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 February 11, 2019

APPELLANT'S REPLY BRIEF

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TABLE OF CONTENTS

Page(s)

TABLE OF CITATIONS

Page(s)

Cases

Rules

ARGUMENT

I. THE COMPLAINT'S ALLEGATIONS CREATE A REASON TO DOUBT THE IMPARTIALITY OF THE BB USA DIRECTORS TO CONSIDER A DEMAND TO SUE PAUL KRUSE AND GREG BRIDGES

Plaintiff has made particularized allegations that raise a reasonable doubt concerning the impartiality of the 11-member BB USA Board to consider a derivative demand to bring a derivative fiduciary duty claim for substantial personal liability against Paul Kruse and Greg Bridges.[1] Defendants concede that Plaintiff need only show that the alleged facts and inferences create a reasonable doubt concerning the impartiality of one of Rankin or Ehlert in order to succeed on appeal, but argue that Plaintiff's Complaint fails to do so.[2] (DB at 19). The particularized allegations in Plaintiff's Complaint and the reasonable inferences therefrom, which must be drawn in favor of Plaintiff, are markedly different from the bare-boned allegations of lack of independence that have resulted in dismissal in other cases.

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[1] Defined terms shall have the same meanings as set forth in Appellant's Opening Brief ("OB").

[2] As Plaintiff maintained in the Court-below and in its Opening Brief, Plaintiff concedes only that the Complaint does not contain the requisite particularized allegations with respect to directors Reimann and Ryan sufficient to satisfy the demand futility standard under Ct. Ch. R. 23.1. (OB at 5, 26; A0143). Citations to Appellees' Answering Brief are cited herein as "DB."

A. PLAINTIFF'S ALLEGATIONS MUST BE VIEWED IN THE CONTEXT OF THE SMALL COMMUNITY OF BRENHAM, Texas

In Plaintiff's Opening Brief and below, Plaintiff argued that the BB USA directors' relationships must be viewed "in the context of the small community of Brenham, Texas," when considering the totality of the facts alleged and drawing all reasonable inferences in favor of Plaintiff, to assess whether they establish reason to doubt their impartiality to consider a demand to sue Paul Kruse and Bridges.[3] (OB at 5, 30; A0119, A0141, A0241, A0245). The Defendants, as did the Court-below, gloss over Plaintiff's particularized allegations about Brenham's small community without giving due deference to this important context. A court must "consider all the particularized facts pled ... about the relationships between the director and the interested party in their totality and not in isolation from each other, and draw all reasonable inferences from the totality of those facts in favor of plaintiffs." *See also Del. County Emples. Ret. Fund v. Sanchez*, 124 A.3d 1017, 1019 (Del. 2015).

The Complaint alleges that over the last 100 years, in this small community of Brenham, three generations of members of the Kruse family expanded Blue Bell

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[3] Paul Kruse and Greg Bridges are both members of the Kruse family: both are grandchildren of Blue Bell's founder E.F. Kruse; both are nephews of Howard Kruse; both are cousins with each other and with Jim Kruse; and while Ed Kruse is Paul's father and Bridges' uncle, Ed Kruse had stated "I'd be proud to have Greg as a son." (OB at 7-8; A0014-A0018, A0116-A0117). The demand futility analysis based on ties to the Kruse family is thus applicable to both senior Officers.

from a small company that purchased extra cream from local farmers to make butter and ice cream to a $700 million-revenue-generating company, which has kept its headquarters in Brenham, employs 850 people at its Brenham facility, and has a Board filled with directors almost all of whom have worked in Brenham for decades either at or near Blue Bell. (OB at 7-9; A0013-A0018, A0020-A0022, A0028-A0030, A0115-A0118, A0121). Even with this expansion, Brenham has a present population of only approximately 17,000. (OB at 7; A0245). Given the small size of the community and the large size of Blue Bell, it is reasonably inferable that Blue Bell makes significant economic contributions to the community, whether directly or indirectly.

Further, the Complaint alleges that not only have members of the Kruse family held the highest senior executive positions within Blue Bell since its founding by E.F. Kruse nearly 100 years ago, but also that they hold prominent positions within the small community of Brenham – at organizations mere miles from Blue Bell's Brenham facility. Ed Kruse was selected for induction into the Hall of Honor at Brenham-based Blinn College. (A0018, A0140). Howard Kruse has served as president of Brenham Rotary Club and St. Pauls' Evangelical Lutheran Church Council of Brenham. (A0018). Paul Kruse has served as Chairman of Brenham-based Trinity Medical Center, Chairman of Brenham-based Blinn College Foundation and is a member and past president of Brenham Rotary

Club. (A0017). Jim Kruse, who previously served as Blue Bell's Vice President of Information Technology, is now President of the Bank of Brenham. (A0016). These particularized allegations (and all reasonable inferences drawn in favor of Plaintiff) regarding Brenham's small size and the Kruse family's prominence as significant people within Blue Bell and within this close-knit community provide an essential context in determining whether the alleged facts and reasonable inferences create a reason to doubt the impartiality of Rankin (a 30-year career employee who rose from Ed Kruse's assistant to CFO) and Ehlert (a Brenham businessman and member of an old Brenham family with a long-relationship with the Kruse family) to consider a demand to bring suit against Paul Kruz and Bridges. *See In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 945 (Del. Ch. 2003) (acknowledging "the simple fact that accusing [] a significant person in that community of such serious wrongdoing is no small thing.").

