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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE GENERAL MOTORS COMPANY, PAUL NASH, *et al.,* derivatively on behalf of Nominal Defendant GENERAL MOTORS CORPORATION, a Delaware corporation, Plaintiffs Below, Appellants, v. MARY T. BARRA, *et al.*, Defendants Below, Appellees, and GENERAL MOTORS COMPANY, Nominal Defendant Below, Appellee.	No. 392, 2015 Court Below: Court of Chancery of the State of Delaware, C.A. No. 9627-VCG PUBLIC VERSION

APPELLANTS' OPENING BRIEF

Dated: September 11, 2015

BIGGS AND BATTAGLIA
Robert D. Goldberg (ID # 631)
N. Orange Street
P.O. Box 1489
Wilmington, Delaware 1989
Tel: (302) 655-9677
Goldberg@batlaw.com

OF COUNSEL:

ABBEY SPANIER, LLP
Nancy Kaboolian
212 East 39th Street
New York, New York 10016

HARWOOD FEFFER LLP
Robert I. Harwood
Daniella Quitt
Samuel K. Rosen
488 Madison Avenue
New York, New York 10022

SMITH, KATZENSTEIN & JENKINS LLP
David A. Jenkins (DE No. 932)
1000 West Street, Suite 1501
P.O. Box 410
Wilmington, Delaware 19899
Telephone: 302-652-8400
djenkins@skjlaw.com

Attorneys for Plaintiffs Below-Appellants

KANTROWITZ, GOLDHAMER &
GRAIFMAN, P.C.
Gary S. Graifman
Reginald H. Rutishauser
747 Chestnut Ridge Road, Suite 200
Chestnut Ridge, New York 10977

MORGAN & MORGAN, P.C.
Peter Safirstein
Domenico Minerva
Elizabeth Metcalf
28 West 44th Street, Suite 2001
New York, New York 10036

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NATURE OF THE PROCEEDINGS

Through this appeal, Plaintiffs Below, Appellants, seek relief from the Court of Chancery's Order of June 26, 2015, dismissing Plaintiffs' stockholder derivative action for failure to sufficiently allege a substantial likelihood of personal liability on the part of a majority of the General Motors Company ("GM") Board of Directors (the "Board") that would excuse Plaintiffs' lack of demand for action on the Board.

This litigation concerns GM's well-publicized ignition switch defect which caused the vehicle's engine and electrical system to shut off in Cobalt and Saturn Ion GM models, causing a catastrophic failure of airbag deployment. The defect resulted in the death or injury of hundreds of individuals, more than 45 recalls covering approximately 13 million vehicles, a staggering cost to the Company resulting in charges against earnings measured in the billions of dollars, unprecedented regulatory fines, varied investigations (including two Congressional investigations as to whether GM violated the Transportation Recall Enhancement, Accountability and Documentation Act ("TREAD Act"); and a criminal investigation by the U.S. Department of Justice ("DOJ") for obscuring a deadly defect that killed or injured hundreds of individuals), and an abundance of civil litigation, some of which subjects the Company to punitive damages. The Vice Chancellor referred to the "corporate activity in question [as]…particularly distressing" (Ex. A at 2) and the context of the case "unsettling." *Id*. at 28.

Although Plaintiffs challenge both specific actions by the Board and inaction by way of failure of oversight, Appellants claim error by the Vice Chancellor only with regard to the allegations charging Board inaction. The Vice Chancellor concluded that Plaintiffs "conflate concededly *bad outcomes* from the point of view of the Company with *bad faith* on the part of the Board." (Ex. A at 29) (emphasis in original). However, the Complaint charges GM's Board with breach of its fiduciary duties in connection with the Board's utter failure to implement a reporting system and failure to oversee previously existing, inadequate reporting systems. Consequently, although the ignition switch defect had been problematic at GM for years, the Board did not learn of the problem until February 2014 – when the issue had already reached crisis mode. And then, inexplicably, when the Board did learn of the issue, it still utterly failed to implement a reporting system, resulting in the U.S. Government imposing the then largest civil fine for failure to comply with its vehicular safety reporting requirements. The Board is responsible for the systemic failure alleged here, and their liability necessarily attaches.

Indeed, a majority of the Board faces a substantial likelihood of liability. At the time of the time of the filing of the complaint, the Audit Committee together with the insiders comprised a majority of the Board. The Audit Committee was charged by the Board with compliance with legal and regulatory requirements and risk assessment. The Court below decided that mere snippets of board materials and

agendas that mentioned quality and compliance with crucial requirements that go to the core of GM's business satisfied the director defendants' fiduciary obligations. In effect, by inferring that passing references in documents without action complies with long-standing Delaware director responsibilities, the decision below turns fiduciary duties on its head.

In April 2014, the Board retained Jenner & Block partner Anton R. Valukas ("Valukas") to investigate why it had taken so long for GM to recall cars with defective, unsafe ignition switches. After interviewing outside directors and others and reviewing documents, Valukas issued a report on May 29, 2014 (the "Valukas Report"). The Valukas Report concluded that the system put in place by the Board did not require that serious defects detected by GM's legal department, engineering department, consumer protection organizations or law enforcement agencies be reported to the Board and that "no single committee of the Board was responsible for vehicle safety-related issues." In short, the Valukas Report describes GM as a company lacking effective corporate governance at the Board level. (A044, ¶ 62).

