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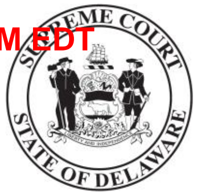

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DELAWARE COUNTY EMPLOYEES' RETIREMENT FUND and CITY OF STERLING HEIGHTS GENERAL EMPLOYEES' RETIREMENT SYSTEM, derivatively and on behalf of SIMON PROPERTY GROUP, INC.,	:	No. 199, 2015
Plaintiffs Below, Appellants,	:	
v.	:	APPEAL FROM THE OPINION AND ORDER DATED MARCH 27, 2015 OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN C.A. No. 10249-VCL
MELVYN E. BERGSTEIN, LARRY C. GLASSCOCK, KAREN N. HORN, ALLAN HUBBARD, REUBEN S. LEIBOWITZ, DANIEL C. SMITH, J. ALBERT SMITH, JR., HERBERT SIMON, DAVID SIMON, and RICHARD S. SOKOLOV,	:	
Defendants Below, Appellees,	:	
and	:	
SIMON PROPERTY GROUP, INC.,	:	
Nominal Defendant Below, Appellee.	:	

APPELLANTS' AMENDED REPLY BRIEF

COUNSEL LISTED ON FOLLOWING PAGE

Dated: July 23, 2015

Respectfully submitted,

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FORM OF CITATIONS

Citations in the form “A[_]” are to the Appendix to Appellants’ Opening Brief and page number.

Citations in the form “AB [_]” are to Individual Appellees’ Answering Brief and page number.

Citations in the form “B[_]” are to the Appendix to Individual Appellees’ Answering Brief and page number.

Citations in the form “OB [_] ” are to Appellants’ Opening Brief and page number.

ARGUMENT

I. DEFENDANTS' ANSWERING BRIEF CONCEDES THAT MATERIAL FACTUAL DISPUTES EXIST

Defendants' Answering Brief cites the Affidavit of Steven K. Broadwater, which was submitted in the Original Action, for the proposition that the Committee exhibited good faith modifying the Original Award. AB 8-9, B454-59. But that affidavit was not introduced into the record below, referenced in the Complaint, or subjected to discovery. In fact, Mr. Broadwater's testimony is contested.[1] By introducing contested non-record facts into this argument, Defendants concede that material facts are disputed, thus admitting that their motion to dismiss was improperly granted.[2] For this reason alone, the judgment below should be reversed, or because this Court does not "consider any materials contained in [a] brief that are beyond the scope of the record on appeal," the affidavit should be stricken. *Viola v. Viola*, 53 A.3d 303, 303 n.2 (Del. 2012)(TABLE).

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[1] Mr. Broadwater's affidavit is intended to convey that it was less expensive to amend the Original Award than to cancel it and issue a new one. But this rests on the unsupported assumption that the new award would need to have the same number of LTIP units as the Original Award. If the Board had wanted to keep the amount of the award constant notwithstanding the increased share price, it could have issued fewer units.

[2] *Mann v. Oppenheimer & Co.*, 517 A.2d 1056, 1060 (Del. 1986) (determining that motion to dismiss was improperly granted because non-moving party should have been afforded discovery when defendants relied on evidence outside the four corners of the complaint in support of their motion to dismiss and the court treated the motion as one for summary judgment); *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 860 A.2d 312, 320 (Del. 2004) (holding that trial court "could not properly consider [extraneous] materials, under judicial notice principles, to resolve conflicting factual inferences on a [ ] motion to dismiss"); *White v. Panic*, 783 A.2d 543, 548 n.5 (Del. 2001) ("the court may not employ assertions in documents outside the complaint to decide issues of fact against the plaintiff without the benefit of an appropriate factual record.").

II. THE *ARONSON* STANDARD APPLIES

Defendants do not dispute Plaintiffs' specific factual allegations demonstrating that at least seven of SPG's ten directors actively participated in the decision to grant the Amended Award. Instead, Defendants argue that *Rales* must apply because only four of the directors actually voted. AB 15-18. But *Rales* applies where the subject of a derivative suit is not a business decision of the board "out of a concern that demand upon a board should not be excused when a board did not have the opportunity to consider a corporate action." *Ryan v. Gifford*, 918 A.2d 341, 353 n.29 (Del. Ch. 2007), citing *Rales v. Blasband*, 634 A.2d 927, 934 n.9 (Del. 1993) ("Demand 'permits the board to have an opportunity to take action where it has not previously considered doing so.'"). This concern is not present here, where six out of ten directors participated in the deliberative process that led to the Amended Award and five formally approved the Amended Award. Whether A. Smith and Glasscock "observed" the Compensation Committee meetings and did not have the authority to vote on the Amended Award is legally irrelevant. It is because A. Smith and Glasscock participated in the Compensation Committee's decision to grant the Amended Award (A18-19, 38-41, 162-165), and "chose to *participate* in certain Compensation Committee meetings" (A119)[3] that causes

