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IN THE SUPREME COURT OF THE STATE OF DELAWARE

KEVIN ANDERSON and SUSAN FITZGERALD, Plaintiffs Below/Appellants, v. STEVEN LEER, JENNIFER SCANLON, JOSE ARMARIO, WILLIAM H. HERNANDEZ, RICHARD P. LAVIN, BRIAN A. KENNEY, GRETCHEN R. HAGGERTY, MATHEW CARTER, JR., and THOMAS A. BURKE, Defendants Below/Appellees.	No. 106, 2021 On appeal from the Court of Chancery, C.A. No. 2018-0602-SG **PUBLIC VERSION FILED JUNE 11, 2021**

APPELLANTS' OPENING BRIEF

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NATURE OF PROCEEDINGS

This appeal challenges the Trial Court's misapplication of well-established jurisprudence in a cash out sale governed by *Revlon* enhanced scrutiny. The Trial Court's rulings, if not reversed, undermine the integrity of the rule that fiduciaries may not allow "extraneous considerations or influences" to triumph over shareholders' best interests.

This case arises from the acquisition ("Buyout") of USG Corporation ("USG" or "Company") by Gebr. Knauf KG ("Knauf"), USG's second largest stockholder and competitor, with the support of USG's largest stockholder, Berkshire Hathaway Inc. ("Berkshire") for $44.00/share ("Merger Consideration").[1]

When Knauf approached USG's Board of Directors ("Board") and CEO ("Scanlon"; collectively, "Defendants") about an acquisition, they repeatedly rebuffed it, consistently stating publicly that Knauf's offers "significantly undervalued" USG's intrinsic value. Indeed, Defendants even concluded a multi-month strategic review *after* Knauf approached them, in which they determined to proceed with USG's standalone plan because there was no "strategic value" in

[1] Any capitalized term not defined herein has the same meaning as in the Amended Class Action Complaint ("Complaint"). A037-A149. Unless otherwise indicated, emphasis is added and internal citations are omitted.

combining with Knauf. Privately, *but never disclosed*, Defendants determined that USG's intrinsic value was $50.00/share.

However, after: Knauf and Berkshire started working together; Berkshire publicly offered Knauf an option to buy its shares for $42.00/share and publicly supported Knauf's Withhold Campaign; and Defendants suffered a stunning defeat at their annual meeting, Defendants abandoned the standalone plan they had *just determined* was superior to Knauf's offer, acceded to the Buyout and, over a few weeks, went from determining that USG was worth $50.00/share to accepting just $44.00/share – almost $1 billion less than what they considered fair.

Defendants then knowingly misled shareholders. Although Defendants repeatedly considered telling stockholders their specific views of USG's intrinsic value, they *deliberately* decided to withhold this material information from stockholders. As a result, USG's definitive proxy statement ("Proxy") failed to inform stockholders that their fiduciaries had determined USG's standalone value was $50.00/share, that USG's standalone plan was "realistic and achievable," and that Defendants did not believe that it was the right time to sell.

These allegations plausibly indicate that all Defendants acted disloyally and/or in bad faith. At the least, they indicate Scanlon was grossly negligent as an officer for the nondisclosure. Shareholders are therefore entitled to pursue damages.

SUMMARY OF ARGUMENT

I. The Trial Court erred by failing to apply the *Revlon* enhanced scrutiny lens and ignoring sixteen months of a seventeen-month process. *See In re Pattern Energy Grp. Inc. Stockholders Litig.*, 2021 Del. Ch. LEXIS 90, at *119 (Del. Ch. May 6, 2021). It then erroneously dismissed Plaintiffs' loyalty/bad faith claims against all Defendants, despite the fact that they sold USG for less than what they believed to be its intrinsic value as a result of being browbeaten and defeated by USG's largest shareholders – classic "extraneous considerations or influences" and "non-stockholder-motivated influence[s] that call[] into question the integrity of [a] process." These facts and Defendants' own statements – especially their ***own question*** regarding whether their agreeing to the Buyout would mean that "Knauf would be obligated to vote for the Corporation's director nominees at the ***next*** annual meeting" – plausibly support this conclusion and merit reversal. *See In re Columbia Pipeline Grp., Inc.*, 2021 Del. Ch. LEXIS 39, at *85 (Del. Ch. Mar. 1, 2021).

