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IN THE SUPREME COURT OF THE STATE OF DELAWARE

CITY OF BIRMINGHAM RETIREMENT AND RELIEF SYSTEM, ROBERT L. REESE, POLICE RETIREMENT SYSTEM OF ST. LOUIS, EDWARD TANSEY, AND ESTATE OF LEATRICE SEINFELD, Plaintiffs-Below, Appellants, v. LYNN J. GOOD, ANN M. GRAY, G. ALEX BERNHARDT, SR., MICHAEL G. BROWNING, HARRIS E. DELOACH, JR., DANIEL R. DIMICCO, JOHN H. FORSGREN, JAMES H. HANCE, JR., JOHN T. HERRON, JAMES B. HYLER, JR., WILLIAM E. KENNARD, E. MARIE MCKEE, E. JAMES REINSCH, JAMES T. RHODES, CARLOS A. SALADRIGAS, B. KEITH TRENT, LLOYD M. YATES, JAMES E. ROGERS, WILLIAM BARNET III, PHILIP R. SHARP, Individual Defendants-Below, Appellees, and DUKE ENERGY CORPORATION, Nominal Defendant-Below, Appellee.	No. 16, 2017 On Appeal from The Court of Chancery, C.A. 9682-VCG PUBLIC VERSION Filed April 11, 2017

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NATURE OF THE PROCEEDINGS

In this stockholder derivative action, the Plaintiffs-Appellants ("Plaintiffs") seek to hold the Individual Defendants-Appellants (the "Individual Defendants"), most of whom are or were outside directors of Nominal Defendant-Appellee Duke Energy Corporation ("Duke Energy" or the "Company"), personally liable for liabilities incurred by the Company as a result of what Plaintiffs admit was the accidental and unforeseeable rupture of a stormwater pipe and the Company's on-the-ground environmental operations. Because Plaintiffs failed to meet the stringent standards to plead such a claim under Delaware law in the absence of a pre-suit demand, the Court of Chancery correctly dismissed their Complaint.

* * *

In February 2014, a 1950's-era underground stormwater pipe traversing a coal ash pond at Duke Energy's Dan River Steam Station accidentally ruptured and resulted in a spill of coal ash into North Carolina's Dan River. As a result, federal and state regulators investigated, found Duke Energy's coal ash storage disposal facilities had violated federal environmental laws, and imposed upon the Company fines and penalties exceeding $100 million. No Duke Energy officer or director was ever accused of any wrongdoing by those regulators. On

November 21, 2014, Plaintiffs filed this stockholders' derivative action against Duke Energy's directors, without having made a pre-suit demand as Delaware Court of Chancery Rule 23.1 requires. The Individual Defendants moved to dismiss for failure to comply with this demand requirement.

In opposing dismissal, Plaintiffs argued that demand would have been futile because the allegations of their operative complaint (the "Complaint") showed that the directors faced a substantial likelihood of liability—implicating *Caremark* and its progeny—for failure to adequately monitor or oversee, in good faith, the Company's compliance with applicable environmental laws. Consequentially, Plaintiffs alleged, the Individual Defendants allowed Duke Energy to be exposed to significant fines and other financial penalties, which they should be required to restore to the Company.

In dismissing the Complaint, the Court of Chancery correctly held that, for liability to attach to directors for alleged failure of oversight, "a demonstration of bad faith by the . . . directors is . . . necessary" and that "[t]o show bad faith, the 'plaintiffs must plead particularized facts that demonstrate that the directors acted with scienter; *i.e.*, there was an 'intentional dereliction of duty' or 'a conscious disregard' for their responsibilities amounting to bad faith.'" A501. The trial court concluded that no such showing had been made—nor could

it be reasonably inferred—from the particularized facts alleged in the Complaint. The sole issue on this appeal is whether the Court of Chancery erred in dismissing this derivative action for failure to plead, with requisite particularity, that the Duke Energy directors faced a substantial risk of liability for failure to monitor, in good faith, the Company's compliance with applicable environmental laws.

On this appeal, Plaintiffs contend that the Court of Chancery erred as a matter of law by declining to make two inferences: *first*, that the board *knew* that "seepages" from the Company's coal ash ponds violated environmental regulations; and *second*, that even though Duke Energy was working with its primary regulator, the North Carolina Department of Environmental Quality ("DEQ") to resolve the seepage issues (which ordinarily would negate any inference of director bad faith), the board *knew* that DEQ was a "rogue," "corrupt," "captive" agency, yet the board allowed the Company to collude with DEQ to not enforce the environmental laws to shield the Company from liability. The Court of Chancery rejected these inferences, and Plaintiffs' entire premise on appeal is that their Complaint *required* the Court of Chancery to *accept* them.

This Court should affirm the trial court's well-reasoned decision, because Plaintiffs' contentions are not grounded in actual particularized allegations of the Complaint or in logic. Specifically: (1) *nothing* in the Complaint permits a

reasonable inference that the directors knew that the seepage issues—or the arrangements being undertaken to resolve them with DEQ—violated any environmental law, state or federal; (2) *nothing* in the Complaint permits a reasonable inference that DEQ was a "rogue" or "corrupt" regulator, or even if it were, that the Duke Energy directors knowingly "colluded" with DEQ to circumvent known environmental requirements; and (3) *nothing* in the Complaint permits a reasonable inference that the directors could have prevented the Dan River spill, which even Plaintiffs concede was unforeseeable and accidental.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery properly held that Plaintiffs failed to raise a reasonable inference that the Director Defendants faced a substantial likelihood of liability for acting in bad faith, and correctly dismissed the Complaint for failure to plead demand futility under Rule 23.1.

2. Denied. The Court of Chancery properly held that Plaintiffs failed to allege a *Caremark* claim because Plaintiffs failed to plead particularized facts that the Director Defendants had knowledge that the Company was violating environmental laws or that the Director Defendants knew about and condoned a corporate strategy of colluding with DEQ.

STATEMENT OF FACTS

Duke Energy is a Delaware corporation based in Charlotte, North Carolina. A053 ¶ 31. The Company is currently the largest provider of electricity in the United States, and its stock is listed on the New York Stock Exchange. *Id.* Plaintiffs are stockholders of Duke Energy. A040-52 ¶¶ 25-30. The "Individual Defendants" include the fifteen Duke Energy directors at the time the original consolidated complaint was filed (A053-54 ¶¶ 33-47), three former directors of the Company (A063-64 ¶¶ 51-53), one former officer, (A061 ¶ 48), and one current officer (A061-62 ¶ 49).[1]

A. Duke Energy's Coal Ash Ponds.

For years, Duke Energy has used coal-fired power plants to generate a large portion of its energy output. A038 ¶ 2. These coal-fired plants produce byproducts known generally as coal combustion residuals ("CCRs"). A038 ¶ 2; A066-67 ¶ 59. The largest component of CCRs is coal ash, which environmental regulations allow to be disposed of by several methods, including disposal in unlined coal ash ponds. A039 ¶ 3.