On February 6, 2014, GM belatedly notified the National Highway Transportation Safety Administration ("NHTSA"), about the ignition switch defect in 619,122 vehicles, model year ("MY") 2005-2007 Chevrolet Cobalt and MY 2007 Pontiac G5 vehicles, and between February and March 28, 2014, supplemented the notice three times, adding additional vehicle brands and model years, comprising

millions of additional vehicles. On February 26, 2014, NHTSA opened a civil enforcement investigation to evaluate the timing of GM's defective decision-making and reporting of a safety-related defect to NHTSA.

On May 16, 2014, GM entered into a Consent Decree with NHTSA in which "GM admit[ted] that it violated the Safety Act by failing to provide notice to NHTSA of the safety-related defect that is the subject of the Recall No. 14V-047 within five working days" and agreed to pay a record-breaking penalty of $35 million for such "failure to report a safety defect in the vehicle to the federal government in a timely manner." NHTSA announced, "Federal law requires all auto manufacturers to notify NHTSA within five business days of determining that a safety-related defect exists or that a vehicle is not in compliance with federal motor vehicle safety standards and to promptly conduct a recall. GM admits in the Consent Order that it did not do so."

Prior to the filing of the operative Complaint on October 13, 2014, Appellants' counsel made a demand and obtained documents from relevant Board and committee meetings under 8 *Del. C.* § 220. Appellants did not make a demand on the Board to bring this action because doing so would be futile. On December 5, 2014, Defendants moved to dismiss the Complaint pursuant to Court of Chancery Rule 23.1 contending that Plaintiffs had not alleged particularized facts sufficient to excuse demand. Plaintiffs responded on January 9, 2015, and Defendants replied on February 6, 2015. Oral argument was held on March 10, 2015. On the following

day, March 11, 2015, the Vice Chancellor wrote a letter to counsel for Defendants seeking supplemental record citations regarding the Board's knowledge of vehicle recalls and compliance with governmental reporting requirements. Counsel for Defendants responded with a letter submission dated March 13, 2015 and Plaintiffs' counsel responded on March 16, 2015. Counsel for Defendants responded on March 17, 2015. On March 26, 2015, the Vice Chancellor notified the parties in writing of receipt of the additional arguments and wrote that the matter was "fully submitted" as of that date.

The Chancery Court issued its Memorandum Opinion, on June 26, 2015 ("Opinion" or "Ex. A. at__"), finding that decisions made by the Board were business decisions and there was a lack of particularized pleading in the Complaint showing bad faith that would upset the business judgment presumption. Moreover, the Court found that the conduct at issue, as pled, fell short of an utter failure to attempt to establish information or reporting systems, a conscious failure to monitor existing systems, or conduct otherwise taken in bad faith. Accordingly, the Court found that there was not a substantial likelihood of personal liability on the part of a majority of the Board excusing demand, and by concurrent order ("Order"), granted the Motion to Dismiss for failure to comply with Rule 23.1.

Reviewing *de novo*, this Court should reverse the Order.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in failing to give Plaintiffs all reasonable inferences that logically flowed from the particularized facts alleged.

2. The Court of Chancery erred in finding that Plaintiffs failed to allege demand futility because the Court found a lack of bases on which to infer knowledge and bad faith on the part of the Board, when in fact the Complaint is replete with particularized allegations demonstrating reasonable doubt upon which inferences of the Board's conscious knowledge and bad faith can be based resulting in a substantial likelihood of personal liability faced by the majority of directors in connection with the faulty ignition switches.

3. The Court of Chancery erred in holding that Plaintiffs failed to plead facts with particularity that raised a reasonable doubt of an utter failure to attempt to establish information or reporting systems, a conscious failure to monitor existing systems, or conduct otherwise taken in bad faith with respect to the Defendant Directors' failure to implement a risk management system for a regulated automotive company that ensured the Board would receive adequate information in core areas of risk management including: (i) whether and why individuals were dying or being seriously injured in GM vehicles; and (ii) whether regulators received full, accurate and timely information concerning serious safety defects and recalls, which the Company was required by law to timely produce.

STATEMENT OF FACTS

A. The Parties

Appellants are institutional and individual beneficial owners of GM common stock at all pertinent times referenced in the Complaint. (A027-8, ¶¶10-12). Various Appellants also participated in the books and records demand pursuant to §220. *Id*.

Appellee GM, a Delaware corporation with its primary place of business in Michigan, designs, manufactures, promotes and sells vehicles and component parts worldwide. (A028, ¶ 13). Because of the declared bankruptcy of the former version of GM, Appellee GM is the entity that came into existence following bankruptcy proceedings in July 2009 as, at first, a government sponsored entity. *Id*.

Appellees Theodore Solso, Stephen Girsky, Patricia Russo, Thomas Schoewe, Erroll Davis, Jr., Kathryn Marinello, E. Neville Isdell, Carole Stephenson, James Mulva and Michael Mullen are all current directors of GM (A032-5, ¶¶ 24-33). Solso, Schoewe, Davis, Marinello, Isdell and Mullen are also members of GM's Audit Committee. *Id*. Appellee Mary Barra is currently GM's Chief Executive Officer and is a director (A030, ¶19). Appellees Daniel Akerson, David Bonderman, Robert Krebs, Philip Laskawy, Cynthia Telles all were former directors of GM. (A035-6, ¶¶ 34-38). Each of the individual Appellees has high level experience in industry and has successfully implemented effective risk management systems elsewhere (Ex. A at 8, fn. 8).