B. RANKIN

Recognizing that the Court-below found similar allegations regarding Barnhill and Dickson to satisfy the demand futility standard (Op. at 39-40), the Defendants attempt to circumvent Plaintiff's particularized allegations regarding Rankin's career-long relationship with the Kruse family by characterizing them as "conclusory" and "concerning his prior employment at Blue Bell," stating that Rankin is a "former long-term employee of Blue Bell." (DB at 4, 20). However,

Plaintiff alleges that Rankin owed his more than 30-year career at Blue Bell to the Kruse family, starting as Ed Kruse's administrative assistant and swiftly rising to the senior executive positions of CFO and Treasurer, which he held for the next 28 years. (OB at 26; A0017). As discussed in Plaintiff's Opening Brief, Rankin's career-long employment under the Kruse Family and continuation as director provide reason to doubt his ability to exercise impartial judgment. (OB at 27-28, citing *In re Freeport-McMoran Sulpher S'holder Litig.*, 2005 Del. Ch. LEXIS 96, at *12 (June 30, 2005)). Further, while Defendants emphasize that Rankin was a "former long-term employee" at the time at the time the Complaint was filed, he had retired from his position less than three years prior, which pales in comparison to his career-long employment. *See id. See also Klein v. H.I.G. Capital, L.L.C.*, 2018 Del. Ch. LEXIS 577, at *32 (Dec. 19, 2018) ("Relatedly, NASDAQ and NYSE guidelines provide for a three-year cooling-off period before a former officer of a corporation can be considered independent of that corporation.") (citation omitted). In addition, Rankin remained on the Board and spearheaded the Company's search for rescue financing in the wake of the *listeria* crisis. (OB at 19, 26; A0017, A0042).

Defendants also attack Plaintiff's particularized allegations regarding the "Ed Kruse and Friends" presentation of a significant check to Brenham-based Blinn College Foundation to fund the "W.J. "Bill" Rankin Agricultural Complex"

as "conclusory." (DB at 20-21). The donation presented by "Ed Kruse and Friends" was in honor of Rankin toward the funding of a new facility to be named for Rankin. (OB at 26; A0017-A0018). This honoring gesture by his career-long employer has the necessary material nexus to call into question Rankin's impartiality to consider a demand to sue two members of the Kruse family, Paul Kruse and Bridges. *See Teachers' Ret. Sys. v. Aidinoff*, 900 A.2d 654, 667 n.15 (Del. Ch. 2006) (acknowledging the "delicate questions [regarding independence]" in the case of donations which fund the "endowment of a director's eponym"); *Off v. Ross*, 2008 Del. Ch. LEXIS 175, at *11 (Nov. 26, 2008) ("the donation of such a prodigious sum coupled with the fact that Ross became the eponym of the benefiting institution calls into question the independence of Defendant Dolan.");. Plaintiff's particularized allegations go far beyond the bare allegations of *In re J.P. Morgan Chase & Co. S'holder Litig.*, cited by Defendants, of contributions made to an organization of which an independent is a trustee. 906 A.2d 808, 822 (Del. Ch. 2005).

Further, the facts regarding Rankin's relationship with the Kruse family must be considered together in their totality. Plaintiff has alleged that:

- Ed Kruse, who hired Rankin as his assistant and under whom Rankin was promoted to the executive ranks at Blue Bell, and members of the Kruse

family were more than likely significant contributors to a $450,000 check from "Ed Kruse and Friends," which bears Ed Kruse's name;

- The "Ed Kruse and Friends" check was presented to Blinn College Foundation, where Ed Kruse's son Paul Kruse previously served as Chairman; and
- this check was presented to Blinn College Foundation for the endowment of Rankin's eponym - a newly constructed facility on the Brenham campus of Blinn College, near the headquarters of the prominent Brenham-based company where he had spent his more than 30-year career under Ed Kruse and where he continues to serve as a member of the Board; and
- Rankin's connection with Blinn College was reinforced when, the following year, he was inducted into the Blinn College Hall of Honor, alongside Ed Kruse.