[3] Not only does this acknowledgement negate Defendants' citation to *Highland Legacy Ltd. v. Singer*, 2006 WL 741939 (Del. Ch. Mar. 17, 2006), and *Citron v. E.I. du Pont de Nemours & Co.,* 584 A.2d 490 (Del. Ch. 1990), but neither of these cases involved a Court's determination that a director's participation in a process was insufficient to trigger the *Aronson* analysis

Arsonson to be the proper standard.[4] Although Defendants now want to claim that A. Smith and Glasscock were mere wallflowers, that is a question that can only be answered after discovery, not at the motion to dismiss stage.

Similarly, without disputing that Simon was an active and essential participant in the approval of the Amended Award, they argue that his approval is irrelevant because he was a "contractual counterparty."[5] But this argument ignores Plaintiffs' specific allegations that the Amended Award was not the product of an adversarial negotiation between contractual parties, but was part of a *common and shared plan* to moot the underlying claims while ensuring Simon would receive everything he was promised in the illegal Original Award. A28-30, 34, 35, 43, 44.

Defendants also ignore the legal authority cited in Plaintiffs' Opening Brief

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because the director did not vote on the transaction in question. *See Highland Legacy*, 2006 WL 741939, at *8 (the defendant in question was not an officer or director of the company and plaintiff failed to provide any allegations that the defendant actively managed the company); *Citron,* 584 A.2d at 494, 499 n.12 (the director in question did not attend a single committee or board meeting where the merger was considered or approved).

[4] Similar participation to that here has been found sufficient to trigger a review of demand futility under *Aronson*. *See Halpert v. Zhang*, 966 F. Supp. 2d 406, 412-413 (D. Del. 2013). In *Halpert*, the plaintiff alleged that the board of AsiaInfo - Linkage, Inc. ("AsiaInfo") violated the company's stock incentive plan by exceeding the annual cap on option grants. *Id*. at 410. The stock option grants were approved by AsiaInfo's compensation committee, which consisted of four directors. *Id*. According to AsiaInfo's proxy statement, the Executive Co-Chairman also "participate[d] in the discussions and decisions" to award the options in question. *Id*. The Court in *Halpert* held that the Executive Co-Chairman counted "as a director who participated in making the challenged grants," and together with the compensation committee constituted a majority of the Board, making *Aronson* the proper analysis. *Id*. at 413.

[5] Defendants' reliance on *In re John Q. Hammons Hotels Inc. S'holder Litig*. 2011 WL 227634 (Del. Ch. Jan. 14, 2011), is misplaced. *Hammons* was a class action and, as such, the court did not consider whether an interested director's approval of a transaction implicated the *Aronson* or *Rales* standard. Moreover, the Court's ultimate ruling in *Hammons* occurred after a trial on the merits, not at the motion to dismiss stage.

demonstrating that Delaware law does not permit an analysis of demand futility with blinders. Rather, it is a fact specific inquiry and does not turn solely on the number of directors who voted to approve the challenged transaction. *See Katz v. Halperin*, 1996 WL 66006, at *8 (Del. Ch. Feb. 6, 1996) (applying *Aronson* after making a factual inquiry into which directors "participated in the decision making processes leading to the challenged transactions"). Limiting the determination of the applicable standard to a simplistic vote count serves only to elevate form over substance and allow a majority of a board, including conflicted directors, to participate in the "formulat[ion], negotat[ion] or facilitat[ion]" of a wrongful transaction, yet shield themselves from liability by not voting on the transaction. *In re Tri-Star Pictures, Inc., Litig.,* 1995 WL 106520, at *3 (Del. Ch. Mar. 9, 1995). At the motion to dismiss stage, the correct inquiry must be: taking plaintiffs' allegations, and the inferences drawn therefrom, as true, how many directors ***participated*** in the challenged decision?[6] Delaware courts cannot permit directors to manipulate the standard of review by choosing not to vote or by delegating to committees the voting power to approve decisions in which a majority of the directors have actually participated.

