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IN THE SUPREME COURT OF THE STATE OF DELAWARE

LABORERS' DISTRICT COUNCIL CONSTRUCTION INDUSTRY PENSION FUND and HALLANDALE BEACH POLICE OFFICERS AND FIREFIGHTERS' PERSONNEL RETIREMENT FUND, derivatively on behalf of LULULEMON ATHLETICA, INC.,	
Plaintiffs Below, Appellants,	No. 358, 2016 Court Below: Court of Chancery C.A. No. 11293-CB
v.	
ROBERT BENSOUSSAN, MICHAEL CASEY, ROANN COSTIN, CHRISTINE M. DAY, WILLIAM H. GLENN, MARTHA A.M. MORFITT, RHODA M. PITCHER, THOMAS G. STEMBERG, JERRY STRITZKE, EMILY WHITE, and DENNIS J. WILSON,	**PUBLIC VERSION** **E-FILED Oct. 26, 2016**
Defendants Below, Appellees,	
-and-	
LULULEMON ATHLETICA, INC., a Delaware Corporation,	
Nominal Defendant Below, Appellee.	

APPELLANTS' REPLY BRIEF ON APPEAL

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Appellees do not offer any satisfactory response to the arguments raised by the Delaware Plaintiffs[1] regarding the purported preclusive effect of the New York Action. It is self-evident from any examination of that proceeding that the actions of the U.S. District Court were intended to preserve the opportunity for the Delaware Plaintiffs to pursue derivative claims on behalf of Lululemon following resolution of their Section 220 books and records action – not to preclude such claims. It was, therefore, error for the Court of Chancery to hold that the New York Action precluded Plaintiffs' claims here.

On the merits, Delaware Plaintiffs have sufficiently alleged demand futility on the grounds that the Lululemon Board's utter failure even to investigate then-Chairman Chip Wilson's highly suspicious June 2013 stock trades was not a valid exercise of business judgment.

I. *RES JUDICATA* AND COLLATERAL ESTOPPEL DO NOT PRECLUDE THIS ACTION

A. The District Court Made Clear Its Intent To Preserve The Delaware Plaintiffs' Ability To Pursue Their Claims

Delaware Plaintiffs initiated their Section 220 books and records demands on Lululemon, seeking documents related to a potential *Brophy* claim against

[1] All capitalized terms not defined herein have the same meanings as set forth in Appellants' Opening Brief on Appeal ("Opening Brief") filed with the Court on August 29, 2016.

Chip Wilson, before the filing of any shareholder derivative litigation in New York. However, the New York Action progressed more quickly than the 220 Action and reached the motion to dismiss stage before the Delaware Plaintiffs had received any documents from their Section 220 efforts. Although the New York Complaint almost exclusively concerned Lululemon's quality control problems with its Luon yoga pants, it also included a thinly-pled *Brophy* claim concerning Wilson's June 2013 trading.[2] The Delaware Plaintiffs recognized that an adverse ruling in the New York action could potentially preclude derivative claims related to Wilson's trades that they might bring as a result of their Section 220 investigation. They therefore moved to intervene in the New York Action to ensure that the claims would not be dismissed in haste and without benefit of a proper investigation.[3]

In their motion to intervene, the Delaware Plaintiffs requested one of two forms of relief: (i) a limited stay of the New York Action pending the results of the 220 Action, or (ii) dismissal "without prejudice" of the *Brophy* claim asserted in that case.[4] The Delaware Plaintiffs explained that they sought this relief in order to protect their ability to "plead[] demand futility in a subsequent action" based on

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[2] *See* N.Y. Compl. at ¶¶ 193-98 (A283-A285).

[3] *See* Mot. to Intervene 1 (A049).

[4] *Id*.

information obtained through their 220 Action.[5] Although the New York Plaintiffs opposed this intervention,[6] Defendants did not. They conceded that the Delaware Plaintiffs should be permitted to pursue a derivative claim following Lululemon's production of books and records, but sought to compel them to bring such a claim only in the New York Action.[7]

U.S. District Judge Forrest took a different approach to protect the Delaware Plaintiffs' rights: she dismissed the New York Plaintiffs' *Brophy* claim "without prejudice"[8] – with the obvious intent to thereby eliminate any *res judicata* effect under New York law[9] – and then denied the motion to intervene "as moot,"[10] because she already had granted the relief that the Delaware Plaintiffs requested.