B. The Defective Ignition Switch

GM manufactured and sold millions of vehicles with a defective, unsafe ignition switch that caused vehicle stalls and failure of airbag deployment resulting in serious injuries and deaths. (A042, ¶ 57). GM's failure to correct the defective ignition switches continued unabated after GM emerged from bankruptcy in 2009. There is no dispute that members of senior and middle management, including GM's in-house legal staff (and outside counsel) were well aware of the persistent problem for a number of years. (A029-32, 064-73 ¶¶ 17, 19-23, 124-25, 127-46, 150).

C. GM's Reporting Requirements to NHTSA and Its Failure to Assemble and Review the Required Information

[redacted]

(A037, ¶ 42). GM is subject to the Safety Act, pursuant to which manufacturers of motor vehicles have a duty to notify NHTSA, purchasers, and dealers if the manufacturer learns that a vehicle contains a defect that it decides in good faith to be related to vehicle safety within five working days after the determination that the defect is related to safety. (A038, ¶ 44).

GM is also subject to the TREAD Act (part of the Safety Act) which requires "NHTSA to collect data, notice trends and warn consumers of potential defects in vehicles." (A040, ¶ 49). Failure to comply with the TREAD Act reporting requirements may result in monetary or criminal penalties. (A040-1, ¶¶ 50-52).

The Valukas Report concluded that "until 2014, the [GM] TREAD Reporting team did not have sufficient resources to obtain any of the advanced data mining software programs available in the industry to better identify and understand potential defects." (A050, ¶ 81). Further, as the parties addressed at oral argument and in subsequent submissions to the Court, there is nothing in the Section 220 record substantiating that, post-2009 (after new GM emerged), the Board monitored either the Company's responses to NHTSA inquiries or the Company's TREAD Act reporting obligations despite those responsibilities being part of the Audit Committee's mandate. (A094-5, ¶¶ 200-03; A299-345).

After February 2014, with GM's serial recalls related to the ignition switch defect disclosed to NHTSA and the Board was aware of the widespread publicity concerning the existing crisis, NHTSA asked GM to explain the circumstances surrounding certain crashes to help identify potential defects. Strikingly, as reported by *The New York Times*, "[GM] repeatedly found a way not to answer the simple question from regulators of what led to a crash. In at least three cases of fatal crashes ...GM said it had not assessed the cause," or "GM opts not to respond." (A061, ¶ 114). GM's continued intransigence with the regulators resulted in additional fines of $7,000 per day.

Given the highly publicized news surrounding the crisis, one would have thought the Board would have at least assured itself that such basic questions from

the regulators would be answered. Instead, as the regulators knew from years of experience, "GM's decision-making, structure, process and corporate culture stood in the way of safety." (A062, ¶ 116). *See also* A057, 089-92, ¶¶ 99, 188, 191, 193. To send a further message to GM, NHTSA has sought authorization from Congress to increase the maximum penalty from $35 million to $300 million. The message is that "delays will not be tolerated." (A057, ¶ 99).

D. The Board Knew That its Oversight and Management of the Company Was In Conscious Disregard of Its Duties

In a damning investigative September 7, 2014 report, *The New York Times* reported that,

> "[a]fter General Motors emerged from bankruptcy and a government bailout five years ago, the board of directors of the 'new G.M.' was expected to keep a more watchful eye on a company that had gone seriously off track. But on the issue of vehicle safety, the Board, until it was forced by events described below to face the ignition switch problem, took a mostly hands-off approach, rarely even discussing the topic beyond periodic reviews of product quality with company executives, according to interviews with current and former board members, as well as G.M. officials with knowledge of the board's actions." (A060, ¶ 111).

Defendant Solso admitted, "[y]es, we should have known earlier [about the ignition switch defect]…The way I look at it, G.M. has not been well run for a long period of time." (A060, ¶ 112).

The Valukas Report concluded that the Board "did not discuss individual safety issues or individual recalls except in rare cases." (A047, ¶ 70). The Valukas

Report states that, by at least October 2010 and again in July 2011 and April 2012, GM management and legal staff learned a defective ignition switch was causing serious accidents, but GM lacked the risk management procedures to escalate this defect to the Board. (A064-70, ¶¶ 124-42). Valukas concluded that, "the system put in place by the Board did not require that serious defects detected by GM's legal department, its engineering department, consumer protection organization, or law enforcement agencies be reported to the Board." (A044, ¶ 62).

[redacted] (A074-81, ¶¶ 154, 159-65, 167-72). To make matters worse, the Board received specific information that management was incapable of addressing the Company's major risk issues. [redacted] (A081, ¶ 170). In other words, the Board knew that not only was there no mechanism in place by which the Board would be notified of serious risks, but the Board also knew that that

management lacked the knowledge and/or skill sets necessary to perform risk assessments and develop risk mitigation strategies.

As the Board also knew, reporting did not improve during the period in question, in fact it got worse. In 2013 the Board learned that GM had established a corporate culture of dishonesty. [redacted] (A089, ¶ 187).

Overriding all of the Board's inaction was what Valukas concluded to be a "phenomenon of avoiding responsibility" that was so institutionalized and pervasive throughout GM that it was known by employees throughout the Company by the contemptuous phrase "the 'GM salute,'" described as "a crossing of the arms and pointing outward towards others, indicating that the responsibility belongs to someone else, not me." (A071-2, ¶ 147). Defendant Barra was aware of GM's culture of deception and avoidance, which she described to Valukas by the similarly named contemptuous phrase, that GM's institutionalized corporate policy was "known as the 'GM nod,'" that occurred "when everyone nods in agreement to a proposed plan of action, but then leaves the room with no intention to follow

through, and the nod is an empty gesture." (A072, ¶ 148).