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[6] *In re Jefferies Grp. Inc. S'holders Litig.*, C.A. No. 8059-CB, Tr. at 76-78 (Del. Ch. Nov. 4, 2013) (TRANSCRIPT) (after taking plaintiffs' allegations, and all reasonable inferences therefrom, as true, the Court denied a motion to dismiss by directors who participated in a challenged transaction but recused themselves from the final vote); *Halpert*, 966 F. Supp. 2d at 412-413 (finding at the motion to dismiss stage that a director that did not vote on, but participated in, the issuance of challenged option grants counted for purposes of applying the *Aronson* standard).

III. PLAINTIFFS' DETAILED ALLEGATIONS RAISE A "REASONABLE DOUBT" AS TO WHETHER THE AMENDED AWARD WAS A VALID EXERCISE OF BUSINESS JUDGMENT

A. THE COMPLAINT ADEQUATELY ALLEGES FACTS RAISING A REASONABLE DOUBT AS TO WHETHER THE APPROVAL OF THE AMENDED AWARD SATISFIED THE DIRECTORS' DUTY OF LOYALTY

Plaintiffs' Opening Brief explained, based on specific factual allegations revealed through their 220 investigation, that in approving the Amended Award the Defendants subjugated the interests of the Company to their own interests in avoiding an adverse judgment in the Original Action and Simon's interest in getting everything he was promised in the illegal Original Award. OB 5-7; 8-11; A27-41. That constitutes a breach of the duty of loyalty and excuses demand under the second prong of *Aronson*. *See La. Mun. Police Emp. Ret. Sys. v. Fertitta*, 2009 WL 2263406, at *7-9 (Del. Ch. July 28, 2009).

Defendants' Answering Brief dismisses Plaintiffs' allegations in this regard, by arguing that Defendants did not face a "sufficient risk of personal liability" in the Original Action. AB 23. But whether Defendants' faced exposure to monetary liability in the Original Action sufficient to render them "interested" for purposes of *Rales* or the first prong of *Aronson* is a different inquiry from whether elevating their own interests and the interests of David Simon over the interests of the Company constitutes disloyal conduct. *See In re Southern Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 787 n.68 (Del. Ch 2011) ("The bottom line

requirement of loyalty is that a director act in the best interests of the company and its stockholders, ***rather than for any other reason***.") (emphasis added).

Here, Plaintiffs alleged that in adopting the Amended Award the Defendants made *absolutely no attempt* to evaluate whether the performance metrics adopted provided appropriate or adequate incentives to Simon, or to determine whether the cost of the Amended Award *at the time it was made* was a justified and reasonable expense for the Company. A29-37, 40, 45. In fact, Defendants admitted, and the Chancery Court credited, that they deliberately chose not to do so because they had determined, three years earlier, to grant a certain level of compensation to Simon at that time. OB Ex. A at 75-78, A112, B758. But Delaware law does not permit corporate directors to sit idle and choose not to exercise their business judgment when approving a new corporate act. Rather, a director's fiduciary obligation attaches to each decision he or she makes. OB 18. Plaintiffs alleged, based on particularized facts, that in approving the Amended Award Defendants deliberately failed to weigh the expense of that award, at the time it was made, against the benefits to the Company from the incentives to Simon provided under that agreement. Defendants do not dispute this, and instead claim that they had no obligation to do so. AB 27-28. They thus concede that the Amended Award was designed simply to moot the Original Action (and prevent an adverse judgment against them) and provide Simon with all of the benefits they had determined

(illegally) to grant him several years earlier, *without regard to the cost to the Company at the time the Amended Award was made*. This is more than sufficient to raise a reasonable doubt as to Defendants' compliance with their duty of loyalty.

B. THE COMPLAINT ADEQUATELY ALLEGES FACTS RAISING A REASONABLE DOUBT AS TO WHETHER THE APPROVAL OF THE AMENDED AWARD SATISFIED THE DIRECTORS' DUTY OF CARE

Defendants claim that the Committee was adequately informed (AB 24-28), touting that "[t]he Committee held five special meetings and consulted with Semler Brossy and legal counsel in setting the performance metrics for the Amended Award." AB 24. But as revealed through Plaintiffs' 220 investigation, a close examination of what happened (and did not happen) at these meetings gives rise to a reasonable doubt as to whether the Board exercised due care in approving the Amended Award, which is sufficient to excuse demand under *Aronson*'s second prong notwithstanding the Company's Section 102(b)(7) provision. Defendants assert that "Plaintiffs allege, at most, a breach of the duty of care." AB 25. That is enough to excuse demand under the second prong of *Aronson.*