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[1] "Director Defendants" refers to the fifteen directors who were members of the Duke Energy Board at the time the first complaint was filed in May 2014.

Historically, Duke Energy Carolinas, LLC ("Duke Energy Carolinas") and Duke Energy Progress, LLC ("Duke Energy Progress"), two subsidiaries of Duke Energy, combined their coal ash with water to form "slurry," which was then transported to coal ash basins, also known as "ponds." These ponds acted as wastewater treatment centers, inasmuch as "particulate matter and free chemical components separated from the slurry and settled at the bottom of the basin," while "less contaminated water remained at the surface of the basin, from which it could eventually be discharged if authorized under relevant law and permits." A155-56 ¶ 14.

B. Applicable Environmental Laws and Regulations.

The discharge of water from Duke Energy's coal ash ponds is regulated, in part, by the federal government pursuant to the Clean Water Act ("CWA"). A070 ¶¶ 66-67. The CWA "prohibits the discharge of any pollutant into waters of the United States except in compliance with a permit issued pursuant to the CWA under the National Pollutant Discharge Elimination System ("NPDES") by the United States Environmental Protection Agency ("EPA") or by a state with an approved permit program." A157 ¶ 19 (citing 33 U.S.C. §§ 1331(a) and 1342). Both coal ash and coal ash wastewater are classified as pollutants under the CWA. A157 ¶ 20.

In North Carolina, the CWA's NPDES permit program is administered and enforced by the North Carolina Department of Environmental Quality ("DEQ"), formerly known as the Department of Environmental and Natural Resources ("DENR"). A154-59 ¶¶ 23-25; A162 ¶ 37. NPDES permits typically contain, among other things: effluent limitations; water quality standards; monitoring and reporting requirements; standard conditions applicable to all permits; and, special conditions where appropriate. A159 ¶ 26. There are two types of NPDES permits: wastewater and stormwater. *Compare* A162 ¶ 37 (discussing a wastewater NPDES permit issued to Duke Energy Carolinas) *with* A163 ¶ 41 (describing stormwater permits). In general terms, NPDES permits allow wastewater to be discharged from a treatment system, such as a coal ash pond. A163 ¶ 41. Stormwater permits, however, generally do not allow wastewater or particulates to be discharged from coal ash ponds. A163 ¶ 41. Each of the Company's North Carolina facilities with coal ash basins received NPDES permits to discharge treated coal ash wastewater through specified permitted outfalls into United States waterways. A156 ¶ 17.

The Company's coal ash ponds within North Carolina are also subject to state statutes that regulate discharges into North Carolina waters. A071 ¶¶ 69-70.

C. Duke Energy's Compliance Efforts.

To monitor environmental risks associated with coal ash, the Duke Energy Board formed the Regulatory Policy and Operations Committee ("RPOC") in July 2012. A072 ¶ 71. That committee met numerous times during each of 2012, 2013, 2014 and 2015.[2] The RPOC regularly reported to the Board on the Company's ongoing environmental compliance efforts. A033 ¶ 72; B19.

Since 2012, the RPOC considered or discussed the following issues relating to coal ash:

- [redacted] (B10; A090-91 ¶ 107);
- [redacted] (B8);
- [redacted] (A214; A091-92 ¶¶ 108-09);
- [redacted] (A216-20); and
- [redacted] (B84).

[2] *See* A033 ¶ 71; B5; A211; A231; A257; B21; B50; B76; B82; A297.

In addition, during this same time period the Board was informed of and considered the following coal ash issues:

- [redacted] (A230; A244; A260);
- [redacted] (A265-66; B24); and
- [redacted] (A270-71).

D. The Dan River Spill.

When the coal ash pond at Duke Energy Carolinas' Dan River Steam Station in Eden, North Carolina was created, it was placed above a pre-existing stormwater drainage pipe. A040 ¶ 6. On February 2, 2014, a corroded five-foot long elbow joint in that stormwater pipe failed (A175-76 ¶¶ 81-82), and, as a result, coal ash from the pond entered the stormwater pipe and flowed into the Dan River. A040 ¶ 6; A42-43 ¶ 9; A175 ¶ 81.

Before the Dan River spill, no camera inspections of the stormwater pipes underneath the Dan River coal ash pond had been performed. A174-75 ¶ 79. An unspecified senior program engineer had recommended including a $20,000 line item in the Dan River budget for camera inspections, but the engineer later

removed that line item due to the anticipated closure of the coal ash ponds at the Dan River facility. A172-73 ¶¶ 70-74. As part of the criminal investigation conducted by the federal government, the government found that had a camera inspection been conducted, the interior corrosion of the elbow joint in the 48-inch pipe would likely have been visible. A174-75 ¶ 79.

1. The Criminal Investigation And Resulting Plea Agreements.

Following the Dan River spill, the U.S. Attorney's Office for the Eastern District of North Carolina issued grand jury subpoenas to, among others, the Company, DEQ, and the North Carolina Utilities Commission. A049 ¶ 19. The subpoenas sought documents relating to (i) the coal-fired plants operated by Duke Energy Carolinas and Duke Energy Progress where coal ash was stored, including the Dan River facility (*id.*); and (ii) the contracts between Duke Energy Carolinas and Duke Energy Progress and North Carolina state regulators regarding those facilities. *Id.*

On February 20, 2015, three Duke Energy subsidiaries—Duke Energy Carolinas, Duke Energy Progress and Duke Energy Business Services, LLC ("DEBS")—each entered into a Memorandum of Plea Agreement (the "Plea Agreements") with the U.S. Attorney's Offices for the Eastern, Middle, and Western Districts of North Carolina. B3; A049 ¶ 20. Under those Plea

Agreements, DEBS and Duke Energy Progress pled guilty to four misdemeanor CWA violations, and DEBS and Duke Energy Carolinas pled guilty to five misdemeanor CWA violations. B3; A111-12 ¶¶ 145-46.

All nine misdemeanor counts were negligence-based counts that charged technical violations of the CWA. A401-02. None of the Individual Defendants is alleged to have had knowledge of any of these violations at the time they occurred. A503-04. No Individual Defendant is referenced, either by name or position, in the 192-paragraph Joint Factual Statement detailing the negligent conduct. A148-206; A111-20 ¶¶ 145-59 (alleging negligent conduct by Duke Energy's subsidiaries and their low-level employees).

As part of the Plea Agreements, Duke Energy Carolinas and Duke Energy Progress agreed to pay approximately $102 million in fines, restitution, community service, and mitigation. A112 ¶¶ 146-47. Duke Energy Carolinas, Duke Energy Progress, and DEBS also agreed to a five-year probation period, during which they agreed to establish environmental compliance plans subject to the oversight of a court-appointed monitor. A113-14 ¶¶ 148-49.