GM's Board failed to assure itself of learning about important legal developments facing the Company, including its risk for liability for punitive damages. Any settlement for a products liability action between $100,000 and $1.5 million required department committee ("Roundtable") approval; any settlement between $1.5 million and $5 million required approval of the Settlement Review Committee; and larger settlements needed the approval of the General Counsel. Here, the GM legal department was aware of the risk and potential damage to the Company of the ignition switch defect (A062-73, ¶¶ 117-51) yet the General Counsel testified that he was unaware of the defect and the litigation surrounding the defect until February 2014. (A063-4, ¶ 122).

For example, GM's outside counsel King & Spalding ("K&S") prepared a case evaluation for GM's in-house counsel, in the fall of 2010, concerning a lawsuit based on an accident involving a Cobalt. This evaluation found that "the failure of the airbags to deploy because of a 'sensing anomaly' made this case difficult to defend," and that "the facts and circumstances surrounding the investigation into the sensing system 'anomaly' *that may be present in some Cobalts could provide fertile ground for laying the foundation for an award for punitive damages, resulting in a significantly larger verdict.*" (A064-5, ¶¶124-25 (emphasis added)).

A second litigation-based punitive damages' warning was issued by K&S in

July 2011 by which time GM's Legal Department had determined that the Cobalt issue needed urgent attention. K&S again warned of the possibility of "punitive damages." (A066, ¶ 130). In addition, another GM outside counsel performed an analysis, dated April 18, 2012, of a 2009 Cobalt accident, making the connection between the ignition switch issue and the non-deployment of airbags and advised, "GM was at risk for imposition of punitive damages..." (A067-8, ¶¶ 134, 135).

The Court of Chancery dismissed this punitive damage potential as not rising "to the level of pleading with particularity facts demonstrating that the Board utterly failed to implement a system by which it would be informed of risks." (Ex. A at 37.) But punitive damages are a very serious matter. As the United States Supreme Court has related, "in our judicial system compensatory and punitive damages . . . serve different purposes . . . ." Compensatory damages redress a plaintiff's concrete loss resulting from a defendant's wrong, but "punitive damages serve a broader function; they are aimed at deference and retribution . . . [and] 'may properly be imposed to further a State's legitimate interests in punishing unlawful conduct and deterring its repetition.'" *State Farm Mut. Auto. Ins. Co. v. Campbell*, 583 U.S. 408, 416 (2002). Plaintiffs are not alleging, by hindsight, that additional metrics should have been used to inform the General Counsel. (Ex. A at 38). [redacted]

[redacted] (A092, ¶ 194).

As if these punitive damage warnings were insufficient, in June 2012, GM was provided with another direct warning. The plaintiff's expert in a crash case pending against GM, reviewed GM documents and opined that GM's own wiring diagrams showed the Cobalt's airbags could not deploy when the ignition was in the accessory position (A068, ¶137) and that GM's "improper design resulted in a vehicle that was defective in a manner that caused the airbags to not deploy in a crash") (*id*., ¶ 138). In light of this, GM's outside counsel, in July 2012, advised GM's Legal Department that GM would lose the case and that "the verdict exposure will increase and the defense of the case will become more complicated." (A069, ¶ 139). In May 2013, K&S' case evaluation concluded that a jury would almost "certainly" find that the Ignition Switch was unreasonably dangerous, and that low torque would lead to the inadvertent shutting off of the engine. (*Id*., ¶ 144).

Defendant Barra had independent, additional direct knowledge of the defective switch, which should have been escalated to the then-constituted Board, but she too failed to act. On October 3, 2011, after Barra had become Senior Vice President for Global Product Development, she received an email containing a press report disclosing that NHTSA was investigating the Saturn Ions from MYs 2004-07

as a result of heightened concern that a sudden loss of electric power steering could cause crashes. (A031, ¶ 21; A058, ¶¶ 105-06). In addition, on April 22, 2012, Barra received an email from a former GM employee reporting the existence of the "moving stall" with the Buick directly attributable to the key design and suggesting that the Company investigate and perhaps issue a service bulletin. (A031-2, ¶ 22). Additional facts belie Barra's claim not to have known of the defect until 2014. In December 2013, Barra's department placed an unusually huge order of 500,000 units of replacement ignition switches, weeks before GM's massive recall of vehicles. This order was 51 days prior to GM's reporting the ignition switch defect to NHTSA (A151, fn. 7).

The Board also failed to establish a policy or procedure to assure that the Company provided federal regulators, in this heavily regulated industry, with full, accurate, and timely information, as required by law. (A061, ¶ 115). No document was produced by GM evidencing this oversight obligation or even any discussion of such obligations. GM under the direction of the Board violated the TREAD Act in failing to submit truthful and adequate reports to NHTSA. (A052, ¶ 85). As indicated above, GM angered the government by its handling of the ignition switch defect, resulting in the imposition of the maximum civil penalty of $35 million. (A054, ¶ 92). NHTSA also required GM to provide a comprehensive written plan regarding completion of the ignition switch recall and in addition to

other reporting requirements, ordered GM to establish a procedure "for its employees to report expeditiously concerns regarding actual or potential safety defects, or non-compliance with Federal Motor Vehicle Safety Standards." NHTSA also ordered GM to meet with that agency on a monthly basis for one year to discuss the implementation of the recommendations in the Valukas Report. NHTSA's remedial directives to GM are a clear censure by the government of the Board's failure to implement a proper reporting system relating to motor vehicle safety. (A047, ¶ 68).