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[5] *Id.* at 13 (A061).

[6] N.Y. Pls.' Letter 1, 3. (A065-A068)

[7] *See* Appellees' Answering Br. 12-13 (Del. Sept. 30, 2016) ("Defs.' Br.") (quoting Letter from Defendants to The Hon. Katherine B. Forrest at 3-4 (Apr. 1, 2014), ECF No. 48).

[8] *Id.* at 23.

[9] *See Landau, P.C. v. LaRossa, Mitchell & Ross*, 892 N.E.2d 380, 383 (N.Y. 2008) ("[A] dismissal "without prejudice" lacks a necessary element of res judicata – by its terms such a judgment is not a final determination on the merits.").

[10] *See* N.Y. Order at 24 (A093).

Defendants and the court below[11] erroneously reason that the district court's dismissal "without prejudice" was nevertheless a final adjudication on the merits for purposes of *res judicata* because of the phrase that followed "without prejudice" in Judge Forrest's order: "in the event plaintiffs seek to pursue these claims after making a demand on the board." That conclusion is nonsensical for at least three reasons apparent on the face of the New York Order.

First, as the Court of Chancery recognized,[12] Judge Forrest's order clearly contemplates the possibility that Lululemon could still pursue a *Brophy* cause of action based on Wilson's alleged insider trades, as could the New York Plaintiffs following a demand on and refusal by the Board.[13] Thus, unquestionably this *Brophy* claim had not been finally adjudicated on the merits.[14]

Second, the New York Order carefully distinguishes between the New York Plaintiffs ("plaintiffs") and Delaware Plaintiffs (LDC and Hallandale), making clear

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[11] Op. at 35.

[12] *Id*.

[13] *Canty v. Day*, 13 F. Supp. 3d 333, 350 (S.D.N.Y. 2014).

[14] Defendants' response to this argument (that the only "claims that are precluded are the claims that a stockholder suing derivatively could assert without making a demand – not claims a stockholder who makes a demand or the corporation could assert," Defs.' Br. 18) continues to erroneously conflate issue and claim preclusion. In all these cases, the cause of action is the same: the claim of the corporation for a wrong done to the corporation. *See* Opening Br. 17.

Judge Forrest's intent to apply the "after making demand" condition only on the New York Plaintiffs:

> [D]efendants' motion to dismiss the consolidated amended complaint pursuant to Rule 23.1 is GRANTED, because ***plaintiffs*** have failed to adequately allege particularized facts showing demand on lululemon's Board of Directors was excused. The Court thus DISMISSES the complaint without prejudice, in the event ***plaintiffs*** seek to pursue these claims after making a demand on the Board.
>
> Accordingly, the pending motions to intervene by the ***Laborers' District Council Construction Industry Pension Fund and the Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund*** are DENIED as moot.[15]

Third, as just noted, the district court denied the motions to intervene as "moot." Given that the Delaware Plaintiffs had sought to intervene to ensure that any dismissal in the New York Action would not have preclusive effect on them, their intervention could only have been rendered moot by a ruling that lacked such preclusive effect, i.e., a dismissal without prejudice to their subsequent claims.

This reading of the dismissal order – that the district court did not intend to foreclose the Delaware Plaintiffs' right to plead demand futility – is further supported by Judge Forrest's own explicit statements at the hearing. As the court explained, "what [the Delaware Plaintiffs] really want to be sure of is that if something gets dismissed, it doesn't get dismissed with prejudice ***that would then***

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[15] N.Y. Order at 23-24 (A092-A093) (emphases added).

foreclose any rights that you may have."[16] Counsel for the Delaware Plaintiffs readily agreed.[17] Later in the hearing, counsel for Defendants sought clarification from the judge regarding what the court meant by the "without prejudice" language contained in the court's preliminary order.[18] Judge Forrest responded:

> Let's put it this way. The counts are not dismissed with prejudice. . . . Because it's just that there's no standing. The pleading standards have not been met. So I think ***that corresponds . . . with what [counsel for the Delaware Plaintiffs] were suggesting***.[19]

Again, the Delaware Plaintiffs agreed.[20] They did so because a "without prejudice" dismissal, and Judge Forrest's statements, aligned perfectly with the relief they were seeking: the opportunity to file a derivative action without "foreclos[ing] any rights."