2. The Environmental Actions.

During the first quarter of 2013, citizens' environmental groups gave formal notices of their intent to sue, under the CWA, to Duke Energy Carolinas

and Duke Energy Progress, alleging groundwater violations and CWA violations relating to coal ash basins at coal-fired power plants in North Carolina. A094 ¶ 112, A094 ¶ 114. In response, DEQ filed enforcement actions in North Carolina state court against Duke Energy Carolinas and Duke Energy Progress alleging illegal seepage[3] from ash ponds and violations of groundwater standards. A097 ¶ 121, A100-01 ¶ 127, A110-11 ¶ 143. The citizens' environmental groups also filed separate actions in North Carolina federal district courts. Those actions alleged CWA violations for unpermitted discharges to surface water and groundwater at Duke Energy Carolinas's Riverbend and Buck plants and Duke Energy Progress's Sutton, Cape Fear, and H.F. Lee plants. A111 ¶ 144. The citizens' complaints further claimed that the enforcement actions filed by DEQ did not adequately address all of the CWA violations alleged by the citizens' groups. *Id.*

Before the Dan River spill, the Company negotiated with DEQ on consent orders that would have resolved the state enforcement actions pertaining to certain Duke Energy coal-fired plants. A100 ¶ 126, A102-03 ¶ 130, A104-06

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[3] Seeps develop in the earthen dam walls of coal ash basins when water, often carrying dissolved chemical constituents, moves through porous soil and emerges at the surface. A189-90 ¶ 133.

¶¶ 132-35; A270. The practice of entering into consent decrees to resolve environmental issues with state regulators was a common one that Duke Energy and other energy companies in other states followed. A270-71. After the Dan River spill, DEQ withdrew from the proposed consent order with the Company. A110-11 ¶ 143.

3. The Derivative Litigation.

After initial complaints were stayed pending resolution of underlying environmental cases, on April 22, 2016, Plaintiffs filed an amended verified consolidated shareholder complaint. The Complaint alleges that the Dan River spill was a "foreseeable and inevitable result of a pattern of willful violations of the Clean Water Act and North Carolina state law, sanctioned over a period of years by the Individual Defendants." A041 ¶ 7. Specifically, the Amended Complaint claims that: (i) for years the Individual Defendants knew that "coal ash ponds were seeping toxic chemicals into the soil and rivers, yet took no action to remedy the problems;" (ii) the Board "was specifically told that all 14 of Duke Energy's North Carolina facilities had groundwater quality violations;" (iii) "the Company was illegally operating without proper stormwater permits in at least six coal plants, including at the Dan River Steam Station;" and (iv) the Individual Defendants "permitted [Duke Energy's] deliberate discharge of tens of millions of

gallons of coal ash slurry into the Cape Fear River." A041 ¶ 7. Plaintiffs also allege that, had the Company obtained the proper stormwater permit for the Dan River facility, testing would have been required and the accident at Dan River would never have occurred. A132 ¶ 188.

Plaintiffs assert that the Company, rather than cleaning up its ash ponds, "co-opt[ed] DEQ, by all accounts a captive regulator, to intervene in [citizens'] lawsuits and extinguish [Duke Energy's] liability in exchange for a minimal 'slap on the wrist' penalty and no requirement to actually remediate any of its coal ash ponds." A044 ¶ 12, A094-100 ¶¶ 115-124, A101 ¶ 128.

Plaintiffs charge that the Individual Defendants' wrongful acts have cost the Company "billions of dollars in fines, penalties and clean-up costs." A089 ¶ 171. The Amended Complaint advances three claims for relief: (i) breach of fiduciary duty, (ii) waste, and (iii) unjust enrichment. A136-39 ¶¶ 194-201; 202-05; 206-09.

E. Plaintiffs' Demand Futility Theory.

Plaintiffs failed to make a pre-suit demand as required under Court of Chancery Rule 23.1. Plaintiffs would excuse this failure on the ground that the Director Defendants face a substantial likelihood of liability for acting in bad faith by failing to monitor and oversee the Company's coal ash management, and

because, they assert, the Director Defendants actually conspired with DEQ to violate environmental laws. A128-34 ¶¶ 181-93. In the Court of Chancery, Plaintiffs conceded that their theory of demand refusal depends on their ability to plead particularized facts raising a reasonable inference that the Director Defendants face a substantial likelihood of liability because the Board knew and exploited the fact that DEQ is a captive regulator that was refusing to enforce the law. A352-53. Indeed, Plaintiffs admitted, "that the captive and corrupt and nonenforcing agency is a linchpin of our argument." A453; *see also* A451-53.

F. The Court Of Chancery's Opinion Dismissing The Amended Complaint Under Rule 23.1.

The Court of Chancery held extensive oral argument on November 16, 2016, following full briefing, and on December 8, 2016, dismissed the Amended Complaint under Rule 23.1 for failure to plead particularized facts demonstrating that demand on Duke Energy's board is excused. In its bench ruling, the Court of Chancery correctly analyzed demand futility under the test set forth in *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), noting that to satisfy the *Rales* test, "a majority of the directors who would have considered the demand as of the time that complaint was filed must face a substantial likelihood of personal liability . . . ." A499. Finding that the allegations in the Amended Complaint "amount to a *Caremark* claim . . . that seeks to hold directors accountable for the

consequences of a corporate trauma" (A500), the Court of Chancery correctly held that "[f]or liability to attach to the directors for their alleged failure of oversight here, a demonstration of bad faith by the [Duke Energy] board of directors is a necessary element." A501. The trial court further held that bad faith requires a showing of scienter—either an "intentional dereliction of duty" or "a conscious disregard" for their responsibilities. *Id.* (internal quotation marks omitted).

The Court of Chancery rejected Plaintiffs' assertion that the Individual Defendants had failed to implement reporting systems or controls to enable board oversight of the Company's obligations with respect to the handling of coal ash. A502. The court noted that the allegations of the Amended Complaint themselves precluded such a finding, because Plaintiffs alleged not only that the Board was aware of seeps in Duke Energy's coal ash ponds, but also that the Board knew that the Company was actively working with regulators in North Carolina "to achieve regulatory compliance in a cost-effective way with limited liability." *Id.*

The trial court also rejected as "unsustainable" Plaintiffs' central contention that DEQ was a "rogue agency" that was "captive" to Duke Energy. That theory, Plaintiffs admitted, was "critical to the success of their case" and required a determination that (i) the Board knew that DEQ would permit Duke Energy to violate the law and shield the Company from liability for any such

violations, and (ii) Duke Energy improperly exploited its relationship with DEQ. *Id.* In rejecting this "unique theory," the trial court closely analyzed Plaintiffs' "proof of collusion" allegations (A506), and found each and every purported factual allegation "insufficient to draw a reasonable inference that the DEQ was corrupt and, if so, that the board knew of any corruption and allowed the company to exploit such corruption in bad faith." A507. The court then concluded:

> Essentially, the complaint alleges that the directors were aware of the environmental problems at various coal ash storage facilities, that the directors were aware of what the company was doing to attempt to address those situations, that Duke was working with its regulators at DEQ to minimize its liability and maximize the time it had to bring its facilities into compliance with environmental regulations and to avoid the consequences of lawsuits by environmental groups.
>
> ***These facts, if true, do not raise a reasonable inference of a substantial likelihood that the directors face liability for bad faith.*** The further conclusory allegations that the company should have rejected the oversight of a business-friendly regulator whose actions the plaintiffs find insufficiently rigorous, or even wholly inadequate, fall short, to my mind, of a cogent theory of director liability.

