was retained, in part, because of its competitive fee structure.

35. On October 30, 2009, Orchard announced the resignation of Stein as Interim CEO and the appointment of Navin as Interim CEO. Orchard also disclosed in this filing that Dimensional had made a proposal to acquire the Company at the proposed price of \$1.68 to \$1.84 per share.

36. On November 3, 2009, the special committee was contacted by a minority stockholder requesting information about the special committee’s process and seeking direction about how to propose an alternative transaction. On November 18, 2009, the minority stockholder submitted to the special committee a written indication of interest to lead a group of investors in (1) the acquisition of all of the outstanding shares of our common stock (including

those held by Dimensional and its affiliates) for cash consideration in the range of \$2.36 to \$2.84 per share, (2) the acquisition of all of the outstanding shares of our Series A convertible preferred stock (including those held by Dimensional and its affiliates) for a combination of cash and equity in the surviving entity, and (3) a possible concurrent combination with one or more third party entities in our industry.

37. The special committee also reviewed the proposal and determined that it would be best if the minority shareholder negotiated directly with Dimensional to determine whether it would sell its position in the Series A convertible preferred stock as proposed in the minority shareholder's offer.

38. Stein informed the minority shareholder that its proposal was not acceptable to Dimensional due to the fact that (1) it did not contemplate a purchase of Dimensional's shares of the preferred stock at their full liquidation value and (2) the consideration offered was a combination of cash, a promissory note and equity interests in the surviving entity, which was conditioned obtaining third party financing.

39. On December 11, 2009, the special committee received a letter from the minority shareholder withdrawing its proposal to acquire Orchard. According to the letter, Dimensional was unwilling to accept terms presented and made a counter offer that was "neither economically viable nor with solid financial justification."

40. Despite this letter, the special committee did nothing to reign in Dimensional or to require Dimensional to negotiate in good faith for the sale of its preferred shares so that the minority shareholders could obtain increased consideration. Instead the special committee continued to negotiate a buyout with Dimensional.

41. On January 13, 2010, Donahue contacted Stein and asked him to raise his price to \$2.10 per share. Stein acknowledged that Dimensional had offered \$2.10 per share on December 18, 2009 but he stated that the offer at the time was contingent on, among other things, having a simple majority vote condition. Stein called Donahue later that day to state that Dimensional would be willing to raise its offer to \$2.05 per share, with a majority of the minority vote condition and the “go-shop” provision, and that it represented Dimensional’s best and final offer.

42. On January 14, 2010, the special committee held a meeting to discuss the terms and conditions proposed by Dimensional and authorized and directed Patterson Belknap to negotiate the terms and conditions of a merger agreement with Dimensional based on the material terms agreed to in principle by the parties.

43. On the afternoon of March 15, 2010, Orchard, Dimensional and The Orchard Merger Sub, Inc., a wholly owned subsidiary of Dimensional, executed the merger agreement.

44. The agreed upon price in the merger agreement was fundamentally unfair, and the process was inappropriately controlled by Dimensional.

45. Furthermore, the special committee hired a financial advisor that tailored its financial valuation to make Dimensional’s Buyout price appear fair.

46. The financial advisor hired by the special committee provided financial valuations based on hypothetical situations and inappropriate valuation inputs. For example, Fesnak deducted a \$25 million liquidation preference from the Company’s enterprise value because Dimensional *could* demand the preference as a precondition to a third party transaction. The liquidation preference is payable only if one of the triggering events under the Certificate of Designations occurs, events that involve the end of Orchard’s existence as a going concern, specifically:

(i) a “voluntary or involuntary liquidation, dissolution, or winding up” of Orchard; (ii) “the sale or exclusive license of all or substantially all of [Orchard’s] assets or intellectual property,” in which case the company is required to liquidate, dissolve and wind up” as soon as possible thereafter; and (iii) a “Change of Control” transaction “in which the stockholders of [Orchard] will receive consideration from an unrelated third party.”

See In re Orchard Enterprises, Inc., 2012 WL 2923305 at *3

47. The Buyout was not an event triggering the payment of the liquidation preference. Thus the exclusion of the \$25 million from the enterprise value of the Company was inappropriate.

48. Further, the comparable companies and comparable transactions analyses performed by Fesnak were not reliable because “not one of the eight comparables chosen by Fesnak was really similar to Orchard.” *See In re Orchard Enterprises, Inc.*, 2012 WL 2923305 at *10.

