EFiled: Jan 25 2019 03:30PM EST
Filing ID 62900060
Case Number 533,2018

IN THE SUPREME COURT OF THE STATE OF DELAWARE

JACK L. MARCHAND II, Plaintiff-Below, Appellant, v. JOHN W. BARNHILL, JR., GREG BRIDGES, RICHARD DICKSON, PAUL A. EHLERT, JIM E. KRUSE, PAUL W. KRUSE, W.J. RANKIN, HOWARD W. KRUSE, PATRICIA I. RYAN, DOROTHY MCLEOD MACINERNEY, and BLUE BELL CREAMERIES, USA, INC., Defendants-Below, Appellees.	No. 533, 2018 Court Below: The Court of Chancery of the State of Delaware C.A. No. 2017-0586-JRS Redacted Public Version E-Filed January 25, 2019

APPELLEES' ANSWERING BRIEF

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Dated: January 10, 2019

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NATURE OF PROCEEDING

On August 14, 2017, Plaintiff filed his Verified Stockholder Derivative Complaint (the "Complaint") seeking to hold certain directors and officers of Blue Bell personally liable for harm to the Company allegedly resulting from a voluntary recall instituted in 2015 to address *listeria monocytogenes* contamination of some of the Company's ice cream products. Plaintiff's claims are divided into two counts for breaches of fiduciary duty, with Count I asserted against Paul Kruse and Greg Bridges in their capacities as officers[1] and Count II against all Individual Defendants in their capacities as directors.[2] Count I, asserted only against the Officer Defendants, purports to assert a derivative claim for breach of fiduciary duty based on an unrecognized variation of a *Caremark* oversight duty or some other novel theory for "knowing disregard" of risks. Meanwhile, Count II asserts a *Caremark* claim against all but one of the Company's directors for their alleged failure to institute and maintain reporting and information systems or controls at the Company.

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[1] Because Count I was asserted only against Paul Kruse and Greg Bridges in their capacity as officers, they are sometimes referred to herein as the "Officer Defendants."

[2] The "Individual Defendants" consists of Defendants John W. Barnhill, Jr., Richard Dickson, Paul A. Ehlert, Jim E. Kruse, W.J. Rankin, Howard W. Kruse, Patricia I. Ryan, Dorothy McLeod MacInerney, Greg Bridges and Paul W. Kruse.

On October 30, 2017, Defendants moved to dismiss the Complaint pursuant to Court of Chancery Rules 12(b)(6) and 23.1. The parties subsequently briefed the motion to dismiss and oral argument was held on March 19, 2018. At oral argument, the Defendants offered to submit additional Board meeting minutes in response to questions from the Court regarding the existence of a board-level reporting system. (A0272-273). On March 28, 2018, the Defendants submitted a letter to the Court enclosing minutes from monthly Board meetings from April 2014 through February 2015. (A0157-A0190). On May 11, 2018, the Court of Chancery further requested supplemental submissions from the parties on certain issues generally related to holding company level oversight of subsidiaries. (A0275-A0283). The parties' supplemental submissions were filed on June 13, 2018. (A0284-A0302; B176-B197).

On September 27, 2018, the Court of Chancery issued its Memorandum Opinion ("Opinion" or "Op."), granting Defendants' motion to dismiss the Complaint with prejudice under Rule 23.1 for failure to make a demand on the Board. (Op. at 1-2, 29, 51-52). Specifically, the Court held that demand was not excused with respect to Count I because Plaintiff failed to plead particularized facts sufficient to raise a reasonable doubt that a majority of the Board could have impartially considered a pre-suit demand with respect to Count I. Similarly, as to Count II, the Court held that Plaintiff failed to state a viable *Caremark* claim against

the Individual Defendants and, consequently, failed to raise a reasonable doubt that a majority of the otherwise disinterested Board could have exercised their business judgment in responding to a demand. Plaintiff now appeals that decision.