A507-08 (emphasis added).

ARGUMENT

I. THE CHANCERY COURT PROPERLY HELD THAT PLAINTIFFS FAILED TO PLEAD DEMAND FUTILITY.

A. Question Presented

Did the Court of Chancery legally err in dismissing the Complaint for failure to plead, with requisite particularity, that the Director Defendants faced a substantial risk of liability for failure to monitor in good faith Duke Energy's compliance with applicable environmental laws?

B. Standard of Review

The Supreme Court reviews a Court of Chancery's decision to dismiss a complaint *de novo*. *See Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008); *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

C. Merits of the Argument

1. Standard for Demand Futility.

A central principle of Delaware law is that "directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *see also Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 366 (Del. 2006) (noting that "[i]t is a fundamental principle of the Delaware General Corporation Law that '[t]he business and affairs of every

corporation . . . shall be managed by or under the direction of a board of directors'" (citation omitted)). Shareholder derivative actions inherently infringe on the "primacy of board decision-making regarding legal claims belonging to the corporation." *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009) (internal quotation marks omitted).

Consequently, a stockholder is permitted to bring a derivative suit only if the stockholder either made a demand on the board to take appropriate remedial action that the board wrongfully refused, or alleged facts sufficient to show that a demand would have been futile. *See Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004). To demonstrate that a demand would have been futile, a stockholder must allege particularized facts that meet the heightened pleading standard required under Delaware law. Under Rule 23.1, "[v]ague or conclusory allegations do not suffice to challenge the presumption of a director's capacity to consider a demand." *In re INFOUSA, Inc. S'holders Litig.*, 953 A.2d 963, 985 (Del. Ch. 2007).

The trial court correctly applied the standard for assessing demand futility adopted in *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), which governs where, as here, the stockholder does not challenge an affirmative business decision

made by the board collectively.[4] As the Vice Chancellor held, the "*Rales* test may be satisfied by showing that the plaintiffs' claims pose a serious threat to a majority of the board 'so egregious on its face' that the board could not have exercised its business judgment in responding to a demand to pursue those claims." A499; *see also Rales*, 634 A.2d at 934. Plaintiffs' allegations were woefully insufficient.

In their Complaint, Plaintiffs assert that demand was excused because the Director Defendants face a substantial likelihood of liability for failing to exercise sufficient oversight over the Company's operations that would have *prevented* the Dan River spill, the environmental lawsuits, the criminal investigation, and resulting settlement. A062 ¶ 50 (accusing the Individual Defendants of failing "to instill adequate internal controls to prevent the wrongdoing detailed herein"). The Court of Chancery correctly found that this is a classic claim governed by *In re Caremark Int'l Inc. Derivative Litig.* 698 A.2d 959,

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[4] The result would be the same even if the Court were to find that Plaintiffs were challenging an affirmative decision by the Board and applied the *Aronson* test for demand futility. Under *Aronson*, the complaint must allege with particularity facts sufficient to create a reasonable doubt that either "(1) the directors [who made the decision] are disinterested or independent" or "(2) the challenged transaction was otherwise the product of a valid exercise of business judgment." 473 A.2d at 814.

967-68 (Del. Ch. 1996) and its progeny. *See* A500 ("The Plaintiffs' allegations here amount to a *Caremark* claim[.]").

Under *Caremark*, oversight liability exists only where: "(a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of the risks or problems requiring their attention." *Stone*, 911 A.2d at 370 (emphasis in original); *accord In re General Motors*, 2015 WL 3958724, at *14 (Del. Ch. June 26, 2015), *aff'd*, 133 A.3d 971 (Del. 2016) (citing *Stone*). As the trial court properly observed, "[f]or liability to attach to the directors for their alleged failure of oversight here, a demonstration of bad faith by the board of directors is a necessary element. To show bad faith, 'the plaintiffs must plead particularized facts that demonstrate that the directors acted with scienter; *i.e.*, there was an 'intentional dereliction of duty' or a 'conscious disregard' for their responsibilities amounting to bad faith.'" A501; *see also Stone*, 911 A.2d at 370 ("In either case, imposition of liability requires a showing that the directors *knew* that they were not discharging their fiduciary obligations." (emphasis added)). The bar is indisputably high. As the Vice Chancellor recognized, a *Caremark* claim "'is possibly the most difficult theory in corporate law upon which a plaintiff might

hope to win a judgment.'" A501 (citing *Caremark*, 698 A.2d at 967-68 (Del. Ch. 1996)). Plaintiffs' allegations fell far short of this stringent standard.

Caremark applies to cases where plaintiffs allege oversight failures due to inadequate controls, as well as to cases where "plaintiffs argue that defendants are liable for damages that arise from a failure to properly monitor or oversee employee misconduct ***or violations of law***.'" *Melbourne Mun. Firefighters Pension Trust Fund v. Jacobs* ("*Qualcomm*"), 2016 WL 4076369, at *7 (Del. Ch. Aug. 1, 2016), *aff'd*, 2017 WL 836928 (Del. Mar. 3, 2017) (emphasis added) (citing *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 123 (Del. Ch. 2009)). The trial court determined that this case fell into the second category, because, according to Plaintiffs, the Director Defendants knew of violations of law by Duke Energy but took no action to remedy them. *See* A502.