B. *Parkoff v. General Telephone & Electronics Corp.* Renders Preclusion Inapplicable

As Delaware Plaintiffs explained in their Opening Brief, *Parkoff v. General Telephone & Electronics Corp.*[21] prohibits the application of *res judicata* or

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[16] SDNY Tr. at 67:10-13 (A513) (emphasis added).

[17] *Id.* at 67:17-19 (A513).

[18] *Id.* at 73:25-74:10 (A519).

[19] *Id.* at 74:11-18 (A520) (emphasis added).

[20] *Id.* at 74:22 (A520).

[21] 425 N.E.2d 820 (N.Y. 1981).

collateral estoppel to this case.[22] *Parkoff* held that a final judgment rendered in a derivative action brought by one shareholder will have preclusive effect on a subsequent action brought by another shareholder only where "the shareholder sought to be bound by the outcome in the prior action [had] not . . . been frustrated in an attempt to join or to intervene in the action that went to judgment."[23] As the New York Court of Appeals explained, the reason for this limitation on preclusion stems from the fact that:

> corporate shareholders—who in principle have an equal interest and right in seeing that claims for wrongs done to the corporation are prosecuted—should not be compelled against their will to have the prosecution of the corporate claims depend on the diligence and ability of the first shareholder to institute litigation when their own attempts to participate in the litigation have been rebuffed and no other appropriate provision for the protection of their interests has been made.[24]

Defendants have no answer to *Parkoff*, which remains binding precedent on New York preclusion law. In an attempt to avoid the issue, Defendants misleadingly claim that "Plaintiffs concede they did not make this argument in the Court of Chancery."[25] Not so. As the Delaware Plaintiffs explained, "the issues and interests

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[22] Opening Br. 18-22, 30.

[23] 425 N.E.2d at 824.

[24] *Id*. (citation omitted).

[25] Defs.' Br. 20 n.93.

raised by the *Parkoff* doctrine . . . were all properly raised and preserved below,"[26] fully justifying this Court's consideration of the *Parkoff* decision. If this Court disagrees for any reason, the Delaware Plaintiffs again respectfully request the Court's consideration under Rule 8.[27]

Defendants also make a feeble attempt to distinguish *Parkoff* on the grounds that they were not "'agents of . . . exclusion' opposing intervention."[28] But *Parkoff* does not turn on whether the defendants themselves opposed intervention. Rather, the bar on preclusion is triggered whenever shareholders' "own attempts to participate in the litigation have been rebuffed and no other appropriate provision for the protection of their interests has been made."[29] There is no question that the Delaware Plaintiffs' attempt to intervene in the New York Action was denied. Therefore, either the district court's ruling must be interpreted to be "an appropriate provision for the protection of their interests" because it lacks preclusive effect on

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[26] Opening Br. 19 n.73.

[27] Defendants argue that Rule 8's "interests of justice" exception does not apply because it is applicable only where, *inter alia*, "'the issue is outcome-determinative and may have significant implications for future cases.'" Defs.' Br. 20 n.93 (quoting *Sandt v. Del. Solid Waste Auth.*, 640 A.2d 1030, 1034 (Del. 1994)). The *Parkoff* doctrine clearly is outcome-determinative on the preclusion issues in this appeal, and application of this important principle of New York preclusion law may well have significant implications for future derivative litigation in Delaware.

[28] Defs.' Br. 21 (quoting *Parkoff*, 425 N.E.2d at 421 n.5) (alteration in original).

[29] 425 N.E.2d at 824 (citation omitted).

the Delaware Plaintiffs, or *Parkoff* applies to protect them from the alleged preclusive effect of that ruling.

C. Defendants Have Failed To Show That The Issues In The New York Action And This Action Are Identical

On May 7, 2015, more than one year after the New York Action was dismissed, the Delaware Plaintiffs received the final document production from the 220 Action. It was in that May 2015 production that the Delaware Plaintiffs discovered record evidence of the Board's decision to do nothing in response to Wilson's June 7 trades. Armed with this new information of the Board's strategy of inaction, the Delaware Plaintiffs carefully drafted a complaint for filing in Delaware's Court of Chancery. The Delaware Complaint, by any measure, was very different from the derivative complaint filed in New York – a crucial point that the Court of Chancery unfortunately overlooked.