49. Finally, the DCF, which should be the exclusive analysis to value the Company, was performed using an inappropriate discount rate. Despite the fact that Orchard had experienced management, under the control of Dimensional, Fesnak added 1% to the discount rate. In fact, Fesnak added this percentage to the discount rate after choosing to give almost no weight to the aggressive case, and 90% weight to the base case. “Fesnak therefore dealt with projection risk already through weighting the projections.” *See In re Orchard Enterprises, Inc.*, 2012 WL 2923305 at *21. Thus the addition to the discount rate served no purpose other than to deflate the valuation of the Company.

50. After modifying Fesnak’s valuation model, the Court in *In re Orchard Enterprises, Inc.* applied a discount rate of 15.3% and arrived at a value of \$4.67 per share for Orchard as of the date of the Buyout, which is more than double the price (or an additional \$2.62 per share) the Individual Defendants agreed to in the Buyout.

51. As a result of defendants fiduciary breaches the Class was damaged in that it obtained less than half of the Company's value in the Buyout.

THE PROPOSED TRANSACTION IS SUBJECT TO ENTIRE FAIRNESS

52. Dimensional was the controlling stockholder of Orchard prior to the Buyout owning approximately 42% of the Company's outstanding common stock and 99% of the Company's outstanding Series A Preferred Stock, representing an aggregate of approximately 53% of the Company's voting securities.

53. In addition, Stein, a director of the Company and its former Interim CEO, serves as chief executive officer of Dimensional.

54. As stated in the Company's 2010 Annual Report filed with the Securities and Exchange Commission on March 25, 2010:

Our majority stockholder, Dimensional Associates, LLC, or Dimensional, has significant influence on all stockholder votes and has effective control over the outcome of actions requiring the approval of our stockholders.

Dimensional beneficially owns shares of our capital stock representing approximately 54% of the outstanding voting power of our capital stock. *Dimensional thus has the ability to exert substantial influence or actual control over our management policies and strategic focus, could control the outcome of almost any matter submitted to our stockholders and has the ability to elect or remove all of our directors.* (emphasis added) There is a risk that the interests of Dimensional will not be consistent with the interests of other holders of our common stock.

Dimensional has significant control over our business and significant transactions. In addition to the effects described above, Dimensional's control of our company could make it more difficult for us to raise capital by selling stock or for us to use our stock as consideration in acquisitions. *This concentrated ownership also might delay or prevent a change in control and may impede or prevent transactions in which stockholders might otherwise receive a premium for their shares.* (emphasis added)

55. As controlling stockholder, Dimensional has the power and is exercising such power to enable it to acquire the Company's common stock and to dictate terms that are contrary

to the Company's minority shareholders' best interests and do not reflect the fair value of Orchard's common stock.

56. As such, the transaction is subject to the exacting entire fairness standard under which the Defendants must establish both fair price and fair dealing.

COUNT I

Breach of Fiduciary Duties Against the Individual Defendants

57. Plaintiff incorporates each and every allegation set forth above as if fully set forth herein.

58. The Individual Defendants in violation of their fiduciary duties of care, and loyalty, approved the Buyout, although it is not entirely fair to the Company's public shareholders. By pursuing transactions which are not entirely fair to the Company's public shareholders, the Individual Defendants have violated their fiduciary duties to the public shareholders.

COUNT II

Breach of Fiduciary Duties Against Dimensional

59. Plaintiff incorporates each and every allegation set forth above as if fully set forth herein.

60. As a controlling shareholder of Orchard, Dimensional owed the Company's shareholders, at all relevant times, a duty of entire fairness and a duty not to misuse its own control of the Company for its own ends. By virtue of the acts set forth above, Dimensional has breached such duty and injured the Class directly.

WHEREFORE, Plaintiff and the members of the Class demand judgment against defendants, jointly and severally, as follows:

- A. Declaring that this action is properly maintainable as a class action and certifying Plaintiff as the representative of the Class;
- B. Rescinding the Buyout and setting it aside;
- C. Awarding compensatory damages against defendants, individually and severally, in an amount to be determined at trial, together with pre-judgment and post-judgment interest at the maximum rate allowable by law, arising from the Buyout;
- D. Awarding Plaintiff costs and disbursements and reasonable allowances for fees of Plaintiff's counsel and experts and reimbursement of expenses; and
- E. Granting Plaintiff and the Class such other and further relief as the Court may deem just and proper.

September 6, 2012

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