SUMMARY OF ARGUMENT

1. Denied. The trial court properly held that Plaintiff failed to plead particularized facts sufficient to raise a reasonable doubt that a majority of the Board members could have impartially considered a pre-suit demand with respect to Count I. Plaintiff does not, and cannot, establish that the trial court erred in finding that directors holding eight of the fifteen total Board votes were independent and would have been capable of impartially considering a demand. With respect to defendant Rankin, Plaintiff's allegations consist of nothing more than that he is a former long-term employee of Blue Bell and that unidentified members of the Kruse family made charitable donations (in an unspecified amount) to a local college in his name. Though the trial court recognized that Delaware case law has consistently rejected these types of conclusory allegations as inadequate to establish a lack of independence, it ultimately did not need to decide based solely on those allegations because the Complaint itself provided sufficient evidence that Rankin is independent of the Officer Defendants. In paragraph 115, the Complaint alleges that Rankin voted in support of a Board initiative, sponsored by a concededly independent director, to separate the positions of CEO, President and Chairman of the Board, each of which was held by Paul Kruse. Because this Board vote was on a significant matter of corporate governance and occurred *after* the allegedly disabling charitable contribution, the trial court properly determined that Rankin was independent and

capable of impartially considering a demand as to Count I. The trial court rejected similar allegations with respect to defendant Ehlert, all of which were based on conclusory statements regarding the Kruse and Ehlert families. In doing so, the trial court did not fail to draw all reasonable inferences in favor of Plaintiff regarding Ehlert's relationship with the Kruse family, but rather refused to draw unreasonable inferences in Plaintiff's favor based on conclusory allegations. Accordingly, the trial court's determination that members holding a majority of the Board's voting power could have impartially considered a pre-suit demand to assert Count I must be affirmed.

2. Denied. The trial court's dismissal of Count II should be affirmed because the Complaint fails to state a *Caremark* claim against the Board and, consequently, does not allege particularized facts raising a reasonable doubt that a majority of the otherwise disinterested Board members could have exercised their business judgment in responding to a demand. The Complaint describes at length the regulatory scrutiny under which Blue Bell operated, yet does not allege that Blue Bell failed to implement any of these mandated monitoring and reporting systems. Most importantly, however, the trial court properly recognized that the allegations in the Complaint reveal the existence of monitoring and reporting controls, and Plaintiff instead resorts to taking issue with the effectiveness of those controls. As the trial court held, this is not a valid theory under the first prong of *Caremark*.

Moving to the second prong of *Caremark*, the Complaint fails to allege the existence of any bad faith conduct or "red flags." On appeal, Plaintiff does not even attempt to put forth any argument that would support a second-prong *Caremark* claim. Thus, because Plaintiff has failed to allege any viable theory under either prong of *Caremark*, this Court should affirm the trial court's dismissal of Count II.

STATEMENT OF FACTS

A. Blue Bell and the Board of Directors

Blue Bell is an ice cream manufacturing company headquartered in Brenham, Texas that has been providing its ice cream products to customers throughout the southern United States since the early 1900's. (A0012, A0020-21). At the time the Complaint was filed, Blue Bell's board of directors (the "Board") consisted of eleven individuals, ten of whom have been named as defendants in this action: John W. Barnhill, Jr., Greg Bridges, Richard Dickson, Paul Ehlert, Jim Kruse, Paul Kruse, W.J. Rankin, Howard Kruse, Patricia Ryan, Dorothy McLeod MacInerney, and non-defendant Bill Reimann. (A0013-A0020). Pursuant to Section 1.3 of the Certificate of Amendment to the Certificate of Incorporation, Reimann—as the Board designee and a principal of Moo Partners L.P. ("Moo")—is entitled to one-third of the Board's total voting power on all matters put to a Board vote, which would necessarily include any decision by the Board with respect to a stockholder demand under Rule 23.1. (B12). Because there were eleven members of the Board at the time the Complaint was filed, there are fifteen total votes split amongst the directors, with Reimann entitled to exercise five of the fifteen votes and each of the other directors entitled to exercise one vote.

Though Plaintiff attempts to portray the ten defendant directors as having been [redacted], a majority of the directors are not

employed at Blue Bell outside of their positions on the Board, and seven of the eleven directors are unrelated and are alleged to have only loose personal and/or business connections to any member of the Kruse family. (A0013-A0020). Such connections range from their mutual service on the Board to being associated with certain local businesses and social circles in Brenham. (*Id.*) Many of these connections are even more attenuated, with some relating to the directors' extended family and events unrelated to the claims that took place decades ago. (A0018-19).

As noted above, the Complaint also alleges a separate claim for breach of fiduciary duty (Count I) against the Officer Defendants in their capacities as officers. (A0067-68). Paul Kruse was an officer of the Company from 2004 until his retirement in 2017. (A0048). Meanwhile, Greg Bridges is the Vice President of Operations at Blue Bell. (A0014-15). In that role, Bridges is alleged to have been in charge of all aspects of plant operations and, during the relevant time period, reported directly to Paul Kruse. (A0014-15).