This oversight was surprising given that, under New York's law of collateral estoppel, it is Defendants, not the Delaware Plaintiffs, who bore the burden of showing that the issues litigated in the second action were "'identical in all respects'" with the issues litigated in the first action.[30] As the Delaware Plaintiffs explained to

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[30] *See Brautigam v. Blankfein*, 8 F. Supp. 3d 395, 401 (S.D.N.Y. 2014), *aff'd sub nom. Brautigam v. Dahlback*, 598 F. App'x 53 (2d Cir. 2015) (recognizing use of collateral estoppel "'must be confined to situations where the matter raised in the second suit is ***identical in all respects*** with that decided in the first proceeding") (emphasis added).

the Court of Chancery and reiterate here, the allegations in the Delaware Action could not be more different. First, there is no count in the New York Action against the entire Board related to Wilson's trades, only a *Brophy* claim against Wilson and Day. It stands to reason that the demand futility issue cannot be identical if the claim asserted against the Board in Delaware was never even alleged in New York.[31] By way of example, a director could face a substantial likelihood of liability as to one cause of action but not to another.[32] As such, contrary to Defendants' implausible suggestion, the issues litigated in the New York and Delaware actions are not "'minor variations in the application of . . . the same legal standard.'"[33] Instead, they are entirely different analyses altogether.

As to their burden, Defendants have never identified, using the New York Complaint or the briefing on the motion to dismiss, precisely how the issues in the two actions are identical. Instead, Defendants are left with cherry-picked statements from the Delaware Plaintiffs' motion to intervene – a motion filed more than a year

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[31] *See Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1040 (Del. 2004).

[32] *See Bansbach v. Zinn*, 801 N.E.2d 395, 402 (N.Y. 2003) ("That the [prior court] concluded these defendants were not subject to [the chairman]'s domination and control with respect to the stock options and warrants, however, does not for all time and in all circumstances insulate their conduct from similar claims.").

[33] Defs.' Br. 3.

prior to the production of the final 220 Action documents – to support their view that the issues are identical. The demand futility allegations litigated in the New York Action concerned whether or not the Board was so dominated and controlled by Wilson that it was willing to aid and abet Wilson's insider trading. Those allegations have never been part of this case, which always has been about a decision made by the Board in the aftermath of the trades.[34]

Because the issues raised in the Delaware Action are not identical to those litigated in the New York Action, they could not have been necessarily decided in the prior case. Under New York law, for an issue to have been actually litigated "so as to satisfy the identity requirement, it 'must have been properly raised by the pleadings or otherwise placed in issue and actually determined in the prior proceeding.'"[35] This never happened in New York and Defendants cannot show otherwise. Indeed, Defendants' Answering Brief confirms as much; Defendants made no effort to compare the allegations of the Delaware Complaint with those in the New York Complaint. Defendants have not met their burden and the Court of Chancery erred in holding that they had.

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[34] *Cf. Wietschner v. Dimon*, 2015 WL 4915597, at *5 (N.Y. Sup. Aug. 14, 2015) (noting collateral estoppel does not apply to prior demand futility decision when subsequent litigation raised allegations not addressed in prior action).

[35] *D'Arata v. N.Y. Cent. Mut. Fire Ins. Co.*, 564 N.E.2d 634, 638 (N.Y. 1990).

D. Inadequate Representation In The New York Action Also Bars Preclusion

Defendants suggest that Delaware Plaintiffs shirked their duty to inform the New York District Court that the New York Plaintiffs were inadequate.[36] In reality, however, the whole purpose of the motion to intervene was to protect the Company's interests by ensuring that the New York Plaintiffs would not foreclose the rights of the Company or its shareholders.

In doing so, Delaware Plaintiffs argued that intervention was necessary "to ensure that the nominal defendant in this case, Lululemon, is not prejudiced by the fact that [the New York Plaintiffs] rushed to file actions in this Court asserting *Brophy* claims without first pursuing their Section 220 inspection rights."[37] The Section 220 documents were necessary to understand "whether the *Brophy* claim has merit."[38] That is because the *Brophy* claim was "brought in haste, without the benefit or consideration of the Company's books and records" and threatened to "permanently extinguish" Lululemon's right to bring suit for these claims.[39] The Delaware Plaintiffs argued that "Lululemon's interests are too important to be

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[36] *See* Defs.' Br. 29.