In these circumstances, the standard that Plaintiffs must meet is exacting. To show that the Director Defendants face a "substantial likelihood" of personal liability, Plaintiffs must demonstrate more than a mere threat of liability—the threat must be "substantial," *see Gen. Motors*, 2015 WL 3958724, at *13, and Plaintiffs' contention must be supported by particularized facts. *Rales*, 634 A.2d at 934. Critically, Plaintiffs must also overcome the additional hurdle of showing that the Director Defendants face a substantial likelihood of liability for

bad faith conduct, because Duke Energy's charter contains a provision under 8 *Del. C.* § 102(b)(7), exculpating the Director Defendants from personal liability for monetary damages unless they failed to act in good faith and in the best interests of the company. *See In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 647-48 (Del. Ch. 2008) (finding that the plaintiffs must plead a non-exculpated claim that the defendants breached their duty of loyalty because the company's charter contained a Section 102(b)(7) provision). "Where directors are exculpated from liability except for claims based on . . . 'bad faith' conduct, a plaintiff must also plead particularized facts that demonstrate that the directors acted with scienter, *i.e.*, that they had 'actual or constructive knowledge' that their conduct was legally improper." *In re Citigroup Inc. Shareholder Derivative Litig.*, 964 A.2d 106, 125 (Del. Ch. 2009) (quoting *Wood*, 953 A.2d at 141); *see* 8 *Del. C.* § 102(b)(7). The Court of Chancery correctly held that Plaintiffs' allegations did not satisfy this requirement because they "do not raise a reasonable inference of a substantial likelihood that the directors face liability for bad faith." A507.

Although Plaintiffs are entitled to *reasonable* inferences that *logically* flow from any *particularized facts* alleged in the Complaint (*see Brehm v. Eisner*, 746 A.2d at 255), they are not entitled to any conceivable inference that can be conjured up through baseless speculation. "[C]onclusory allegations are not

considered as expressly pleaded facts or factual inferences." *Id.* "Because of the requirement in Rule 23.1 that allegations be pled with particularity, '[v]ague or conclusory allegations do not suffice,' and this Court 'need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences.'" *Ironworkers Dist. Council of Phila. & Vicinity Ret. & Pension Plan v. Andreotti*, 2015 WL 2270673, at *25 (Del. Ch. 2015), *aff'd* 132 A.3d 748 (Del. 2016) (citation omitted); *see also Wood*, 953 A.2d at 140 ("[I]nferences that are not objectively reasonable cannot be drawn in the plaintiff's favor.").

As the trial court recognized, and as explained below, Plaintiffs rely exclusively on conclusory allegations and unreasonable and baseless inferences—precisely the kind of unparticularized "spin" that Delaware precedents uniformly have held insufficient to satisfy the strict pleading requirements of Rule 23.1.

2. The Allegations Of The Complaint Do Not, As A Matter Of Law, Allow A Reasonable Inference That The Director Defendants Face A Substantial Likelihood Of Liability Under Caremark.

Plaintiffs jumble together a number of characterizations that fundamentally reduce to two main arguments. First, they claim that the Director Defendants were aware that Duke Energy was violating environmental law and

took no action—a course of conduct that allegedly resulted in the Dan River spill and associated liabilities. OB at 10-13. Second, they assert that the Director Defendants condoned a strategy of "collusion" with DEQ, the Company's allegedly captive regulator. *Id.* at 13-19. Both arguments are built on surmise and unreasonable inferences and therefore cannot excuse Plaintiffs' calculation to forego a demand. Fundamentally, Plaintiffs base their entire case on the theory that Duke Energy was "colluding" with a "corrupt" DEQ. A502-03; *see also* A409. Without a single particularized fact to support that position, the Court properly refused to accept such an extraordinary contention.

a. Plaintiffs Failed To Plead Particularized Facts Demonstrating That The Director Defendants Were Aware That Duke Energy Had Violated Environmental Laws.

In this Court, as they did below, Plaintiffs distort the record to advance their unfounded contention that the Director Defendants knew that Duke Energy was violating environmental law and failed to prevent the Dan River spill. OB at 11-13. However, Plaintiffs failed to plead actual facts with sufficient particularity to allow any such reasonable inference.

Plaintiffs' brief asks this Court, to convert negligence by unnamed employees of Duke Energy and its subsidiaries to knowledge of that wrongdoing

on the part of the Director Defendants. For example, Plaintiffs conclusorily assert that "*Duke executives* were well aware that illegal seeps, including deliberately engineered, were occurring at many of its ash ponds" (OB at 10), that "*the Company* was well aware that its coal ash management practices violated environmental laws" (*id.* at 12), and that "*the Company* has acknowledged that it was aware of the seeps" (*id.* (emphasis added throughout)). This is insufficient to meet their burden. Conclusory allegations of "knowledge" on the part of "Duke executives" and "the Company" cannot—without particularized factual allegations—provide a basis to impute that knowledge to the individual directors.[5]

The trial court closely examined the Board materials upon which Plaintiffs rely, and properly determined that they do not support an inference that the Director Defendants knew of any violations of law or illegal conduct. *See* OB at 30-31; *Gen. Motors*, 2015 WL 3958724, at *5 n.33 (noting that courts "need not accept [Plaintiffs'] characterization of a document that is clearly contrary to the face of the document"). On the contrary, these materials gave the Board extensive

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[5] *See In re Lear Corp.*, 967 A.2d at 653 (noting "the reality that even the most diligent board cannot guarantee that an entire organization will always comply with the law"); *Stone*, 911 A.2d at 373 ("[D]irectors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both.").

information about the Company's ongoing efforts to address the coal ash-related environmental issues. For example, [redacted] A267-69.[7]

Plaintiffs do not plead, with particularity or otherwise, that any director knew that any of the matters reported to it constituted violations of law, or

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6 [redacted] A221.

7 Plaintiffs also rely heavily on their leap of logic that the Director Defendants must have known that the Company was engaged in illegal activity because [redacted] OB at 31 (emphasis in original). However, as discussed more fully in Section I.C.3 *infra*, this argument is Plaintiffs' conclusion, without any basis in the facts alleged in the Complaint.

that Duke Energy lacked any required permits. OB at 22-23. Instead, Plaintiffs merely declare that "[t]he Company's failure to comply with the law allowed it to avoid a more stringent inspection regime that would have been required under a stormwater permit, which would likely have resulted in discovery of the corroded pipes that gave rise to the Dan River spill." OB at 23. But Plaintiffs' allegations that "Duke's director of environmental and legislative affairs, met with DEQ officials" regarding stormwater permits and that DEQ personnel "were told to wait until a supervisor could discuss [issuing permits] with the *Company*"—even if stacked one atop the other—cannot generate a reasonable inference that the Board knew of or condoned non-compliance with stormwater permit requirements. *Id.* at 22-23 (emphasis added).

Plaintiffs make a similar impermissible leap of logic when arguing that the fact that Duke Energy subsidiaries pled guilty to misdemeanors demonstrates that the Director Defendants knew of the Company's illegal operational activity. This is a non sequitur: the subsidiaries' guilty pleas and accompanying Joint Factual Statement do not permit a reasonable inference that the Director Defendants actually knew of the underlying illegal conduct by Company employees. The particularized factual allegations that are required to bridge that gap are missing. The Joint Factual Statement does not state, or even

imply, that the Director Defendants knew of the subsidiaries' wrongdoing. *See* A148-206. Moreover, the misdemeanor violations to which the subsidiaries pled guilty were negligence-based (A522-23), and thus provide no foundation for an inference that the Director Defendants were involved in or even knew of the violations. There is no basis to infer from the Complaint that the Director Defendants had actual knowledge of lower-level wrongdoing such that they could face a substantial likelihood of personal liability.