(OB at 26-28; A0017-A0018). The donation confirms the mutual close relationship between Rankin and the Kruse family, which extends beyond merely an employee-employer relationship. *See Freeport*, 2005 Del. Ch. LEXIS 96, at *12; *Oracle*, 824 A.2d at 945; *Sanchez*, 124 A.3d at 1022-1023.

Finally, Defendants adopt the Court-below's incorrect determination that Rankin's vote against rescinding a Board resolution to separate the positions of

President, CEO and Chairman following the *listeria* crisis establishes independence and erases any reasonable doubt regarding Rankin's impartiality to consider a demand to sue Paul Kruse and Bridges. (DB at 21-23). In the proceedings below, the Defendants did not even make this argument but now adopt this issue, which the Court-below raised *sua sponte* in its Opinion. (*See* A0211-A0212, B98, B153-B154). As Plaintiff discussed, the subject of the vote was a matter of corporate governance that, regardless of the outcome, contemplated Paul Kruse would remain at the helm of the Company, and with no impact on Bridges' position or responsibilities. (OB at 28-29). Plaintiff does not, as Defendants' assert (DB at 21), suggest that a vote must expose the director to personal liability in order to find a director to be independent. Rather, the vote must be viewed in the context of the stakes at issue on the vote versus Rankin's consideration of a demand to sue Paul Kruse and Bridges. Paul Kruse's interest at stake and Rankin's respective vote on the governance issue is vastly different in kind and degree than Paul Kruse's interest at stake and Rankin's decision to sue Paul Kruse, given Rankin's career owed to the Kruse family, his close relationship with the Kruse family, and the Kruse family's prominence in the small Brenham community.[4] *See Freeport*, 2005 Del. Ch. LEXIS 96, at *12; *Oracle*, 824 A.2d at 945.

[4] While Defendants and the Court-below emphasize that this donation was made prior to Rankin's vote on a governance issue (DB at 22, citing Op. at 42 n.

Defendants' citation to *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, is consistent with Plaintiff's reading of *Khanna v. McMann* and only adds support to Plaintiff's assertion that the Court must look to the context and relative interests at stake of votes when conducting an independence analysis. *See Beam*, 833 A.2d 961, 981 (Del. Ch. 2003) ("Board minutes or voting records, for example, could ... show on which issues the outside directors have been more or less likely to go along with Stewart's wishes."); (OB at 29, citing *Khanna v.* McMinn, 2006 Del. Ch. LEXIS 86, *75 (May 9, 2006)).

C. EHLERT

Like the Chancery Court's opinion below, Defendants again label Plaintiff's particularized allegations regarding Ehlert as "conclusory," characterizing Plaintiff's allegations as "vague claims regarding the Ehlert family" and that Ehlert is a "Brenham businessman." (DB at 23-24). But Defendants once again ignore the context of Plaintiff's particularized allegations, which go beyond that of the ordinary personal or professional relationships like those at issue in *Beam v. Stewart*. *See Beam v. Stewart*, 845 A.2d 1040, 1051 (Del. 2004).

The Complaint alleges that in the context of this small community of Brenham, the Kruse and Ehlert families are old Brenham families that have lived and remained close from its early days through the exponential expansion of Blue

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172), the Brenham building continuously bears Rankin's name.

Bell. (OB at 11, 30; A0015-A0016, A0141, A0244-A0245). The Complaint further alleges that when E.F. Kruse, the founder of Blue Bell, passed away suddenly, Ehlert's uncle's relationship with E.F. Kruse was such that he served as pallbearer for his good friend. (*Id.*). The Complaint also asserts that Ehlert, a member of one of the old Brenham families, is President of a local Brenham Insurance Company not far from Blue Bell and has served on other boards in the Brenham community, including the Blue Bell Board. (*Id.*). The Blue Bell Board consists of nearly all Kruse family members and/or Blue Bell executives. (OB at 9; A0013-A0018, A0118). Given the Kruse and Ehlert families' long association, the makeup of the Board and the Company, and the context of the small community of Brenham, Plaintiff submits that this longstanding close familial relationship is a relationship for demand futility purposes that is likely to compromise Ehlert's impartiality to sue these immediate members of the Kruse family. *Cf. Sanchez*, 124 A.3d at 1022-1023; *Oracle*, 824 A.2d at 945.