[37] Mot. to Intervene at p. 2 (A050).

[38] *Id.* at 6 (A054).

[39] *Id.* at 8 (A056).

sacrificed by a hastily-filed complaint."[40] The 220 Action was necessary to "uncover[] evidence of wrong[do]ing," which is why the Delaware Plaintiffs acknowledged in their motion that they did not yet "know the precise parameters of [their] legal and factual claim until [the] books and records request is complete and the documents are reviewed and analyzed."[41] Ultimately, the 220 Action was necessary "so that the *Brophy* claim [could] be pleaded with specificity."[42] The Delaware Plaintiffs' suspicions proved to be true; the New York Plaintiffs could ***not*** plead the *Brophy* claim with specificity.[43]

The New York Plaintiffs actively opposed the Delaware Plaintiffs' motion to intervene in their action. They expressly disputed the Delaware Plaintiffs' argument that a Section 220 books and records request would be essential to establishing demand futility in this case, arguing instead that "the Delaware courts also have repeatedly found that derivative plaintiffs adequately alleged demand futility ***without*** first [having] sought books and records pursuant to Section 220."[44] While that may be true, as this Court acknowledged in *Pyott v. Louisiana Municipal Police*

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[40] *Id.* at 13 (A061).

[41] *Id.* at 15 (A063).

[42] *Id*.

[43] N.Y. Order at 18, 23 (A087, A092).

[44] N.Y. Pls.' Letter at p. 3 (A067).

Employees' Retirement System,[45] "[u]ndoubtedly there will be cases where a fast filing stockholder also is an inadequate representative."[46] And this is precisely such a case because, as discussed below, the information obtained through the Delaware Plaintiffs' 220 Action was essential to be able to adequately plead demand futility based on Defendants' failure and determination not to conduct any investigation whatsoever into Wilson's suspicious stock trades.

Here again *Parkoff* provides the essential rationale for denying preclusive effect to an earlier defense judgment obtained against inadequate shareholder representatives: "corporate shareholders . . . should not be compelled against their will to have the prosecution of the corporate claims depend on the diligence and ability of the first shareholder to institute litigation."[47] The Court of Chancery ruling is contrary to this principle and must be overturned.

II. THE DELAWARE PLAINTIFFS HAVE SUFFICIENTLY ALLEGED THAT DEMAND IS EXCUSED

Apparently recognizing the weakness of their arguments for affirmance of the Court of Chancery ruling on preclusion grounds, Defendants also assert as an alternate ground that the Delaware Plaintiffs have not adequately alleged

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[45] 74 A.3d 612 (Del. 2013).

[46] *Id.* at 618.

[47] 425 N.E.2d at 824.

particularized facts excusing demand, an issue never reached by the court below.[48] Defendants' arguments on this score are equally unavailing.

A. Wilson's June 7 Stock Sales Were Unusual In Timing And Amount

Delaware courts recognize that insider sales that are "unusual in timing and amount . . . support a pleading-stage inference that the seller[] took advantage of confidential corporate information not yet available to the public."[49] The Delaware Plaintiffs' complaint alleges both.

On the issue of unusual timing, Wilson's June 7, 2013 sales were executed at a remarkably convenient time: immediately before the announcement of the surprise departure of the Company's long-tenured CEO.[50] Not surprisingly, the Company's stock price dropped seventeen percent on this news.[51]

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[48] *See* Defs.' Br. 30-35.

[49] *Pfeiffer v. Toll*, 989 A.2d 683, 694 (Del. Ch. Mar. 3, 2010), *abrogated on other grounds by Kahn v. Kolberg Kravis Roberts & Co.*, 23 A.3d 831 (Del. 2011); *see also In re Primedia, Inc. S'holders Litig.*, 2013 WL 6797114, at *14 (Del. Ch. Dec. 20, 2013) ("A court may infer scienter when a trade is 'sufficiently unusual in timing and amount.'").