The essence of a performance-based award is that it is supposed to align the interests of management and stockholders by setting benchmarks that will drive management to improve corporate performance.[7] If management does not need to

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[7] Simone M. Sepe, *Making Sense of Executive Compensation*, 36 Del. J. Corp. L. 189, 196 (2011) ("Well-designed pay arrangements should incentivize managers to further shareholder interests, or, in the jargon of economists, should induce more effort."); Michael B. Snyder, HR Series, 1 Compensation and Benefits, § 2.32.4 (July 2015) (goals in a performance-based

improve performance in order to earn the award, then it is salary, not an incentive. As the Company has conceded, its stock incentive plan ***does not permit*** SPG to make non-performance based grants of LTIP units. A26. Nonetheless, when the Board was amending the Original Award (purportedly to comply with this restriction), it made no effort to determine whether it was setting benchmarks that would actually require Simon to improve performance.

As detailed in the Complaint, conspicuously absent from any of the Committee's meetings was any analysis of what Simon would have to do – if anything – to meet the targets in the Amended Award. A40. Thus, when the Committee granted Simon the Amended Award – which is valued at over $150 million – it simply had no idea whether or not he would have to put in any extra effort to reap its rewards. A14; 40. In fact, he does not. A25-26; A40.

Where a board "violated an unambiguous provision of a stock plan, it is proper to infer that such violation was committed knowingly or intentionally, and therefore, that demand should be excused." *Pfeiffer v. Leedle*, 2013 WL 5988416, at *6 (Del. Ch. Nov. 8, 2013).[8] Similarly, where a board adopts an "incentive" award without even questioning whether that award can fulfill the key function that

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compensation plan "should be attainable provided employees make a real effort" and should "encourage employees to stretch to reach the target.").

[8] *See also Sanders v. Wang*, 1999 WL 1044880, at *11 (Del. Ch. Nov. 8, 1999) (holding that a board exceeds its authority, thereby excusing demand under the second prong of *Aronson*, when it adopts a share grant that violates the terms of a plan).

the stock incentive plan requires, the board has violated its duty of care.

Defendants have failed to rebut Plaintiffs' allegations regarding the duty of care, and indeed, mischaracterize those allegations. For example, Plaintiffs' duty of care claim is not solely "based on the lack of a Monte Carlo analysis estimating the amount by which the changes to the award would decrease the likelihood of Mr. Simon earning the award[.]" AB at 25. The claim is based on far more than that. Plaintiffs' Section 220 demand revealed that at the time the Committee gave Simon an award valued at approximately $150 million, it did not know, *inter alia*:

- The estimated cost of the Amended Award to the Company (A40);
- *Anything* about the *actual* performance metric used in the Amended Award -- so-called "Adjusted FFO";
- How the threshold and target Adjusted FFO levels they approved compared to SPG's most recent FFO results (A39);
- That the $8.86 target Adjusted FFO for 2015 was only 1 cent higher than SPG's 2013 FFO of $8.85 (A25; A40);
- That the lowest of the sixteen analyst estimates for FFO in 2015 was $9.50 (A25; A40);
- That a Monte Carlo analysis would demonstrate that Simon's likelihood of receiving all of the LTIP units granted under the Amended Award was between 94.7% and 96.8% (A26);
- That agreeing to Simon's request to utilize Adjusted FFO rather than unadjusted FFO increased the Amended Award's value to Simon by approximately $20 million (A36-37; 254; B722);
- That Simon could manipulate Adjusted FFO by using his position as CEO to implement corporate actions such as retiring debt early (A36; 158);

- The effect of using any performance metric other than FFO (A40); or
- How the Retroactive Bonus would incentivize Simon (A39).