II. THE COMPLAINT ADEQUATELY ALLEGES THAT THE BOARD FAILED TO ACTIVELY DO ANYTHING WITH RESPECT TO A SYSTEM OF CONTROLS AND REPORTING IN BREACH OF THEIR FIDUCIARY DUTY OF LOYALTY

Defendants, as did the Court of Chancery, adopt the false premise that the mere existence of testing, procedures and manuals at Blue Bell is sufficient to fulfill a board's duties with respect to its crucial oversight function under the first prong of *Caremark*.[5] (DB at 28-29, Op. at 46-49). That is not the standard. Instead, "good faith in the context of oversight must be measured ***by the directors' actions*** 'to assure a reasonable information and reporting system exists.'" *Stone v. Ritter*, 911 A.2d 362, 373 (Del. 2006) (quoting *Caremark*, 698 A.2d at 971) (emphasis added). "[A] ***board[] [is] obligat[ed] to adopt internal information and reporting systems*** that are 'reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed, judgments concerning both the corporation's compliance with law and its business performance." *La. Mun. Police Emples. Ret. Sys. v. Pyott*, 46 A.3d 313, 341 (Del. Ch. June 11, 2012), *rev'd on other grounds*, 74 A.3d 612 (Del. 2014) (quoting *Caremark*, 698 A.2d at 970) (emphasis added). Put another way, directors are charged with actively "assur[ing] that a corporate information and reporting system ... exist[s] and actively "conclud[ing] [that such a system] is adequate." *Id.* And, if a corporation suffers

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[5] *In re Caremark Int'l, Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

losses proximately caused by illegal conduct and these active duties were not fulfilled, then there is a sufficient connection between the occurrence of the illegal conduct and board level action or conscious inaction to support liability. *Id.*

The cases cited by Defendants only further illustrate this concept. In *Stone*, cited by Defendants (DB at 28 & 29) and the Court of Chancery (Op. at 48 and 49, n. 191 & 194)), the Court first recognized that the Board had actively adopted internal information and reporting systems, stating that "the Board received and approved relevant policies and procedures" and "[the Board] delegated to certain employees and departments the responsibility for filing SARs and monitoring compliance." *Stone*, 911 A.2d at 373. It was only then, predicated on the fact that the board had actively "approved" and "delegated ... responsibility" with respect to these systems, that the Court determined that the Board had "exercised oversight by relying on periodic reports from [management]." *Id.*

The allegations *In re General Motors Co. Derivative Litig.*, also cited by Defendant (DB at 28), further demonstrate the BB USA Board's failure here. 2015 Del. Ch. LEXIS 179 (June 26, 2015). In *GM*, the Court found that the board at issue had not "utterly failed to implement any reporting or information system or controls," reasoning that the complaint, among other things, alleged that the GM board routinely received and reviewed correspondence from customers informing it regarding quality defects, followed developments on "Safety Regulations," and

discussed implementing a chief risk infrastructure system. *Id.* at *50-51, n.105.

The Court in *GM* also noted that:

> The documents incorporated by reference into the Complaint further show that the Finance and Risk Committee, and then its successor, the Audit Committee, reviewed GM's risk management structure regularly; that the Finance and Risk Committee, and then its successor, the Audit Committee, reviewed GM's risk management structure regularly; that the Finance and Risk Committee, then the Audit Committee reviewed the Company's "Top 25 Risks," which included "quality" (defined as "[m]ajor or chronic product problems result[ing] in a large product recall") in several meetings ..., and the Board was given presentations on safety and quality issues.

Id. at *49.

[redacted] In fact, the Complaint alleges the Board lacked ***any*** "goals and guidelines to allow for the Board to evaluate the Company" or standards for oversight of management's performance.[6] (AB at 20-21; A0050-A0059).

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[6] Plaintiff never argued Defendants were required to create an audit committee. *Compare* A0130, *with* DB at 29 n.6. Rather, Plaintiff cited to [redacted]

Without the predicate of Board action, as illustrated in *Stone* or *GM*, the Board cannot rely on periodic reports from management concerning operations generally to demonstrate they had exercised the crucial oversight function. [redacted] As set forth more fully below and in Plaintiff's Opening Brief, [redacted] (OB at 14-17, 35).[7] [redacted] (OB at 35). [redacted]

[redacted] as illustrative of one of the many ways in which the Board could have but did not implement ***any*** monitoring or reporting systems.

7 [redacted]

[redacted] (OB at 34; A0058).

This absence of Board action is precisely what was contemplated to demonstrate that Individual Defendants "utterly failed to implement any reporting or information system or control."[8] *See Stone*, 911 A.3d at 370. Further, the Board's inaction is more glaring in light of the fact BB USA holds all of its key operations at the subsidiary level, "making oversight of subsidiaries a crucial aspect of the parent board's function." *See Grace Bros. v. UniHolding Corp.*, 2000 Del. Ch. LEXIS 101, *43-44 (July 12, 2000).

[8] Because Plaintiff has particularly alleged that the Board utterly failed to actively implement any reporting or information system or control, the predicate has not been met under the second prong of *Caremark*. Thus, Plaintiff has not advanced a claim for liability under the second prong of *Caremark*.

CONCLUSION

For the foregoing reasons and the reasons set forth in Appellant's Opening Brief, the Court of Chancery's Opinion should be reversed in its entirety.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Vera G. Belger, do hereby certify that I caused a true and correct copy of the foregoing to be served upon all Parties on February 11, 2019 in the manner indicated below:

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