[50] *See Primedia*, 2013 WL 6797114, at *14 (recognizing allegations of insider trades "timed conveniently to occur just before [a] public announcement" of a major corporate event are sufficiently "unusual" at pleadings stage to support *Brophy* claim).

[51] Compl. ¶ 53 (A117-A118).

Comparing an insider's prior trading history to the challenged trades, which the Delaware Plaintiffs did here, can provide evidence of "unusual" trading.[52] As the Complaint makes clear, the June 7 sales involved 210,000 more shares than Wilson's next-highest single-day sale and more than doubled (321,000 more shares) any other single-day trade made in 2011 or 2012.[53] Additionally, the aggregate value of the June 7 trades ($49,515,161) was over $17 million more than any prior day's trades under his trading plan, and $32 million more than any single-day proceeds from sales made in 2011 and 2012.[54]

In addition to particularized allegations concerning the unusual timing and amount of Wilson's trades, the Delaware Plaintiffs also alleged that the 607,545 shares sold on June 7 were the maximum number of shares that Wilson could have sold that day under his trading plan.[55] In other words, despite the fact that Lululemon had announced just days earlier that the previously recalled Luon pants would return to the market,[56] thereby putting an end to the quality control scandal, Wilson sold

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[52] *See Primedia*, at *14 (noting court "may infer scienter when a trade is 'sufficiently unusual in timing and amount,'" and that "'[o]ther factors relevant to scope and timing are whether the sales were normal and routine'").

[53] Compl. ¶ 53 (A117-A118).

[54] Compl. ¶ 73 (A129-A130).

[55] *Id*.

[56] *Id*. ¶ 45 (A114-A115).

every share available under the trading plan's monthly allotment in the first seven days of June. This fact, when combined with the timing of the June 7 trades and Wilson's prior trading history, supports a pleading-stage inference that Wilson likely passed the news of Ms. Day's resignation to his broker.

But, the Delaware Plaintiffs went many steps further. Using the documents from the Section 220 investigation, the Delaware Plaintiffs also alleged precisely what Wilson knew about Day's resignation and when he knew it, including that he was aware of the timetable for public disclosure.[57] Though such detail is not required at the pleading stage in order to sufficiently plead a *Brophy* claim,[58] these and other facts easily negate Defendants' contention that the existence of Wilson's trading plan, ipso facto, removes any and all "unusual" suspicions that may otherwise be inferred from the trades. Moreover, Defendants offer no authority to support their view that a 10b5-1 trading plan effectively trumps Delaware's well-established pleading requirements for a *Brophy* claim.

The unusual timing and amount of the trades, along with news coverage published in *The Wall Street Journal* and *Reuters* concerning the suspicious nature

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[57] *See, e.g.*, *id*. ¶¶ 47-53 (A116-A118).

[58] *Pfeiffer*, 989 A.2d at 694 ("Although the plaintiffs . . . cannot establish the exact moment in time when the defendants [became aware of material non-public information], they have pled a claim that merits discovery.").

of the trades, amounted to red flag warnings of potential wrongdoing.[59] It is axiomatic that directors of Delaware corporations are on constructive notice of the contents of prominent news reports that concern companies for which they serve as fiduciaries.[60] Here, *The Wall Street Journal* published a story about Wilson's trading under the headline "Timing of Stock Sales Favors Lululemon Insider."[61] The article outlined the suspicious timing of the trades, stating, among other things:

> On Friday, the day Lululemon's board was notified that CEO Christine Day intended to vacate her post, Mr. Wilson sold 607,545 shares at a price of $81.50 apiece, for proceeds of $49.5 million.
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> The company announced the CEO's departure plans after the market closed on Monday. On Tuesday, Lululemon's stock fell more than 17% to $67.85. A sale at that price would have brought Mr. Wilson about $8 million less than he reaped by selling his stock the previous week.[62]

The next day, a *Reuters* article titled "Lululemon Chairman Sold Stock Before CEO's Surprise Departure" similarly noted that "Wilson sold stock worth

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[59] *In re Primedia*, 2013 WL 6797114, at *13 ("[P]urchas[es of] large quantities of Preferred Stock just weeks before the public announcement of a material sale of assets . . . ***were a red flag***.") (emphasis added).