Defendants try to paint the Board's deliberate ignorance as a dispute "with the selection of the performance metrics under the Amended Award … and the negotiated performance targets[.]" AB 26. This is wrong. Whatever compensation metrics and targets the Board chose, the Board was required to evaluate how those metrics and targets would affect Simon's performance and benefit the Company. The Complaint's allegations illustrate why the chosen metrics are detrimental to the Company and fail to actually incentivize Simon, but the fundamental failure (and the breach of the duty of care) was the Board's failure to analyze what, if anything, its metrics and benchmarks would achieve. A32-41.[9]

Defendants claim (based on unpled facts) that "[t]he Committee had previously determined that an award to David Simon of one million LTIP units was an appropriate level of compensation." AB 28. The Board was not entitled to use the non-performance-based Original Award as a baseline for a performance-based award without giving any consideration to how and if that baseline would

[9] The cases cited by Defendants on this point (AB 26) are inapposite because they both involved instances in which directors were alleged to have made the "wrong" decision, not instances in which (as here) directors failed to evaluate the corporation's interests when making a decision. *Cf. In re Goldman Sachs Grp., Inc. S'holder Litig.*, 2011 WL 4826104 at *14 (Del. Ch. Oct. 12, 2011) ("The Plaintiffs acknowledge that the compensation plan authorized by Goldman's board, which links compensation to revenue produced, was intended to align employee interests with those of the stockholders and incentivize the production of wealth."); and *Sutherland v. Sutherland*, 2010 WL 1838968, at *10 (Del. Ch. May 3, 2010) (discussing the corporate benefits that the directors expected to flow from the challenged transaction).

actually benefit the Company by improving performance. Defendants' statement that "Plaintiffs have never claimed that the Original Award was not made on an informed basis" (AB 28) is totally immaterial. Whatever the informational basis for the Original Award, three years earlier, the decision to grant the Amended Award was a new and different decision, requiring the Board to observe its fiduciary duty of care. *See also Dweck v. Nasser*, 2012 WL 161590, at *22 (Del. Ch. Jan. 18, 2012) ("[e]ach payment [of consulting fees] represented a discrete decision to perpetuate an unfair course of conduct" where fiduciary could have discontinued payments at any time); *accord Teachers' Ret. Sys. of La. v. Aidinoff*, 900 A.2d 654, 666 (Del. Ch. 2006); *see also Buerger v. Apfel*, 2012 WL 893163, at *3 (Del. Ch. Mar. 15, 2012) ("When fiduciaries have the power to terminate or modify an agreement, the decision to leave the agreement in place" can be challenged as a breach of duty).

Defendants' assertion that directors are afforded "great deference" in determining executive compensation and their claim that they were allowed to consider other interests (such as their desire to keep a promise to Simon) (AB 27-28) are irrelevant and improper, given the Board's acknowledged requirement to approve a ***performance-based*** compensation package. A15. The Board had no right to depart from its mandate to make performance-based awards and instead grant millions in compensation based on whatever criterion it saw as "appropriate."

"A board's knowing and intentional decision to exceed the shareholders' grant of express (but limited) authority raises doubt regarding whether such decision is a valid exercise of business judgment." *Ryan v. Gifford*, 918 A.2d at 354.

There is no requirement that Plaintiffs plead "deliberate wrongdoing by the directors," such as actual or constructive knowledge that their conduct was improper. AB 25. It is sufficient to plead that Defendants wholly failed to conduct the appropriate analysis. For example, in *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275 (Del. Ch. 2003), a case that the Court of Chancery recognized as factually similar (OB Ex. A at 77-78; *see also* OB at 20-21), the court held that demand was excused and that a ***non-exculpable*** breach had been pled where the "complaint suggests that the Disney directors failed to exercise ***any*** business judgment and failed to make ***any*** good faith attempt to fulfill their fiduciary duties" in approving an executive compensation agreement. *Id.* at 278 (emphasis in original); *see also In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 66 (Del. 2006) (failing to act in good faith is a non-exculpable breach).[10] The same analysis applies here. Approving a transaction valued at over $150 million without conducting any analysis of what the Company can be expected to receive in return adequately alleges conduct that is outside the bounds of good faith and therefore

[10] Defendants cite to *Disney*, 906 A.2d at 64-65 for the proposition that bad faith cannot be inferred from directors' alleged failure to adequately inform themselves (AB 25), but that decision was decided on summary judgment, not a motion to dismiss.

not exculpated by Section 102(b)(7).[11]

C. MONETARY LIABILITY IS NOT THE *SINE QUA NON* OF ARONSON'S SECOND PRONG SINCE, IF IT WERE, THE DUTY OF CARE WOULD BE UNENFORCEABLE IN DERIVATIVE LAWSUITS