Rather than plead particularized facts as Rule 23.1 requires, Plaintiffs resort to rhetoric, arguing that, because the subsidiaries pled guilty, the Director Defendants *must* have known about the wrongdoing. But cloaking the argument in different words does not make it any better. The argument is insufficient on its face to meet the requisite pleading standard.[8] "Delaware courts routinely reject the conclusory allegation that because illegal behavior occurred, internal controls must

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[8] Relying upon the August 28, 2014 letter from DEQ's Deputy Secretary & Energy Policy Advisor (*see, e.g.*, A072-73 ¶ 72), Plaintiffs stress that the letter demonstrates that "Duke" was aware that it was violating environmental laws. OB at 11 n.6. However, to demonstrate that the Director Defendants faced a substantial likelihood of liability, Plaintiffs must plead with particularity that *the directors* themselves knew of such violations. It is not enough to assert that "Duke" was aware. Nothing in the letter supports an inference that the Director Defendants were aware of any violations prior to the Dan River spill. A801.

have been deficient, and the board must have known so." *Horman v. Abney*, 2017 WL 242571, at *7 (Del. Ch. 2017). Instead, the Complaint must "plead with particularity a sufficient connection between the corporate trauma and the board." *Id.* Plaintiffs have not done that.

Indeed, Plaintiffs concede that the Director Defendants were unaware of the circumstances that led to the Dan River spill. *See* OB at 22. Despite that, they vaguely assert that, "there is ***reason to believe*** that the failure to properly inspect the stormwater pipes was the product of a high-level decision within the Company." *Id.* (emphasis added). This speculation disguised as argument pervades Plaintiffs' pleading and underscores why Plaintiffs have not met the pleading standard required to withstand a Rule 23.1 motion to dismiss.

b. Plaintiffs Failed To Plead Particularized Facts That Allow The Inference That The Director Defendants Consciously Disregarded Red Flags.

The trial court held correctly that Plaintiffs failed to sufficiently plead their *Caremark* claim. On appeal, Plaintiffs persist in arguing that the factual allegations in this case are more compelling than those in *Louisiana Municipal Police Employees' Retirement System v. Pyott*, 46 A.3d 313 (Del. Ch. 2012) ("*Pyott*"), *rev'd sub nom on other grounds*, *Pyott v. Louisiana Municipal Police*

Employees' Retirement System, 74 A.3d 612 (Del. 2013), and *In re Massey Energy Co.*, 2011 WL 2176479 (Del. Ch. May 31, 2011). To the contrary, these decisions illustrate the significant differences from this case and demonstrate that the court below properly rejected Plaintiffs' contention.

Pyott involved red flags signaling employee illegal conduct that were materially more prominent and serious than the purported "flags" Plaintiffs concoct here. In *Pyott*, Allergan's general counsel advised the board that the company had likely engaged in illegal off-label marketing. 46 A.3d at 320. Although the board was told that the FDA was investigating off-label marketing by a physician, the Allergan directors did nothing to stop the practice for years. *Id.* at 354-55. Later, the Allergan board approved a business plan that expressly detailed marketing Botox for off-label uses—illegal under FDA regulations. That board also closely monitored sales numbers that showed dramatic growth in sales for off-label uses. *Id.* at 356. Vice Chancellor Laster held that the plaintiffs had adequately pled a *Caremark* claim, and that the Allergan directors "understood the difference between legal off-label sales and illegal off-label marketing" yet "continued to approve and oversee business plans that depended on illegal activity." *Id.* at 355-57. By contrast, Plaintiffs here have utterly failed to plead

particularized allegations indicating that the Director Defendants *actually* caused, let alone *knowingly caused*, Duke Energy to violate the CWA.

Equally misplaced is Plaintiffs' reliance on *Massey*. OB at 39. *Massey* is not a Rule 23.1 case. Instead, the shareholders there, who had pending derivative claims against the company, sought to enjoin a merger between Massey and another company. In reviewing the preliminary injunction motion, the Court of Chancery considered the allegations pled by the shareholders in their derivative action. The court noted the allegations that the CEO dominated the Board and "believ[ed] [that] he knew better about how to run mines safely than the" mining regulator did, and publicly described that the idea that the regulators knew more about mine safety than he did as "silly." 2011 WL 2176479, at *19. Further, the plaintiffs had pled a well-documented pattern of noncompliance with safety regulations, culminating in a 2006 accident that caused the death of two miners and led to guilty pleas being entered on one felony count of willful violation of mandatory safety standards resulting in death, eight counts of willful violation of mandatory safety standards, and one count of making a false statement. *Id.* at *6. Given those pled facts, then-Vice Chancellor Strine found that the plaintiffs had adequately alleged that, "the independent directors of the Massey Board did not make a good faith effort to ensure that Massey complied with its legal obligations"

and therefore faced a substantial likelihood of liability rendering any demand futile. *Id.* at *19. Nothing alleged here comes close to the extraordinary facts pled in *Massey.*

The decision in *Qualcomm* dismissing stockholder derivative claims, recently affirmed by this Court, is far more apt. In *Qualcomm*, the Company was subject to several regulatory actions and antitrust lawsuits that resulted in large fines and settlements totaling over $2 billion. 2016 WL 4076369, at *3-5. The *Qualcomm* plaintiffs alleged that the defendants acted in bad faith by consciously disregarding their oversight duty to ensure that the company complied with antitrust laws. *Id.* at *9-10.

The *Qualcomm* plaintiffs argued that the defendants faced a substantial likelihood of liability because they were aware of Qualcomm's antitrust violations. Specifically, materials provided to the directors "explicitly considered the past and potential future regulatory actions" and allegedly amounted to red flags that should have "put the Board on notice as to misconduct at Qualcomm, triggering the Board's obligation to take actions in good faith to avoid further misconduct." *Id.* at *11. The *Qualcomm* plaintiffs also argued that various SEC filings demonstrated board knowledge, because those filings disclosed the various

regulatory actions and settlements and because those filings had been signed by a majority of the Qualcomm board. *Id.* at *8, 10.