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN FAILING TO GIVE PLAINTIFFS ALL REASONABLE INFERENCES THAT LOGICALLY FLOWED FROM THE PARTICULARIZED FACTS ALLEGED.

A. Question Presented:

Did the Court of Chancery err in failing to give Plaintiffs all reasonable inferences that logically flowed from the particularized facts alleged? Issue preserved at A163-6, 169-70, 179, 189.

B. Scope of Review:

The Court's review of a decision dismissing a complaint is *de novo* and plenary. *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

C. Merits of the Argument:

In evaluating a motion to dismiss pursuant to Rule 23.1, the Court must apply the following standards:

> [P]laintiffs' well-pleaded factual allegations must be taken as true and the complaint has to be read in the light most favorable to the plaintiffs.
>
> Plaintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but conclusory allegations are not considered as expressly pleaded facts or factual inferences.

Brehm v. Eisner, 746 A.2d at 255, 268.

The logical inferences to which Plaintiffs are entitled, based on their allegations, are that Board members and the relevant committees failed to act in the face of a known duty to act. The inferences to which Plaintiffs are entitled

demonstrate the requisite threshold showing that their claims have merit.

The Chancery Court acknowledged that Plaintiffs are entitled to inferences but then denies them to Plaintiffs. Instead, the Opinion, in certain instances, stands Delaware law on its head and provides inferences to Defendants. In the first instance, the Chancery Court finds that "GM has been and will be held liable for any wrongdoing in the engineering and deployment of these ignition switches," (Ex. A at 2), but then does not find, at this pleading stage, any reasonable doubt that any director is disinterested due to a substantial risk of personal liability in connection with the alleged failures surrounding the same catastrophic event. Plaintiffs were entitled to the reasonable doubt inference.

In addition, the Court quotes findings from the Valukas Report, but fails to give Plaintiffs the benefit of any inferences flowing therefrom. They include:

- "the system put in place by the Board did not require that serious defects detected by GM's legal department, its engineering department, consumer protection organization, or law enforcement agencies be reported to the Board." (Ex. A at 9).
- The Board "did not discuss individual safety issues or individual recalls except in rare circumstances." (Ex. A at 9).

In addition, Plaintiffs allege information from an article published in *The New York Times* on September 14, 2014, based on information from people with knowledge of the Board's actions, that the GM that emerged from bankruptcy was expected to be more watchful, "[b]ut on the issue of vehicle safety, the [B]oard until

recently took a mostly hands-off approach, rarely even discussing the topic beyond periodic reviews of product quality with company executives." Ex. A at 27.

Not only did the Chancery Court fail to provide Plaintiffs with any inferences based on these reports, it made an unsupported inference in defendants favor finding, "I note that quality, as it relates to motor vehicles, necessarily invokes safety issues as well." Ex. A at 39, fn. 110. The Court, on its own, improperly conflated "safety" with "quality" and then improperly inferred that any Board discussion of quality necessarily implicated safety issues, notwithstanding well-pleaded facts leading to the inference that the Board failed to implement a reporting system by which it learned of safety defects. The record evidence is that the Board never inquired about deaths or serious injuries in GM vehicles and that the Board lacked a reporting system following 2009 to assure itself of proper reporting to NHTSA. (A058, 61, ¶¶104, 115). This critical error of conflating safety with quality alone justifies reversal inasmuch as the Court should have credited Plaintiffs with successfully alleging that the Board took a hands-off approach regarding the safety of its vehicles. Had the Court properly credited this allegation, it, together with other relevant allegations, demonstrated that Plaintiffs had pled particularized allegations that the Board had utterly failed to implement a reporting system concerning one of the most important issues confronting the Company – the safety of its vehicles.

II. THE COURT OF CHANCERY ERRED IN HOLDING THAT PLAINTIFFS FAILED TO PROPERLY ALLEGE FACTS SUFFICIENT TO ESTABLISH DEMAND FUTILITY

A. Question Presented:

Did the Court of Chancery err in finding that Plaintiffs failed to allege demand futility because it did not find bases on which to infer knowledge and bad faith on the part of the Board, when in fact the Complaint is replete with particularized allegations from which an inference of the Board's conscious knowledge and bad faith can be based? Issue preserved at A160, 166, 173-4, 178-9, 187-8.

B. Standard of Review

The Court's review of a decision dismissing a complaint is *de novo* and plenary. *Brehm v. Eisner*, 746 A.2d at 253.

C. Merits of the Argument

The Court of Chancery dismissed this action for failure to make a pre-suit demand on the Board, notwithstanding Plaintiffs' particularized and well-pled allegations as to why such a demand on GM's Board would have been futile. In dismissing the Complaint for failure to make such a demand, the Vice Chancellor failed to follow long-established Delaware precedent and thereby committed error. Contrary to the Vice Chancellor's findings that "there is no sufficiently pled allegation that the Board was aware that its risk management system was not functioning as it should – *i.e.*, there were no 'red flags' or other bases from which I

can infer knowledge on the part of the Board that its system was inadequate" (Ex. A at 31), the Complaint is replete with particularized allegations ("other bases"), from which an inference of the Board's conscious knowledge and bad faith can be based.