Even if Plaintiffs' monetary due care claims were barred by the Company's exculpation provision (which they are not, due to the Board's failure to act in good faith), that provision is irrelevant to Plaintiffs' claims for non-monetary relief. Defendants' reliance on *MCG Capital Corp. v. Maginn*, 2010 WL 1782271 (Del. Ch. May 5, 2010), for the proposition that "a request for equitable relief does not subject defendants to the type of personal liability necessary to excuse demand" (OB at 30), is completely off the mark. The section of *MCG Capital* upon which Defendants rely (*21) was addressing financial independence under the *first prong* of *Aronson.* Much more relevant to the issue here was the Chancery Court's analysis just a few paragraphs earlier, where it held that specific allegations that the defendants did not conduct an adequate investigation before agreeing to pay an executive $750,000 based on an alleged agreement to do so some six years prior *was* sufficient to raise a reasonable doubt that the decision was entitled to deference under the business judgment rule, excusing demand under the *second*

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[11] Defendants' citation to *Wood v. Baum*, 953 A.2d 136 (Del. 2008) (AB 25) is inapposite because that case involved the interpretation of the Delaware Limited Liability Company Act, which allows LLCs to limit directors' exposure to liability to claims of "fraudulent or illegal conduct" or "bad faith violation[s] of the implied contractual covenant of good faith and fair dealing." *Id.* at 141. By contrast, in the corporation law context, this Court has recognized an "intermediate" standard for fiduciary violations, encompassing situations (such as this one) where the fiduciary fails to fulfill its obligation to act in good faith. *Disney*, 906 A.2d at 66-67.

prong of *Aronson.* 2010 WL 1782271 at *17-18 ("The board was duty bound to take steps to inform itself as to the terms of this transaction. If the board members who voted in favor of the transaction took no steps to inform themselves about the terms of the 2002 Bonus or the reason it was not paid when approved then the action was not a valid exercise of business judgment"). Defendants exhibited the same failings in approving the Amended Award here.

This Court has noted that Section 102(b)(7) charter provisions "***would not affect injunctive proceedings based on gross negligence***." *Malpiede v. Townson*, 780 A.2d 1075, 1095 (Del. 2001) (emphasis added).[12] Defendants' conclusory argument that claims for non-monetary relief cannot be considered for demand futility purposes must be wrong. AB at 22. If Defendants are right, then the duty of care cannot be enforced by stockholders derivatively. This would effectively render the duty of care directors owe to corporations a dead letter. If stockholders could not receive even non-monetary relief for breaches of the duty of care then

[12] *See also In re Cornerstone Therapeutics Inc., S'holder Litig.*, 2015 WL 2394045, at *6 n.32 (Del. May 14, 2015) (noting that Section 102(b)(7) may not have a case-dispositive effect in cases where equitable relief such as rescission is sought); E. Norman Veasey, Jesse A. Finkelstein and C. Stephen Bigler, *Delaware Supports Directors with a Three–Legged Stool of Limited Liability, Indemnification and Insurance*, 42 Bus. Law. 399, 403 (1987) ("[S]ection 102(b)(7) does not eliminate the duty of care that is properly imposed upon directors. Directors continue to be charged under Delaware law with a duty of care in the decision making process and in their oversight responsibilities. The duty of care continues to have vitality in remedial contexts as opposed to actions for personal monetary damages against directors as individuals. For example, it will continue to be vitally important in injunction and rescission cases[.]").

directors would be free to breach that duty willy-nilly, with the courthouse doors closed to the stockholders.

The Delaware courts have acknowledged that Section 102(b)(7) does not bar equitable relief. *See, e.g., London v. Tyrrell*, 2010 WL 877528, at *18 (Del. Ch. Mar. 11, 2010). The General Assembly's purpose in enacting Section 102(b)(7) was to free directors to take business risks without worrying that their personal wealth might be placed at risk in negligence actions,[13] and permitting claims for non-monetary relief to proceed is entirely consistent with that purpose. Holding that non-monetary claims based on the duty of care do not count for demand excusal purposes would deny stockholders any judicial review of transactions that admittedly do not qualify for business judgment protection, without furthering the legislative purpose. Furthermore, such a holding would be particularly anomalous because in direct class action litigation, it is well-recognized that, while stockholders may not recover monetary damages for due care violations, the courthouse doors are expressly left open for non-monetary relief.[14] There is no reason to treat derivative claims differently.

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[13] *See Cornerstone*, 2015 WL 2394045, at *9; *Malpiede*, 780 A.2d at 1095.