The Court of Chancery dismissed the complaint, holding that the plaintiffs had not pled that the defendants acted in bad faith by failing to properly respond to alleged red flags. The trial court made clear that simply alleging that the board's response to red flags was insufficient does not support a conclusion of bad faith. *Id.* at *12. Here, Plaintiffs have likewise not pled that the Director Defendants acted with bad faith—there are no allegations in the Complaint that the Director Defendants "completely failed to act in response to [any] red flags." *Id.*

General Motors is likewise instructive. In *General Motors*, the Court of Chancery dismissed the plaintiffs' *Caremark* claim for similar pleading deficiencies. The plaintiffs alleged, "that the Board utterly failed to implement a reporting system which would have apprised them specifically of serious injuries and deaths resulting from safety defects" in ignition switches produced by GM. 2015 WL 3958724, at *11. As here, the plaintiffs claimed that this failure to oversee the company demonstrated bad faith. *Id.* at *12. The court concluded, however, that the complaint was deficient because plaintiffs had failed to allege a complete lack of a reporting system. *Id.* at *14-15. Instead, the plaintiffs alleged that the reporting system failed to transmit important information to the board,

including information about the ignition switch problem. *Id.* at *15. Moreover, the court emphasized the plaintiffs did not allege that the board knew of the reporting system's deficiencies, or that the board consciously remained uniformed, as the plaintiffs did not allege any red flags putting the directors on notice of problems with the reporting system. *Id.* at *16-17. Lastly, the allegations that GM had a corporate culture that "stood in the way of safety" were not adequately supported by documents from board and committee meetings. *Id.* at *10, *17.[9]

Here, as in *General Motors* and *Qualcomm,* Plaintiffs have failed to plead with the requisite particularity that the Director Defendants acted in bad faith by consciously disregarding their oversight duty to ensure that the Company complied with state and federal environmental laws. Accordingly, the Court of Chancery dismissal should be affirmed.

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[9] The court rejected the plaintiffs' attempt to "conflate concededly *bad outcomes* from the point of view of the Company with *bad faith* on the part of the Board," noting that the plaintiffs' lawsuit was not about holding GM liable to those who were ultimately injured, but rather about "hold[ing] the directors *personally liable* to GM *itself* for breaches of their fiduciary duties in bad faith." *Id.* at *11 (emphasis in original). Plaintiffs' efforts here to improperly conflate bad outcomes with directorial bad faith should be similarly rejected.

3. Plaintiffs' Allegations Do Not Permit A Reasonable Inference That The Director Defendants Colluded With DEQ.

Plaintiffs continue to stake their claim on the entirely unsupported contention that the Director Defendants endorsed a strategy of improper collusion with DEQ. The Court of Chancery properly rejected this claim because the Complaint falls far short of pleading the required particularized factual support for such a claim. The Court of Chancery did not hold Plaintiffs to an "impossible burden of proof," as Plaintiffs argue (OB at 24), but the trial court properly applied the heightened standard under Rule 23.1 to the claim that Plaintiffs chose to plead and then defend. Plaintiffs could not meet that standard.

As the Court of Chancery found, Plaintiffs "allege a unique theory and conceded in oral arguments that this theory was critical to the success of their case." A502-03; *see also* A409. Plaintiffs argued that DEQ was a "rogue agency" that was "captive to Duke Energy" and that the Director Defendants knew of this fact and condoned a strategy of colluding with DEQ. *See* A503; OB at 24. This theory, the trial court properly found, was "at once creative and unsustainable on the facts pled" (A503), and the court correctly held that the "complaint fails to plead specific facts from which I can infer that DEQ was corrupt or that the board

knew of the company's collusion in any corruption." A503-04. This Court should affirm that conclusion.

a. Nothing In The Record Permits A Reasonable Inference That DEQ Behaved Corruptly.

The Court of Chancery properly held that Plaintiffs had not pled sufficient particularized facts to reasonably infer that DEQ was acting corruptly. *See* A504-08. The only factual basis offered to support this "unique theory" consisted of a single allegation: that former North Carolina Governor Pat McCrory ("McCrory") had worked at Duke Energy for 28 years and that Duke Energy and its employees donated a total of $1.1 million to McCrory's 2012 campaign. Plaintiffs imply that those connections with the Company predisposed Governor McCrory to appoint administrators who, in turn, would avoid (if not outright oppose) stringent regulation of Duke Energy. *See* OB at 14-15. In an effort to show that this supposedly corrupt behavior led to a cultural shift at DEQ, Plaintiffs cite a letter from the McCrory-appointed head of DEQ to a Raleigh newspaper, stating that DEQ would begin treating the private sector as "partners" and "customers." *Id.* at 15.[10] This theory fails from the outset on the fact—recognized

[10] Plaintiffs also rely on emails obtained by the New York Times, stating that DEQ staffers were "'hesitant to crack down on polluters who might (Continued . . .)

by the trial court (A504), and admitted by Plaintiffs (OB at 14)—that the conduct that Plaintiffs characterize as "corrupt" predated the McCrory Administration.

Again, the pled facts are insufficient to allow the Court to draw a *reasonable* inference that DEQ was a captive regulator acting in a corrupt manner. It is well established that conclusory allegations, such as these, "are not considered as expressly pleaded facts or factual inferences." *Horman*, 2017 WL 242571, at *12. "Even reasonable inferences 'must logically flow from particularized facts alleged by the plaintiff[.]'" *Id.* (quoting *Wood*, 953 A.2d at 140). Here, rather than lead to a reasonable inference that DEQ was a captive regulator, Plaintiffs' allegations require an unsupported leap of logic.

Plaintiffs rely heavily on *Yadkin Riverkeeper, Inc. v. Duke Energy Carolinas, LLC*, 141 F. Supp. 3d 428 (M.D.N.C. 2015), to support their contention that DEQ was a "corrupt" regulator (*see* OB at 34-37), but they distort the court's findings in that case. The North Carolina court did not in any respect hold, nor did it imply, that DEQ was a corrupt or captive regulator. In *Yadkin*, an environmental

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(. . . continued)

complain'" to McCrory's administrators. OB at 15. Even if these articles could arguably be said to indicate a culture and attitude toward environmental regulation that is more lenient than what Plaintiffs would prefer, they do not permit a reasonable inference that DEQ was enforcing the law improperly, let alone corruptly.

group brought a citizen enforcement action against Duke Energy Carolinas, a subsidiary of Duke Energy seeking to enforce permit requirements and CWA violations that "[DEQ]'s Complaint [did] not seek to enforce." 141 F. Supp. 3d at 434, 436. To have standing to bring the suit, the *Yadkin* plaintiff was required to establish that its suit was not barred under the "diligent prosecution" standard, which "prohibits citizens from filing suits when the EPA or state 'has commenced and is diligently prosecuting' a judicial action" to enforce the relevant provisions.[11] *Id.* at 439. Judge Biggs found that, in the case before him, DEQ's action had not progressed significantly enough to warrant application of the diligent prosecution bar. *Id.* at 442. Judge Biggs did not find that DEQ was acting "corruptly" or that it had been "colluding" with Duke Energy Carolinas. Nothing in *Yadkin* supports Plaintiffs' assertion that Duke Energy asked DEQ to avoid diligent prosecution of their case, that DEQ was a corrupt regulator with which Duke Energy Carolinas' parent company was colluding, or, most relevant here, that the Director Defendants

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[11] "Diligent prosecution" is a term of art that refers to a defense available to defendants in citizen enforcement suits under the CWA. *See Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found., Inc.*, 484 U.S. 49, 60 (1987) (noting that "bar on citizen suits when governmental enforcement action is under way suggests that the citizen suit is meant to supplement rather than to supplant governmental action[.]").

had any knowledge of such improper conduct in the highly unlikely event that it did, in fact, occur.

b. Nothing In The Record Allows A Reasonable Inference That The Director Defendants Were Aware Of Any Strategy To Collude With DEQ.