1. Demand Is Excused Under Aronson

Plaintiffs meet the second prong of *Aronson* by demonstrating a reasonable doubt that "the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). As a gatekeeper, the Court is held to a "reasonable doubt" standard, not a standard that looks for definitive proof. *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). Because Plaintiffs plead here Defendants' bad faith with the necessary particularity, the alleged conduct would fall into the range of activity that is outside the scope of the business judgment rule.

An "intentional dereliction of duty" or "a conscious disregard of one's responsibilities" which is "properly treated as a non-exculpable, non-indemnifiable violation of the fiduciary duty to act in good faith" is sufficient to support breach of the duty of loyalty. *In re Walt Disney Derivative Litig.*, 906 A.2d 27, 66 (Del. 2006). Defendants' breach of the duty of loyalty, as pled, is based on their bad faith actions, and thus the challenged conduct was not the product of a valid business judgment. "A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest." *Stone ex rel.*

AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (quoting *Guttman v. Jen-Hsun Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

Here, "bad faith is shown where a fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." *Walt Disney*, 906 A.2d at 67. *See also*, *In re Citigroup Inc. S'holder Derivative Litig.* 964 A.2d 106, 125 (Del. Ch. 2009). There can be no good faith belief that it was in the "corporation's best interest," for the Board: (a) not once to inquire as to why people were dying or seriously injured in GM vehicles; (b) not to assure itself that the regulators were receiving the required information on a timely basis in this heavily regulated industry of which the directors had notice, or; (c) to have no mechanism by which it would receive notice of the possibility of punitive damages in connection with deadly crashes.

While a "bad faith" standard is undoubtedly a high standard, it is not insurmountable (Ex. A at 1, fn. 1), otherwise all boards would receive immunity for any form of activity. That is precisely why Plaintiffs are only required to show particularized facts creating a **reasonable doubt** that a majority of the Board could have properly exercised its disinterested business judgment in responding to a demand to satisfy their burden in establishing demand futility. Instead, under the standard utilized by the Vice Chancellor, all the Board needed to have done to satisfy its obligations was simply to have discussed risk in a general way, *ad nauseum*, but

not create proper risk assessment and correction procedures. While the Business Judgment Rule quite sensibly permits corporations to self-govern without every business judgment questioned, the Court must be able to distinguish between a Board, as here, that merely pays "lip service" to corporate governance while the record established by the Section 220 demand shows a Board that utterly failed to establish a reporting system affecting the most important issues confronting the Company. Clearly the Vice Chancellor had a "reasonable doubt" as to whether the Board had a reporting mechanism to ensure itself as to GM's compliance with NHTSA regulations. Unsure that the issue had been adequately supported by Defendants, the Vice Chancellor asked Defendants, post oral argument, for record support. (A299). As Plaintiffs pointed out supplementally, Defendants failed to provide such record support. (A342-5). The Vice Chancellor ignored these post-argument events in his opinion, even though no records were provided to overcome such obvious "reasonable doubt."

As Chancellor Bouchard recently explained, relying on Chancellor Allen's decision in *In re J.P. Stevens & Co., Inc. S'holders Litig.*, 542 A.2d 770, 780-81 (Del. Ch. 1988), "a plaintiff may show a lack of good faith by establishing that a director's decision was 'so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.'" *Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera*, C.A. No. 9503-CB, 2015 WL

4192107, at *13 (Del. Ch. July 13, 2015). The Board members' conduct alleged here is inexplicable on any ground other than bad faith.

In *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963), this Court held that business judgment protection is not afforded directors who knowingly or recklessly ignore, or fail to investigate, obvious signs of wrongdoing in breach of their fiduciary duties:

> [T]he question of whether a corporate director has become liable for losses to the corporation through neglect of duty is determined by the circumstances. If he has recklessly reposed confidence in an obviously untrustworthy employee, has refused or neglected cavalierly to perform his duty as a director, or has ignored either willfully or through inattention, obvious danger signs of employee wrongdoing, the law will cast the burden of liability upon him.

Id. at 130.

As a Company in a heavily regulated industry, the Board was required to ensure that GM provided regulators with full, accurate, and timely recall information. [redacted] (A037, ¶ 42). Yet Defendants adopted a "we don't care about the risks" attitude by failing to act on the obvious risks on which it was their duty to act. This conduct seems inexplicable on any ground other than bad faith.

2. A Majority of the Board Was Demonstrably Knowledgeable About Working in a Regulated Environment

This Board was laden with individuals who came to GM with high-level experience from other endeavors where they navigated similar complex risk and regulatory environments and who had implemented effective risk-management systems and controls for those companies. These defendants are thus fully informed of both the necessity of enterprise risk management in corporations of a size and business such as GM, and the manner in which such frameworks are set up, executed, and monitored. These defendants are Davis, Isdell, Marinello, Mullen, Mulva, Russo, Schoewe, Solso, and Stephenson. (A102-3, ¶ 221).

Therefore, it is reasonable to infer that, at minimum, the above-mentioned Defendants were adequately informed that they could not exercise business judgment in overseeing the Company's regulatory compliance and the safety of GM's vehicles in light of the Board's failure to implement and maintain a policy or system whereby serious defects detected by various Company sources were reported to the Board, as well as litigation matters which would incur punitive damages.