[14] *See, e.g., Arnold v. Soc'y for Sav. Bancorp, Inc.*, 678 A.2d 533, 542 (Del. 1996) (stating directors not exempt from equitable relief under § 102(b)(7) in context of post-merger lawsuit in which shareholder alleged direct claims against corporation); *Chaffin v. GNI Grp., Inc.,* 1999 WL 721569, at *6 (Del. Ch. Sept. 3, 1999) (finding class action plaintiffs pled direct claims against former directors and stating that although "[the corporation's] exculpatory clause would bar the plaintiffs from recovering money damages for the plaintiffs' duty of care claims, . . . it would not bar any equitable remedies that would flow if those claims were to prevail.").

D. THE COMPLAINT ADEQUATELY ALLEGES THAT THE APPROVAL OF THE RETROACTIVE BONUS CONSTITUTED WASTE

Demand is also excused under the second prong of *Aronson* because Plaintiffs adequately allege that the Retroactive Bonus constitutes waste. OB 21-23. Defendants' arguments to the contrary (AB 29-30) do not hold up to scrutiny. *First*, as a holdover from the illegal Original Award, the Retroactive Bonus can be reviewed independently from the rest of the Amended Award and challenged as waste. *See Green v. Phillips*, 1996 WL 342093, at *5-6 (Del. Ch. June 19, 1996).

Second, while Defendants characterize the Retroactive Bonus as performance-based (AB 29-30), this ignores the circumstances under which it was adopted. The 46,439 shares at issue in the Retroactive Bonus are "vestigial shares" that were purchased on the open market using cash distributions received from the illegal Original Award. A23-24; 230-32. As "fruits of the illegal share tree,"[15] these shares represent the continuation of a non-performance based award that Simon was never entitled to in the first place. The fact that there are now purported "performance criteria" that "reduce their value to him" (AB 30) does not change the fact that the Retroactive Bonus is still a continuation of an award that the Board had no authority to grant.[16]

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[15] *Lampers v. Bergstein*, C.A. No. 7764-VCL, Tr. at 17:14-18:21 (Del. Ch. Mar. 25, 2014) (TRANSCRIPT).

[16] Defendants' reliance on *Seinfeld v. Slager*, 2012 WL 2501105 (Del. Ch. June 29, 2012) and *MCG Capital*, 2010 WL 1782271 for the proposition that "Delaware courts do not second-guess" retroactive bonus grants is misplaced. AB 30. The *Seinfeld* court recognized that, "payment for

IV. THE COMPLAINT ADEQUATELY ALLEGES THAT A MAJORITY OF THE BOARD IS NOT INDEPENDENT AND DISINTERESTED

Presuit demand was excused under the first prong of *Aronson* (or *Rales*) because the Complaint alleges a majority of the Board was not disinterested and independent with respect to the Amended Award. Defendants do not dispute that the Court of Chancery erred by limiting its first prong analysis to the members of the Compensation Committee and not examining the entire Board.[17]

A. THE COMPLAINT ADEQUATELY ALLEGES THAT A MAJORITY OF THE BOARD FACED A SUBSTANTIAL LIKELIHOOD OF LIABILITY

Defendants' assertion that Plaintiffs allege "at most" a breach of the duty of care is wrong. *See* AB 33. Plaintiffs allege with particularity that in approving the Amended Award the Defendants elevated their own interests (avoiding harm from an adverse decision in the Original Action and still providing Simon the money he was illegally promised) over those of the Company. *Supra* Sec. III.A. That is a breach of the duty of the loyalty, such that each of the Defendants who participated in that decision faced joint and several liability ***in this action***, without regard to

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services previously rendered and compensated generally ***would*** constitute a waste of corporate assets." 2012 WL 2501105, at *4 (emphasis added). However, it also found an exception to this general rule, in that, "an informed and disinterested decision whether or not to award an employee a reasonable bonus for services that have already been rendered, for which the employee has already been compensated, properly falls within a board's business judgment." *Id.* at *6. That exception is not applicable here, where the supposed purpose of the Retroactive Bonus is to incentivize performance and the Board took no steps to inform itself about whether or not the Retroactive Bonus would do so. A27. *Seinfeld* also did not deal with a scenario where the corporation's stock incentive plan requires compensation awards to be performance-based, as is the case here. A14; A43.