B. Operation of Blue Bell Facilities

As discussed in the proceedings below, Blue Bell maintained a comprehensive compliance program that, among other things, was designed to ensure that its employees were adequately trained and that the Company monitored its compliance with state and federal health regulatory guidelines. Such efforts included overseeing Blue Bell's operations to ensure that those operations complied with standards set

forth by regulators and that the Company was producing safe, high quality products in each of its facilities. (*See* A0052, 53, 55-60). Further, the FDA conducts regular inspections of Blue Bell facilities and issues publicly available reports detailing the results of each inspection. While Plaintiff selectively highlights any negative regulatory observation in an attempt to present an inaccurate picture of the Company as a chronic violator of applicable regulations, the trial court correctly recognized that the same FDA reports and other available documents Plaintiff relied upon "reveal the [Company's] distribution of a sanitation manual with standard operating and reporting procedures, promulgat[ion] [of] written procedures for processing and reporting consumer complaints[,] . . . and engage[ment] [of] a third-party laboratory and food safety auditor to test for the presence of dangerous contaminates in its facilities." (Op. at 46-47). Having been exposed for omitting any positive information regarding Blue Bell and its facility operations, Plaintiff's opening brief nonetheless continues to put forth an incomplete narrative that an "escalating *Listeria* problem" existed due to "increasing[] frequent positive test results." (Op. Br. at 14-18). Once again, however, Plaintiff can provide no explanation of how these tests are connected to the ultimate *listeria monocytogenes* contamination and recall in 2015, nor does he explain with any degree of particularity what the significance of these tests are, how the responses to these tests were flawed, or what measures instead should have been taken. Indeed, Plaintiff's claims are further

misleading in light of the fact that the Complaint omits key information from multiple FDA inspection reports regarding Blue Bell's training program, sanitation measures, and formal complaint policy because it does not support the false narrative put forth by Plaintiff. (B14-25; B26-38; B39-47; B68-B69).

Specifically, Plaintiff cites to FDA inspection reports that mention presumptive positive tests for *listeria* from 2013 through 2015 in a transparent and misleading attempt to have the Court infer that the issues the Company encountered in 2015 and that led to the recall were in existence and not adequately addressed in the years leading up to 2015. These conclusory allegations regarding presumptive positive test results were fully addressed during the proceedings below and Plaintiff's opening brief does nothing more to explain how these presumptive positive tests are connected to the ultimate *listeria* contamination and recall in 2015. Accordingly, Defendants will not burden this Court with a complete (and ultimately irrelevant) recitation of these instances, but respectfully refers the Court to consider the entirety of the pleading-stage record which demonstrates that Plaintiff fails to plead facts, let alone particularized facts, to explain what any of the Defendants failed to do or could have done to avoid the 2015 *listeria* contamination and corresponding recall. (*See* B48-B134; B135-B175).

C. *Listeria Monocytogenes* Contamination and Subsequent Product Recall

A thorough review of the FDA inspection reports and Board meeting minutes demonstrate that Plaintiff's conclusory allegations reflect an attempt to emphasize any past issue related to *listeria*, in hopes that the Court will infer that the presence of any form of *listeria* in 2013 or 2014 must have caused the *listeria*-related damage Plaintiff alleges occurred in 2015. As explained in more detail during the Court of Chancery proceedings, the Complaint and documents incorporated therein by reference demonstrate the exact opposite.

As the Complaint alleges, in early 2015 the Company became aware that *listeria monocytogenes* had been found in samples of Blue Bell's ice cream products. (A0036). Prior to that, on January 30, 2015, Blue Bell temporarily ceased operating one of its main production lines at the Brenham facility to undergo routine cleaning and overhaul. (A0077-80). On February 12, 2015, during routine product sampling, the [redacted] found *listeria monocytogenes* in two samples of Blue Bell products manufactured at the Brenham facility. (*Id.*; A0036). Blue Bell was notified of these positive tests the next day by Texas authorities. (*Id.*). [redacted], and conducted cleaning and sanitizing of the

manufacturing line after each manufacturing day. (A0036). Despite these efforts, Blue Bell found positive *listeria* swabs on March 9, 2015.[3] (*Id.*).