3. Demand Is Excused Because Plaintiffs Allege With Particularity That the Board Had Sufficient Knowledge to Impute Bad Faith and Scienter

[redacted] (A037, ¶ 42). The Court of Chancery's decision

ignores: (a) the knowledge imparted to the November 2009 Board members; and (b) the information delivered by the Chief Risk Officer at his Board presentations. Ignoring actual Board member knowledge exalts the absence of "red flags" over conduct based on actual contemporary knowledge. Red flags are not essential to excusing demand. As this Court has explained: "In the absence of red flags, good faith in the context of oversight must be measured by the directors' actions 'to assure a reasonable information and reporting system exists' and not by second-guessing after'" adverse events occur. *Stone*, 911 A.2d at 373. This lawsuit is not based on second-guessing; it is based on what Board members knew and when they knew it. It is viable because the Board members failed to assure that a reasonable information and reporting system existed.

Six Board members received the November 2009 Boards packets. [redacted] Six Board members sat on the Audit Committee and thus at the time of the filing of the Complaint (by virtue of the Audit Committee Charter) were charged with "GM's compliance with legal and regulatory requirements", "GM's policies and compliance procedures regarding ethics and legal risk", and review of "management's assessment of legal regulatory risk identified in GM's compliance programs." (A094, ¶ 200). Two Board members are corporate insiders, one of whom had specific knowledge about the defective switch issue for over three years before it

became publicly known.

It is reasonable to infer that the Board knew its responsibilities from the various backgrounds of the Directors, the primer given to the majority of the Board in 2009, and the regulations applicable to the Company. The Board "had 'actual or constructive knowledge' that their conduct was legally improper." *Wood v. Baum*, 953 A.2d 136, 141 (Del. 2008) (footnote/citations omitted). Even assuming that the Board did not know of the ignition switch defect until February 2014, once it did know, it still took no steps, as the record demonstrates, to assure itself that the regulators were receiving full, accurate and timely information. It was because of GM's conduct before and after February 2014 that GM was subject to the largest civil fines in NHTSA's history. The Court of Chancery therefore erred in finding no sufficiently pled allegations of other bases from which to infer knowledge on the part of the Board that it utterly failed to implement and maintain the necessary reporting system. The Board's decisions can reasonably be said to be in bad faith, made with conscious disregard of its members' fiduciary duties to GM. Accordingly, the majority of the Board faces a substantial likelihood of personal liability, excusing demand. Court of Chancery erred in granting the Motion to Dismiss for a purported failure to comply with Rule 23.1.

III. THE COURT OF CHANCERY ERRED IN HOLDING THAT PLAINTIFFS DID NOT ADEQUATELY ALLEGE A *CAREMARK* CLAIM

A. Question Presented:

Did the Court of Chancery err in holding that Plaintiffs failed to plead facts with particularity that raised a reasonable doubt of an utter failure to attempt to establish information or reporting systems, a conscious failure to monitor existing systems, or conduct otherwise taken in bad faith with respect to Defendants' failure to implement a risk management system for a regulated car company that ensured the Board would receive adequate information in core areas of risk management including: (i) significant and serial lawsuits risking punitive damages; and (ii) whether regulators received full, accurate and timely information concerning serious safety defects and recalls, which the Company was required by law to timely produce and file? Issue preserved at A141, 130-1, 143-9, 173, 178, 181-3.

B. Scope of Review:

The Court's review of a decision dismissing a complaint is *de novo* and plenary. *Brehm v. Eisner*, 746 A.2d at 253.

C. Merits of the Argument:

In re Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996) and its progeny recognize that a "systematic lack of oversight" excuses demand. *See, e.g.*, *David B. Shaev Profit Sharing Account v. Armstrong*, No. Civ. A. 1449-N, 2006 WL

391931 (Del. Ch. Feb. 13, 2006), *aff'd*, 911 A.2d 802 (Del. 2006). A systematic deficiency may be reflected by a failure "to assure the existence of reasonable information and reporting systems" *Armstrong*, at *15. Plaintiffs also sufficiently pled that a majority of the Board faced a substantial likelihood of personal liability as to the conduct alleged which was sufficient to compromise their ability to consider a demand impartially. As stated above, the Vice Chancellor, in error, found that "GM has been and will be held liable for any wrongdoing in the engineering and deployment of these ignition switches" (Ex. A at 2), yet nevertheless determined as a matter of law that there existed no reasonable doubt that the Directors are disinterested or otherwise do not faced substantial personal liability in connection with their failures to adequately supervise GM, as alleged here.

GM is subject to the Safety Act, pursuant to which manufacturers of motor vehicles have a duty to notify NHTSA, purchasers, and dealers if the manufacturer learns that a vehicle contains a defect that it decides in good faith to be related to vehicle safety. (A038, ¶ 44). The manufacturer must provide this notice within five working days after the determination that the defect is related to safety. *Id.* It is well-pled that Defendants did not comply with these laws.

The Valukas Report found that "the system put in place by the Board did not require that serious defects detected by GM's legal department, its engineering department, consumer protection organization, or law enforcement agencies be

reported to the Board." A044, ¶ 62. This statement alone raises a reasonable doubt that GM's directors acted in good faith or otherwise face a substantial likelihood of personal liability in connection with the faulty ignition switches. As part of a heavily regulated industry, manufacturing and selling vehicles, that, if significantly defective, can cause injury and death, what was a more critical Board function?

The Chancery Court found that the Board did not utterly fail to implement a reporting system because GM merely maintained a TREAD database. (Ex. A at 36). But that was in essence no reporting system at all because what GM needed was a system that assured GM they were in compliance with the law and which required serious defects be reported to the Board. This system GM lacked. There was also no requirement for reporting to the Board facts acquired by GM's attorneys that led them to believe punitive damages were likely to result from the continued sale of vehicles with deadly design defects.