[17] As the Court of Chancery determined in its *Rales* analysis, Simon was directly interested in the Amended Award and H. Simon, Sokolov and D. Smith lacked independence. Ex. A at 65-68.

whether they faced liability in the Original Action. *See Conrad v. Blank*, 940 A.2d 28, 40 (Del. Ch. Sept. 7, 2007) (finding demand excused where members of a compensation committee faced a substantial threat of liability for knowingly approving improper option grants).[18] The Court of Chancery completely ignored this loyalty argument.

Defendants also claim that Plaintiffs plead no facts suggesting that any director faced a realistic threat of being found to have acted in bad faith in the Original Action, which might require him to disgorge any advanced fees. AB 34. But the Complaint pleads with particularity that following the motion for summary judgment hearing in the Original Action, the Court indicated that an adverse judgment was imminent with respect to claims that the Defendants' approval of the Original Award was illegal and in breach of their fiduciary duties. A28. That Defendants would be required to disgorge advanced fees in the face of an adverse judgment for breach of fiduciary duty and illegal conduct is a reasonable inference whether evaluated under either Rule 12(b)(6) or 23.1. *See Paolino v. Mace Sec. Int'l, Inc.*, 2009 WL 4652894, at *14 (Del. Ch. Dec. 8, 2009) (a director-defendant "is always obligated to repay the fees advanced if not ultimately entitled to indemnification"). The Court of Chancery erred in rejecting this inference in favor of a hypothetical that Defendants could have avoided disgorgement by arguing that

[18] The cases Defendants cite, which did not involve allegations of self-interest, are thus inapposite.

they relied on counsel. *See Gotham P'rs, LP v. Hallwood Realty P'rs, LP*, 2000 WL 1476663, at *17-19 (Del. Ch. 2000) (exculpation based on good faith reliance on legal advisor represented a triable question of fact).

B. ALL MEMBERS OF THE BOARD FACE NON-MONETARY CONSIDERATIONS COMPROMISING THEIR INDEPENDENCE

Defendants do not dispute that the tests for demand futility do not distinguish between "hard conflicts" and "soft conflicts," and, as the Court of Chancery acknowledged, Delaware precedent dictates that nonmonetary considerations which influence a director-defendants' decision can render him non-independent or interested for demand futility purposes and thus the Court can, and must, consider such interests. *See* OB 32-34.[19] As recognized in *In re MFW S'holders Litig.*, one such consideration is a director's interest in his or her reputation. 67 A.3d 496, 528-29 (Del. Ch. 2013) (directors have a "self-protective interest in retaining their reputations as faithful, diligent fiduciaries").

Defendants claim that Plaintiffs did not plead that Defendants faced a risk of harm to their reputation. AB 33. That is absurd. Plaintiffs specifically alleged that Defendants faced an imminent judicial ruling that they had undertaken an illegal

[19] *See also Rales*, 634 A.2d at 936 ("a director cannot be expected to exercise his or her independent business judgment without being influenced by the adverse personal consequences resulting from the decision"); *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003) ("the question of independence turns on whether a director is, ***for any substantial reason***, incapable of making a decision with only the best interests of the corporation in mind") (emphasis in original); *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984) (lack of independence if "director's decision is based on … extraneous considerations or influences.").

act and violated their fiduciary duties (A13, 28), which necessarily carries with it a substantial risk of reputational harm. *See MFW*, 67 A.3d at 528-29; *Barrett v. Am. Country Holdings, Inc.*, 951 A.2d 735, 744 (Del. Ch. 2008). The elimination of this liability in the Original Action provided Defendants with a "personal benefit," making them interested in the Amended Award. A41-42, 46-47, 52-53.

Contrary to Defendants' claim (AB 33), the risk of reputational harm was far from remote. In *Barrett v. Am. Country Holdings, Inc.*, the Court of Chancery, recognizing the harm adverse judgments can have on a directors' reputation, explained:

> It is cute for counsel for Kingsway to argue that the Former Directors' voluntary acceptance of a judgment against themselves in a fraud case has only a remote and speculative relationship to their reputations and future prospects to serve as directors of other corporations, but entirely unconvincing. . . . No judgment in a fraud or other reputation-implicating case is cost-free.

951 A.2d at 744. Additionally, Defendants' argument that any risk of reputational harm was cured by the Company's disclosures regarding the claims made in the Original Action and the Board's actions to moot those claims (AB at 34), is a red herring. These disclosures, issued in connection with the May 2014 stockholder vote, were made months after the Defendants approved the Amended Award and do not bear on, let alone serve as a cure for, Defendants' self-interest in the Amended Award in the first place.