The meeting minutes during this time period further refute the false narrative put forth by Plaintiff of a willfully uninformed and disengaged Board. [redacted] (A0055-56). By early March 2015, more information did in fact become available, and the Company, recognizing the potential severity of the issue, issued its first voluntary recall of certain ice cream products. (A0036-37). This voluntary recall was expanded ten days later to include more potentially affected Blue Bell products. (A0037). [redacted]. (A0056-57). [redacted]. (*Id.*). [redacted] the Company expanded the recall again on April 7 and 20, 2015, to cover all Blue Bell products. (A0037).

[3] Though omitted from the Complaint, the products being manufactured during this time on the impacted production line were never offered for sale.

The FDA subsequently inspected Blue Bell's facilities and issued inspection reports with their observations. (A0037-41). Almost none of these observations were made in any of the prior FDA inspections of the facilities and were prepared after the Company had recalled all of its products, meaning that the specific observations cited in these reports were not made to any of the Defendants until after the product recall. Importantly, these reports do not suggest or otherwise state that the issues observed by the FDA stemmed from a complete lack of controls or systems in place or from any of the Defendants consciously disregarding any oversight duties. (A0077-98). Instead, Plaintiff's argument amounts to nothing more than conclusory allegations and highlighting every negative observation from several years' worth of inspection reports to reach the unsubstantiated conclusion that Defendants must have breached their fiduciary duties due to the unfortunate events that occurred.

D. Resumption of Plant Operations

Following the complete recall of all products by mid-April 2015, and an overhaul of the Company's facilities, Blue Bell began efforts to resume production of its ice cream products. (A0041-42). [redacted]

[redacted]. (A0023, 42-46). As discussed above, [redacted] entitled to one-third of the total voting power of the Board on all issues put to a vote. (A0020, 46; B11-12).

E. The Court of Chancery Dismisses the Complaint

Plaintiff filed his derivative complaint on behalf of BB USA against Paul Kruse and Greg Bridges as corporate officers of Blue Bell, and all BB USA directors (except Reimann) for breach of fiduciary duty. Specifically, the Complaint sets forth two claims for relief. Count I is alleged against the Officer Defendants for allegedly breaching "their fiduciary duties of loyalty and care" to BB USA by failing to "take any steps to correct or control . . . essential issues regarding [the] health and safety of [Blue Bell's] products[,] despite their knowledge that *Listeria* was present in [Blue Bell's] products" and manufacturing facilities. (A0067-68). Meanwhile, Count II was asserted against the Individual Defendants for "breach[ing] their fiduciary duties of loyalty" to BB USA "by the[ir] willful failure to govern the management of [BB LP] and to institute fundamental controls over managerial operations," including "controls to monitor for, avoid and remediate contamination and conditions exposing [BB LP] to contamination." (Op. at 4). Defendants moved to dismiss the Complaint pursuant to Court of Chancery Rules 23.1 and 12(b)(6). Following full briefing and oral argument on Defendants' motion, the Court of

Chancery dismissed the Complaint with prejudice after finding that Plaintiff failed to plead particularized facts sufficient to raise a reasonable doubt that a majority of the Board could have impartially considered a pre-suit demand to prosecute Count I. (Op. at 43). Specifically, the trial court determined that the Complaint failed to plead particularized facts demonstrating that defendants Ehlert and Rankin could not independently consider a demand to assert Count I against the Officer Defendants. (Op. at 41-43). Accordingly, because Plaintiff concedes the independence of Reimann and defendant Ryan, Plaintiff's failure to establish a lack of independence as to Ehlert and Rankin meant that Plaintiff failed to plead a lack of independence as to holders of a majority of the Board's voting power. With respect to Count II, the Court held that Plaintiff failed to state a *Caremark* claim against the Individual Defendants and, therefore, failed to plead particularized facts necessary to raise a reasonable doubt that a majority of the otherwise disinterested Board could have exercised their business judgment in responding to a demand. (Op. at 4-5).

ARGUMENT

I. The Court of Chancery Did not Err in Dismissing the Complaint for Failure to Plead Particularized Facts Showing that a Majority of the Board was Interested or Lacked Independence.

A. Question Presented

Whether the Complaint alleges particularized factual allegations sufficient to create a reasonable doubt that a majority of the Board could have properly exercised its business judgment in responding to a demand with respect to Count I, had one been made?