[60] *See, e.g.*, Tr. of Oral Argument at 8:15-24, *Szmerkes v. Page*, No. 6981-CS (Del. Ch. Jan. 29, 2013) (Court: "I would draw the inference that an independent director of Google would know something that was in the New York Times or Wall Street Journal. . . . I would charge them with knowledge of something in the New York Times or Wall Street Journal about a company of which they're a director.").

[61] Compl. ¶ 55 (A119-A122).

[62] *Id.*

$50 million days before shares slumped on the news of Chief Executive Christine Day's surprise departure."[63]

After these flags were prominently raised in the press, Defendants should have, consistent with their fiduciary duties of loyalty and good faith under Delaware law, at least taken steps to inquire further into whether Wilson improperly passed information about Ms. Day's resignation to his personal stock broker. Instead, they made a conscious decision to remain uninformed and do nothing.[64]

Defendants speculate that the Board could have performed what effectively amounts to an oral inquiry into the matter,[65] whereby the directors never actually called a meeting to discuss Wilson's trades or recorded minutes, but instead communicated only by phone or in person about these events, and that those hypothetical discussions somehow amounted to an investigation. Even if this were plausible, Defendants at best raise a factual dispute that cannot be resolved at the pleading stage given that the Delaware Plaintiffs have alleged the opposite.

It is implausible that the Board conducted such an oral investigation given that the Delaware Plaintiffs' 220 investigation revealed an email exchange between a

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[63] *Id.* ¶ 54 n.24 (A118).

[64] *Id.* ¶¶ 72-76 (A128-A131).

[65] *See* Defs.' Br. 35.

former director, Jerry Stritzke, and Lululemon's top in-house attorney, Erin Nicholas.[66] In response to a question from Mr. Stritzke about whether a lawyer had looked into Wilson's trades, Ms. Nicholas replied: "***We haven't had an attorney look into the facts surrounding the last trade made under [Wilson's] plan***."[67] Ms. Nicholas thereby unequivocally confirmed that no investigation had been conducted.

Instead, Ms. Nicholas's email established that management and the Board merely relied on a representation from Wilson's "advisors" that the June 7 trades were made in conformance with Wilson's trading plan.[68] Neither management nor the members of the Board thought to question this representation, even though these "advisors" were close associates of Wilson.

Because the Delaware Plaintiffs have alleged with sufficient particularity that a majority of the current Board (eight of the current eleven directors) knowingly made a decision not to inform themselves or otherwise take action following red flag warnings about Wilson's suspicious stock sales,[69] their decision is not protected by

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[66] Compl. ¶¶ 62-64 (A124-A126).

[67] *Id.* ¶ 62 (A124).

[68] *Id.* ("We were advised that the trade was made pursuant to the parameters of the plan ***by his advisors*** and assisted with the drafting of the Form 4 for that transaction.") (emphasis added).

[69] *Id*. ¶¶ 68-76 (A127-A131).

the business judgment rule. Therefore, any demand on the Board to initiate this action would have been futile.

For their part, Defendants primarily rely on the conclusion allegedly reached by Lululemon management that Wilson's stock sales were "in alignment with SEC guidelines for these types of sales" and contend that the Board's reliance on this supposition fully insulates it from any obligation to take any action because Wilson was not a member of management.[70] While technically true (Wilson's title was non-executive Chairman), the suggestion that Lululemon management operated independently of Wilson is belied by documents produced in the Section 220 investigation. For example, in a June 5, 2013 email, Wilson "offer[ed his] edits" to Ms. Day regarding management's 10-year vision for Lululemon.[71] In response, Ms. Day stated: "I am fine with all [of your edits] except declaring factory ownership."[72] Ms. Day then went on to explain that she was resigning because "it is time for new leadership ***to work with you***."[73] That same day, in an email to Michael Casey, the Company's Lead Director, Ms. Day stated that she "spoke with Chip [Wilson] today and it became very apparent that we are very far apart on vision

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[70] Defs.' Br. 8.

[71] Ex. G to Compl. (A180).

[72] *Id*.

[73] *Id.*; *see also* Compl. ¶ 47 (A115-A116).

and strategy" and that "from [Wilson's] perspective . . . I do not have the ability to shape the vision and strategy of the company for the ten year horizon."[74]

Defendants' reliance on Wilson's independence from management is further undermined by the fact that, while Wilson was Chairman, when the Board met in executive session (at which members of management are not present), those closed-door meetings were chaired by Lululemon's Lead Independent Director, and not by Wilson.[75] Thus, the Board did not consider Wilson sufficiently independent from management to lead executive sessions of the Board.