Thus, while management, lower level employees, and the legal department knew of the many ignition switch-caused crashes, no Board oversight –which with a proper reporting system would have provided the big picture to Defendants – was available to eliminate the carnage at an earlier stage. It is a reasonable inference that actual Board oversight could have saved lives, and thus reputational and monetary harm to GM.

The Court of Chancery also states that the Plaintiffs do not allege the Board

had knowledge that this system was inadequate or that the Board consciously remained uninformed on this issue. (Ex. A at 37). To the contrary, as pled in the Complaint, this is precisely what the Valukas Report concluded. Valukas concluded that the Board "did not discuss individual safety issues or individual recalls except in rare circumstances." (A047, ¶ 70). Moreover, as discussed above, the system put in place *by the Board* did not require the Board to monitor serious defects. Again, the findings in the Valukas Report alone should have raised a reasonable doubt in the mind of the Court of Chancery that GM had a system to ensure the reporting of those serious defects in compliance with the Safety Act and that GM's directors acted in good faith or otherwise face a substantial likelihood of personal liability.

Additional allegations in the Complaint support this reasonable doubt. For example, the Valukas Report concluded that "until 2014, the TREAD Reporting team did not have sufficient resources to obtain any of the advanced data mining software programs available in the industry to better identify and understand potential defects." (A050, ¶ 81). It can be reasonably inferred that a properly functioning reporting system would have brought this deficiency to the Board's attention. Further, on May 16, 2014, GM entered into a Consent Order with NHTSA, in which "GM admit[ted] that it violated the Safety Act by failing to provide notice to NHTSA of the safety-related defect that is the subject of the Recall No. 14V-047 within five working days as required by 49 U.S.C. § 30118(c)(l), 49 U.S.C. §

30119(c)(2), and 49 C.F.R. § 573.6(b)." (A054, ¶ 90). In addition, despite its concerns in 2007 and 2010, NHTSA stated that it *lacked the data necessary* to open a formal investigation. (A055, ¶ 94). And, as reported by the *New York Times*, when NHTSA asked GM to explain the circumstances surrounding certain crashes to help identify potential defects, "[GM] repeatedly found a way not to answer the simple question from regulators of what led to a crash. In at least three cases of fatal crashes . . . GM said it had not assessed the cause," or "GM opts not to respond." (A061, ¶ 114). All of these allegations indicate a lack of information reporting and/or a deliberate lack of effort on behalf of the Board to ensure defect reporting and as such these allegations support a finding of reasonable doubt.

Relying on the decisions in *Caremark* and *Stone v. Ritter*, the court in *Rich ex rel. Fuqi International, Inc. v. Yu Kwai Chong*, 66 A.3d 963 (Del. Ch. 2013), sustained a *Caremark*-based complaint in which it found the corporation "had no ***meaningful*** controls in place." *Id.* at 983 (emphasis in original). In *Rich*, the nominal defendant was a Delaware corporation headquartered in China and whose principal business was selling high quality precious metal jewelry. The plaintiff alleged board breaches of fiduciary due to inventory irregularities resulting in re-statements of its financials. *Rich* held that a plaintiff might successfully plead a *Caremark* claim by pleading "facts showing that a corporation had no internal controls in place." *Id.* at 982. As with GM, "*Fuqi* had some sort of compliance

system in place," and even though "it had an Audit Committee . . ., accepting the Plaintiff's allegations as true, the mechanisms Fuqi had in place appear to have been woefully inadequate." *Id.* The Court found Fuqi's inventory problems to be particularly troubling because it was a precious metals and gemstones jewelry company and the "directors allowed the corporation to operate [with] few to no controls over these vulnerable assets." *Id.* at 983. Fuqi's subsequent disclosures of its inventory controls led the Court to conclude "that Fuqi had no ***meaningful*** controls in place." *Id.* (emphasis in original). Here, similar to the facts in *Rich,* GM claims to have had controls in place, but they were not meaningful controls. Just as "[p]roblems with inventory are particularly troubling here, because Fuqi is a jewelry company" (*Id.* at 983), problems with vehicle safety are particularly troubling here, because GM manufactures products that are inherently dangerous.

Here, as a result of a failure to implement a meaningful reporting system, director Defendants "have a disabling interest [for pre-suit purposes] when the potential for liability is not a mere threat but instead may rise to a substantial likelihood." *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1269 (Del. Ch. 1995) (quoting *Rales*, 634 A.2d at 936 (internal quotes omitted)).

CONCLUSION

The Complaint particularizes the substantial risk of liability Defendants face under (a) *Stone v. Ritter*, for failing to act when they knew they had to, and (b) *Caremark*, for failing to establish a functioning reporting mechanism reasonably calculated to put them on notice of egregious misconduct. For all of the foregoing reasons, Plaintiffs request this Court reverse the Court of Chancery's judgment against Plaintiffs in its entirety.

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SMITH KATZENSTEIN & JENKINS LLP

/s/ David A. Jenkins
David A. Jenkins (ID No. 932)
1000 West Street, Suite 1501
P.O. Box 410
Wilmington, Delaware 19899
Tel: 302-652-8400
djenkins@skjkaw.com

BIGGS AND BATTAGLIA

/s/ Robert D. Goldberg
Robert D. Goldberg (ID # 631)
921 N. Orange Street
P.O. Box 1489
Wilmington, Delaware 19899
Tel: (302) 655-9677
Fax: (302) 655-7924
Goldberg@batlaw.com

Attorneys for Plaintiffs Below-Appellants