B. Scope Of Review

This Court reviews *de novo* the decision of the Court of Chancery to dismiss a derivative suit under Rule 23.1. *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). Pleadings governed by Rule 23.1 "must comply with stringent requirements of factual particularity." *Id.* at 254. Rule 23.1 is not satisfied by conclusory statements or mere notice pleading—a plaintiff must set forth particularized factual statements demonstrating that demand would be futile. The Court accepts as true all well-pled facts in the Complaint and reasonable inferences drawn therefrom, but it is not required to adopt "every strained interpretation of the allegations proposed by the plaintiff." *Brinckerhoff v. Enbridge Energy Co.*, 2016 WL 1757283, at *10 (Del. Ch. Apr. 29, 2016), *rev'd on other grounds*, 159 A.3d 242 (Del. 2017).

Instead, such inferences must logically flow from particularized facts alleged by the plaintiff and inferences that are not objectively reasonable cannot be drawn

in the plaintiff's favor. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004). To defeat Defendants' motion to dismiss, the burden was on Plaintiff to plead particularized allegations of fact demonstrating demand futility. As the Court of Chancery recognized, Plaintiff failed to carry this heavy pleading burden. On review by this Court, that pleading burden remains with Plaintiff.

C. Merits Of The Argument

In order to maintain a derivative action, a stockholder must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." Ct. Ch. R. 23.1(a). Where, as here, no demand on the board was made, dismissal is required unless the complaint "allege[s] particularized facts sufficient to establish that demand on the Board would have been futile." *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008). To adequately plead demand futility, plaintiffs must "comply with stringent requirements of factual particularity" and set forth "particularized factual statements that are essential to the claim." *Brehm*, 746 A.2d at 254. Furthermore, where it is alleged that directors lack independence due to their relationship with a purportedly interested party, a plaintiff must show that the directors were "beholden" to the purportedly interested party and "so under their influence that their discretion would

be sterilized." *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). To establish a lack of independence on this basis, Delaware law requires that a plaintiff do more than merely reference past and current business connections or personal relationships. *See, e.g.*, *Beam*, 845 A.2d at 1050 ("[T]o render a director unable to consider demand, a relationship must be of a bias-producing nature."). Rather, to demonstrate that a given director is beholden to a dominant director or officer, plaintiffs must show that the beholden director "continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss might create a reason to question whether the director is able to consider the corporate merits of the challenged transaction objectively." *Telxon Corp. v. Meyerson*, 802 A.2d 257, 264 (Del. 2002).

Here, the Complaint alleges that a majority of the Company's eleven member board is beholden to Blue Bell's former CEO, Paul Kruse, who, Plaintiff argues, should be deemed "interested" because he faces a substantial likelihood of liability with respect to Counts I and II.[4] For demand excusal purposes, a majority of the Board consists of an assortment of directors holding a majority of the Board's voting power—*i.e.*, eight of fifteen total votes. Plaintiff concedes the independence of

[4] As stated in the proceedings below, the Complaint does not plead that the directors were "beholden" to Greg Bridges, and therefore the analysis is devoted to Plaintiff's conclusory allegations that the directors are beholden to Paul Kruse and, by extension, the Kruse family.

Patricia Ryan and non-defendant director Bill Reimann, who together hold six of the fifteen total Board votes. (Op. at 36). Defendants meanwhile concede, for purposes of their Motion, that defendants Greg Bridges, Howard Kruse, and Jim Kruse could not disinterestedly consider a suit against Paul Kruse due to their alleged family ties. (*Id.* at 37). The trial court subsequently considered the allegations in the Complaint and determined that three of the remaining directors—MacInerney, Dickson, and Barnhill—lacked independence for purposes of demand futility, but not without first affording Plaintiff each and every "close call" and noting that persuasive arguments exist for finding that all of the non-Kruse family directors are independent. (Op. at 43 n.173). Now, in order to succeed on appeal, Plaintiff must convince this Court that one of either defendants Rankin or Ehlert was incapable of impartially considering a demand. However, for the reasons set forth below, the Court of Chancery did not err in reaching its conclusion regarding each of these directors and that Court's opinion and order should be affirmed.