The inference that logically flows from the email correspondence and the Lead Director's role is that Wilson did, in fact, work closely with Lululemon management, even though he technically did not hold an official title. As such, Defendants' contention that the Board was free to rely on management's conclusion that the trades were "in alignment with SEC guidelines" is inconsistent with Wilson's true role at Lululemon during this time period. Further to this point, the lightning-quick pace at which Lululemon management reached this conclusion – the day after the article in *The Wall Street Journal* was published[76] – supports the Delaware Plaintiffs' view that the Board should have taken steps independent of

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[74] Ex. H. to Compl. (A184-A185); *see also* Compl. ¶ 48 (A116).

[75] Lululemon, Definitive Proxy Statement (Schedule 14A), at 10 (Apr. 30, 2013).

[76] Compl. ¶ 61 (A124).

management (and certainly independent of Wilson and his advisors) to confirm that he did not pass confidential corporate information to his broker.

B. The Authority On Which Defendants Rely Is Inapposite

Aside from asserting that the Board was entitled to rely on management's conclusions, Defendants also argue that two Delaware Chancery Court cases, *Jacobs v. Yang*,[77] and *Hartsel v. Vanguard Group, Inc.*,[78] buttress their position that the Board was under no obligation to act following news releases related to Wilson's suspicious trades.[79] Both are easily distinguishable.

Jacobs in part concerned whether the board of directors of Yahoo! Inc. ("Yahoo") approved the engagement of Goldman Sachs ("Goldman"), notwithstanding Goldman's alleged provision of sweetheart investment opportunities to company insiders as a quid pro quo for future company business.[80] Without ever deciding the issue of whether the liability could attach for the Board's failure to investigate, the court concluded that a majority of the demand board had

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[77] 2004 WL 1728521 (Del. Ch. Aug. 2, 2004).

[78] 2011 WL 2421003 (Del. Ch. June 15, 2011).

[79] Defs.' Br. 33.

[80] *Jacobs*, 2004 WL 1728521, at *1.

been reconstituted since Goldman had been retained.[81] In other words, a majority of the Board did not participate in the challenged transactions.

Here, in stark contrast, Delaware Plaintiffs have alleged that eight of eleven Board members – a clear majority – participated in the decision not to investigate Wilson's trades.

Hartsel is similarly inapposite. There, the court was unconvinced that the alleged misconduct, mutual fund-related investments in on-line gambling companies, violated positive law;[82] therefore, the board did not face a substantial likelihood of liability because of its action. The same cannot be said of trading on material non-public information – the misconduct at the heart of this case.[83]

Finally, Defendants suggest that Delaware Plaintiffs are doing precisely what Vice Chancellor Parsons encouraged them not to do: drawing an inference that no investigation was conducted because no investigation-related documents were produced in the 220 Action.[84] This mischaracterizes Delaware Plaintiffs' case. To

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[81] *Id.* at *7.

[82] *Hartsel*, 2011 WL 2421003, at *25-26 ("I am not convinced that this conduct is criminal.").

[83] *See Kahn*, 23 A.3d at 840 (recognizing *Brophy* and its progeny advance Delaware's long-held "public policy of preventing unjust enrichment based on the misuse of confidential corporate information").

[84] Defs.' Br. 35.

demonstrate that no investigation took place, Delaware Plaintiffs rely on a specific internal email from the Company's highest attorney that confirms this fact.[85] As Ms. Nicholas explained: "We haven't had an attorney look into the facts surrounding the last trade made under [Wilson]'s plan."[86] What is more, at the time the Vice Chancellor discouraged the drawing of inferences, this email from Ms. Nicholas had not yet been produced. Thus, there should be no question that Delaware Plaintiffs have sufficiently alleged demand futility.

[85] Compl.¶ 62 (A124); *see also* Ex. M to Compl. (A200-A201)

[86] *Id.*

CONCLUSION

For the foregoing reasons, and those set forth in Appellants' Opening Brief, the decision of the Court of Chancery should be reversed and the case remanded for further proceedings.

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