The record amply supports the trial court's conclusion that Plaintiffs' allegations were "insufficient to draw a reasonable inference that DEQ was corrupt and, if so, that the board knew of any corruption and allowed the company to exploit such corruption in bad faith." A507. In opposing the Director Defendants' motion to dismiss, Plaintiffs themselves conceded that they did not plead a "'smoking gun confession'" of collusion with DEQ (*see* A333), yet they urge the Court to draw conclusions that resemble unfounded conspiracy theories rather than reasonable inferences. *See Brehm*, 746 A.2d at 255.

First, Plaintiffs maintain that "Duke's lawyers had contacted DEQ after receiving the NOI letters to seek an agreement concerning the subject of the planned citizen suits." OB at 15. But trying to resolve matters with a regulator rather than facing the cost, distraction, and adverse publicity of litigating with an environmental group is a prudent and common course that is in no way improper or unlawful. Moreover, Plaintiffs provide no factual basis from which to infer that that contact in this case was improper or unlawful or amounted to collusion to

violate applicable environmental law. Instead, Plaintiffs repeatedly speculate that Duke Energy asked DEQ to "preempt" the citizen suits (*see* OB at 15, 16, 35)—yet another supposition. Even if any such request occurred (and there is no factual basis for that assumption), it is not improper for a company to seek a negotiated resolution with its regulator, and Plaintiffs plead no particularized factual basis to infer that there was any impropriety, much less one of which the Director Defendants were aware.

Plaintiffs also cherry-pick excerpts from Board materials to cobble a theory that the Director Defendants were aware of collusion. But the court below held that these materials are utterly "insufficient" to allow any such inference. *See* A507; *Gen. Motors*, 2015 WL 3958724, at *5 n.33 (noting that courts "need not accept [Plaintiffs'] characterization of a document that is clearly contrary to the face of the document").

[redacted]

Nor do these presentations support Plaintiffs' conclusory assertion that "Duke management looked to its captive regulator, DEQ, to facilitate [its] strategy" to avoid remediating its ash ponds. OB at 14. To assert this fiction, Plaintiffs must contort the Board materials beyond any natural or common sense interpretation. For example, [redacted]

[redacted] OB at 16. [redacted] OB at 38 (emphasis added). By what principle of common sense or logic can one infer that a company that wishes to maintain control of its operations is thereby unwilling to follow the law?

As further supposed evidence of collusion, Plaintiffs condemn the "minimal nature" of Duke Energy's proposed settlement with DEQ (OB at 17), but ignore the fact that the consent decrees would also have required the Company to formulate a compliance schedule to be delineated. *Id.* at 19. That is, in addition to the civil penalties, the Company would be required to meet certain to-be-determined compliance tasks. A270; *see also* A271 (noting, among other things, that the decrees would require "[i]dentifying and characterizing seeps," "[g]roundwater studies," and "[r]erouting flows or treatment"). [redacted]

[redacted] OB at 18. Even so, Plaintiffs provide no link between this logical objective and their accusations of collusion, corruption, or bad faith either in the lower court or on this appeal. Nor did Plaintiffs plead any fact that allows a reasonable inference that the Director Defendants knew that the consent decree was a "sham." OB at 38.

Plaintiffs' theory, at bottom, is that the Director Defendants should have objected to Duke Energy employees working with DEQ to resolve regulatory issues, although this is a completely noncontroversial, and in fact desirable, course of action. They imply that the Director Defendants should have concluded that DEQ was not sufficiently punishing the Company for environmental violations. As Vice Chancellor Glasscock sensibly observed during oral argument on the motion to dismiss, "it is hard to imagine even the most environmentally zealous corporate board saying, '[n]o. We prefer to be sued by the environmentalists rather than regulated[.]'" *See* A382-83. Further, it is difficult to imagine how such a course of action would be consistent with the Director Defendants' fiduciary duties or how these Plaintiffs, as would-be stewards of the Company's interests, legitimately can advocate such a choice.

[redacted] OB at 38. As the Court of Chancery aptly concluded, the most reasonable reading is that the quotation marks indicated a "term of art" (A506-07), rather than a "wink and a nod" to the Director Defendants, as Plaintiffs assert (OB at 38). Plaintiffs argue that the court did not have a basis for discounting the "significance of the quotation marks," but Plaintiffs' interpretation lacks support in the record, and the trial court correctly declined to draw that *un*reasonable inference.

4. The Record Does Not Support An Inference That The Director Defendants Proximately Caused Duke's Guilty Plea Or Civil Fines.

Finally, Plaintiffs argue that the Director Defendants "proximately caused" the corporate harms that they allege Duke Energy suffered, namely: "(i) the payment of a $102 million fine as part of the Company's guilty plea to the federal criminal indictment; (ii) the expenditure of more than $24 million in repairs and remediation associated with the catastrophic Dan River coal ash spill; (iii) the assessment of nearly $12 million in fines and penalties to state and municipal entities in North Carolina and Virginia arising from the Dan River spill; (iv) a $7 million fine imposed by DEQ related to groundwater contamination at the

Company's L.V. Sutton Facility; and (v) protracted enforcement litigation with DEQ and related citizens' environmental lawsuits." OB at 40-41.

The trial court correctly rejected this assertion because Plaintiffs' allegations "do not raise a reasonable inference of a substantial likelihood that the directors face a liability for bad faith." A507. Plaintiffs have failed to "provide[] a sufficient nexus between the Board's breach of its duty of loyalty and the harm the Company has sustained." OB at 42. Instead, Plaintiffs rely on conclusory and unsupported allegations, which the trial court properly rejected, that the Director Defendants allowed the Company to operate its coal ash ponds without permits and to collude with the state regulator to avoid compliance with environmental laws. Not only do these allegations fail to raise a reasonable inference of director bad faith, they simply do not provide a causal link between the Director Defendants' actions and corporate harm. Absent allegations creating a reasonable inference that the Director Defendants acted in bad faith, this Court need not to reach the issue of proximate causation.

CONCLUSION

For the foregoing reasons, the Court of Chancery's dismissal of the Complaint pursuant to Rule 23.1 should be affirmed.

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