1. Rankin

With respect to Rankin and his alleged lack of independence, the Complaint puts forth conclusory allegations concerning his prior employment at Blue Bell and the naming of an "Agricultural Complex" at Blinn College [redacted] (A0065). Importantly, Plaintiff fails to make any particularized allegations regarding specifically who made the donation and in what amount, nor

does the Complaint specify how the donation (again assuming it was substantial) would impact Rankin's ability to act impartially in connection with a demand. The Complaint also does not allege that Rankin has any relationship with Blinn College from which to infer the donation would be material to him or that Rankin benefitted in any way, let alone materially, from the donation at issue. The total lack of any nexus between the donation at issue and Rankin's ability to independently evaluate a demand ultimately proves fatal to Plaintiff's claim. Indeed, the Court has previously held that such conclusory allegations about a "philanthropic relationship" are insufficient where, as here, the Complaint lacks any allegations from which to consider the materiality of the donation. (*See* Op. at 42 n.171 (*citing In re J.P. Morgan*, 906 A.2d 808, 822 (Del. Ch. 2005), *aff'd,* 906 A.2d 766 (Del. 2006))). Thus, even though the trial court ultimately found Rankin to be independent on other grounds, it was nonetheless correct in its assessment that the allegations regarding the donation "likely fall[] short of Rule 23.1's particularity requirement[.]" (Op. at 42). For this reason alone, the allegations against Rankin fail to plead the type of relationship that could render him incapable of impartially considering a demand to institute a suit asserting Count I against the Officer Defendants.

Moreover, the trial court recognized that Rankin's vote on the Board initiative provides further evidence of his impartiality to consider a demand. The vote in question was not, as Plaintiff attempts to mischaracterize it, an insignificant matter

that would have no impact on Paul Kruse or his role at the Company. Rather, the Board initiative, [redacted]. Plaintiff attempts to argue that the vote was inconsequential because it "did not expose Paul Kruse to any personal economic risk or liability," thereby apparently requiring some heightened standard in which the vote must expose the director to personal liability. The sole case cited by Plaintiff in support of this position—*Khanna v. McMinn*[5]—is inapposite and does not support this conclusion. Instead, the Court in *Khanna* was tasked with assessing allegations regarding the directors' lack of independence through a "pattern of votes" and "acquiescence" in permitting the allegedly controlling director and others to benefit from self-dealing transactions. *Id.* at *15. In rejecting the plaintiffs' argument, the *Khanna* Court determined that the complaint failed to explain "how the directors' alleged acquiescence benefited them . . . or to set forth particularized facts showing a pattern of votes (in addition to the few challenged transactions) from with the Court could draw a reasonable inference." *Id.*

Here, the Complaint does not contain a single allegation regarding a pattern of votes or acquiescence to an allegedly controlling director, but rather provides

[5] 2006 WL 1388744 (Del. Ch. May 9, 2006).

evidence of the exact opposite [redacted]. [redacted] (A0103). [redacted]. Given that Rankin's vote to "prevent Paul Kruse from holding the CEO, President and Chairman positions came *after* the allegedly disabling contribution to Blinn College," Plaintiff's conclusory allegation that Rankin lacks independence must fail. (Op. at 42 n. 172 (emphasis in original)); *See also Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 981 (Del. Ch. 2003) ("Board minutes or voting records, for example, could reveal if the outside directors have in the past challenged Stewart's proposals, or not, voted in line with Stewart, or in opposition to her, and shown on which issues the outside directors have been more or less likely to go along with Stewart's wishes.").

2. Ehlert

The bare allegations concerning the purported connections between Ehlert's family and the Kruse family were properly found by the trial court to be insufficient to raise a reasonable doubt as to Ehlert's independence. Ehlert has never been an

employee of the Company and holds no professional or financial connection to the Kruse family outside of his service on the Board. The remaining allegations do not even relate to Ehlert personally, but rather claim that Ehlert's presumed independence is compromised due to "longstanding close familial relationship[s]" in the community between members of the Ehlert and Kruse families. Outside of vague claims regarding the Ehlert family, the only actual facts Plaintiff has pled is that Ehlert is a "Brenham businessman" and that his uncle was a long-time friend of E.F. Kruse and served as a pallbearer at his funeral in 1951. Plaintiff claims that these types of relationships are "easily distinguishable" yet offers no explanation of how these facts differ from other cases in which similar types of conclusory allegations were rejected by the Delaware courts. *See*, *e.g.*, *Beam*, 845 A.2d at 1051–52 ("Mere allegations that [directors] move in the same business and social circles, or a characterization that they are close friends, is not enough to negate independence for demand excusal purposes."); *In re J.P. Morgan*, 906 A.2d at 821 n.45 (same); *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, 2017 WL 3568089, at **19-20 (Del. Ch. Aug. 18, 2017) (same).

* * *

Accordingly, Plaintiff has failed to allege sufficient facts demonstrating that a majority of the directors on the Board when this suit was initiated could not independently consider a demand to bring Count I. The Court did not, as Plaintiff

contends, fail to draw all reasonable inferences in Plaintiff's favor regarding the allegations in the Complaint, but rather refused to draw unreasonable inferences based on merely conclusory allegations. Moreover, Plaintiff does not argue that any of the directors are beholden to Greg Bridges. Demand cannot, therefore, be excused and the Court of Chancery was correct in dismissing Count I pursuant to Rule 23.1.

II. The Complaint Fails to Demonstrate that the Individual Defendants Face a Substantial Likelihood of Liability on Count II

A. Question Presented

Whether the Complaint alleges particularized factual allegations sufficient to create a reasonable doubt that a majority of the Board could have properly exercised its business judgment in responding to a demand with respect to Count II, had one been made?

B. Scope Of Review

This Court reviews *de novo* the decision of the Court of Chancery to dismiss a derivative suit under Rule 23.1. *Brehm*, 746 A.2d at 253. Pleadings governed by Rule 23.1 "must comply with stringent requirements of factual particularity." *Id.* at 254. Rule 23.1 is not satisfied by conclusory statements or mere notice pleading—a plaintiff must set forth particularized factual statements demonstrating that demand would be futile. The Court accepts as true all well-pled facts in the Complaint and reasonable inferences drawn therefrom, but it is not required to adopt "every strained interpretation of the allegations proposed by the plaintiff[.]" *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001). Instead, such inferences must logically flow from particularized facts alleged by the plaintiff and inferences that are not objectively reasonable cannot be drawn in the plaintiff's favor. *Beam*, 845 A.2d at 1048. To defeat Defendants' motion to dismiss, the burden was on Plaintiff to plead particularized allegations of fact demonstrating demand futility. As the Court of

Chancery recognized, Plaintiff failed to carry this heavy pleading burden. On review by this Court, that pleading burden remains with Plaintiff.

Moreover, where, as here, the complaint alleges that the board or officers failed to act, demand is excused only if the complaint alleges "particularized factual allegations" sufficient to "create a reasonable doubt" that a majority of the board could have properly exercised its "business judgment in responding to a demand," had one been made. *Rales*, 634 A.2d at 934. To do so, plaintiffs must demonstrate that a majority of the directors serving on the board at the time the action was commenced were incapable of responding objectively and dispassionately to a demand, either because they lack independence or because they are not disinterested. *Id.* In situations where the complaint does not challenge a transaction in which an officer or director could be deemed "interested," a plaintiff must demonstrate that an officer or director is an interested party by alleging particularized facts sufficient to show that such an individual faces a "substantial likelihood" of liability for the wrongdoing alleged. *Id.* at 936. A "mere threat" of director liability does not suffice for this purpose. *In re Gen. Motors Co. Deriv. Litig.*, 2015 WL 3958724, at *13 (Del. Ch. June 26, 2015), *aff'd*, 133 A.3d 971 (Del. 2016) (TABLE). Rather, the likelihood of liability must be "substantial" before director interest can be shown. *Id*. It is "only in rare cases" where a plaintiff is able to show director conduct that is "egregious on its face" that demand can be excused on this basis. *Aronson v. Lewis*,

473 A.2d 805, 815 (Del. 1984) (emphasis added), *overruled on other grounds sub nom. Brehm v. Eisner*, 746 A.2d. 244 (Del. 2000).

C. Merits Of The Argument

In order to state a viable claim under *Caremark*, a plaintiff "must plead the existence of facts suggesting that the [directors] knew that internal controls were inadequate, that the inadequacies could leave room for illegal or materially harmful behavior, and that the [directors] chose to do nothing about the control deficiencies that it knew existed." *Desimone v. Barrows*, 924 A.2d 908, 940 (Del. Ch. 2007). The Complaint must also allege particularized facts demonstrating "that the directors acted with the state of mind traditionally used to define the mindset of a disloyal [fiduciary] – bad faith." *Id.* at 935. Delaware courts will routinely reject conclusory allegations that internal controls must have been deficient because a corporate trauma occurred, and, instead require a plaintiff to plead with particularity "a sufficient connection between the corporate trauma and the board." (Op. at 45 (citing *La. Mun. Police Empls.' Ret. Sys. v. Pyott*, 46 A.3d 313, 340 (Del. Ch. 2012))), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013). Delaware courts have often remarked that, due to these onerous pleading requirements, proving liability for a failure to monitor corporate affairs is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 372 (Del. 2006).

1. *Caremark*'s First Prong—Reporting Systems and Controls

The first prong of a *Caremark* analysis requires the Court to look at whether defendants "utterly failed to implement any reporting or information system or control." *Id.* at 370. In making this assessment, the Court considers only whether any such systems or controls existed during the times relevant to the allegations, and does not examine their adequacy. *Id.* at 370-72; *See also In re Gen. Motors*, 2015 WL 3958724, at *14-15 (finding allegations insufficient where plaintiffs "complain that [Defendant] could have, should have, had a *better* reporting system, but not that it had *no* such system.") (emphasis in original).

Remarkably, Plaintiff continues to argue that the Individual Defendants failed in their oversight duties by failing to implement any reporting or information systems or controls at BB USA. However, as the trial court properly recognized, the Complaint acknowledges the existence of systems and controls at Blue Bell during the relevant time period and, at most, alleges that Plaintiff disapproves of the monitoring systems and controls adopted and employed by Blue Bell. (*See* A0038-40, 49-50, 51, 57, 61-62). The documents incorporated by reference in the Complaint further "reveal that Blue Bell distributed a sanitation manual with standard operating and reporting procedures, and promulgated written procedures for processing and reporting consumer complaints." (Op. at 46-47). Thus, not only has Plaintiff failed to allege there was a lack of any systems or controls in place at

Blue Bell, his own allegations necessarily acknowledge that Blue Bell had systems and controls in place during the relevant time period, satisfying the inquiry under *Caremark*'s first prong.

Plaintiff's sole remaining argument on appeal is that the Court of Chancery "failed to give due deference to the allegations and reasonable inferences therefrom" in the Complaint regarding the existence of Board-level systems and controls.[6] (Op. Br. at 35). However, the trial court did not, as Plaintiff contends, fail to give due deference to the allegations; the court simply refused to draw an unreasonable one in Plaintiff's favor that would directly contradict the allegations in the Complaint and the documents incorporated therein by reference, all of which clearly demonstrate the existence of reporting systems and controls. Thus, the Court of Chancery did not err in concluding that the Complaint failed to plead that the Individual Defendants "utterly failed to implement any reporting or information system or controls." (Op. at 44).

2. *Caremark*'s Second Prong—Red Flags

In order to establish demand futility under the second prong of *Caremark*, the Court must assess whether the Defendants acted in bad faith by "consciously fail[ing] to monitor or oversee" the operation of the company's internal controls and

[6] In the court below, Plaintiff argued that a board of directors must create an audit committee to monitor and manage risk but has since abandoned, and therefore waived, that argument by failing to raise it on appeal.

reporting systems. *Stone*, 911 A.2d at 370. Plaintiff may only prevail under this standard by pleading particularized facts sufficient to demonstrate that the Defendants were aware of proverbial "red flags" indicating that the controls in place were inadequate, "yet acted in bad faith by consciously disregarding its duty to address that misconduct." *Reiter v. Fairbank*, 2016 WL 6081823, at *8 (Del. Ch. Oct. 18, 2016). Where, as here, the Complaint pleads "no facts to suggest even the hint of a culpable state of mind on the part of any [defendant]," that deficiency is fatal to the claim. *See Desimone*, 924 A.2d at 935 ("[T]o hold directors liable for a failure of monitoring, the directors have to have acted with a state of mind consistent with a conscious decision to breach their [fiduciary] dut[ies]").

Here, the Court of Chancery's assessment that Plaintiff did not advance a second-prong *Caremark* claim is correct, as the Complaint fails to allege that the Defendants knowingly disregarded "red flags" in breach of their fiduciary duties. Nothing in Plaintiff's opening brief warrants further discussion of this point, especially given that Plaintiff now entirely abandons any discussion of *Caremark*'s second prong whatsoever. As such, Plaintiff has failed to allege that the Defendants face any liability, let alone a substantial likelihood of liability, with respect to the claims asserted in Count II.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that this Court affirm the Court of Chancery's September 27, 2018 Memorandum Opinion and deny Plaintiff's appeal in all respects.

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CERTIFICATE OF SERVICE

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