Even worse, Defendants then knowingly deceived stockholders. Defendants repeatedly contemplated revealing their $50.00/share intrinsic value determination, but deliberately deprived stockholders of this information. While the Trial Court correctly found that Defendants' failure to disclose the $50.00 intrinsic value was a material omission, it erroneously and contradictorily concluded that their

conscious decision to withhold that information did not amount to bad faith. *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *157-58.

II. The Trial Court erred in dismissing Plaintiffs' care claim against Scanlon as an officer. The initial Opinion did not address this claim. Only on reargument did the Trial Court conclude the issue was not before it because the claim was absent from the Complaint or waived. But later, when Plaintiffs sought leave to amend, the Trial Court again contradicted itself, asserting that the Complaint had actually pled the claim and the Opinion rejected it. At bottom, the Complaint sufficiently pled a care claim against Scanlon as an officer, and Plaintiffs did not waive it. *In re Baker Hughes Inc. Merger Litig.*, 2020 Del. Ch. LEXIS 321, at *42-43 (Del. Ch. Oct. 27, 2020); *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *156-58.

III. Alternatively, the Trial Court erred in denying Plaintiffs leave to amend to include a second, separate count against Scanlon as an officer. *See* Rules 15(a), 15(aaa); *Tvi Corp. v. Gallagher*, 2013 Del. Ch. LEXIS 260, at *63-64 (Del. Ch. Oct. 28, 2013).

STATEMENT OF FACTS

I. FACTUAL BACKGROUND

A. Knauf and Berkshire Secretly Coordinate

Before the Buyout, USG was a domestic manufacturer and Knauf was an overseas manufacturer of building materials. A052-A053. Knauf and Berkshire were longtime USG stockholders who wielded substantial leverage, holding 10.6% and 31.1% of USG's stock, respectively. A045-A047, A052-A058.

Knauf's and Berkshire's interests aligned in the year before the Buyout. Knauf had long viewed USG as a target, had discussed its interest in acquiring USG with Berkshire for "years," and that interest came to fruition at the same time Berkshire sought to exit its "disappointing" investment. A052-A053, A058-A061. However, as Defendants recognized, Berkshire was "positioned differently than…other stockholders," was unable to exit its investment at market price given its position, and would need to take a discount to exit without a whole-Company sale. A058-A061. The Buyout thus served the interests of Knauf (in acquiring a U.S. foothold and competitor) and Berkshire (in exiting its investment at a premium it could not otherwise obtain). A061-A062.

These aligned interests manifested in a coordinated effort. Knauf and Berkshire began discussions regarding Knauf acquiring USG in March 2017 – after

Defendants told Knauf they would not respond to its January inquiries until mid-year, after a strategic review. A063-A064. By mid-May, Knauf understood that Berkshire was ready to sell at $40.00/share. A064-A065. Around the same time, Buffett publicly signaled his readiness to exit USG, deriding the investment. A065.

B. Berkshire Pressures Knauf; Knauf Makes an Offer

Knauf and Berkshire continued to coordinate throughout the next months, during which Berkshire pressured Knauf to make a public offer and communicated its willingness to vote against the Board. A066-A073, A076-A082. On September 19, 2017, *after a **multi-month strategic review**, the Board determined that it would proceed with its standalone plan and that there was **no "strategic value"** in combining with Knauf*. A064, A067.

Thereafter, Knauf presented Buffett with a proposed acquisition for $40.00/share, which it understood Berkshire would support, and asked Berkshire if it was willing to support "escalation." A067-A071. Knauf then tricked Defendants into a meeting under false pretenses and ambushed Defendants with its $40.10 Initial Proposal, which it represented Berkshire supported. A071-A072.

Defendants were "entirely unprepared" and, when they finally met two weeks later, they discussed Buffett's dissatisfaction with USG and desire to exit, but again acknowledged his divergent interests and inability to exit without a discount short

of a sale. A059, A061-A062, A072-A075, A082-A083. Defendants also considered "defenses available" against Knauf, engaged a public relations firm, and included a defense fee in their engagements. A071-A075. However, management expressed confidence in USG's long-term plan, and Defendants decided to reject the Proposal as so "wholly inadequate" that it did not "warrant further discussion" – a decision informed by their determination of USG's "intrinsic value." A073-A075.

Meanwhile, Berkshire continued to pester Knauf to act forcefully and "promised" its support, and Knauf considered how to leverage Berkshire's willingness to sell for $40.00/share. A065-A066, A073. On December 20, 2017, Defendants rejected the Initial Proposal as "wholly inadequate given the Company's intrinsic value and…not in the best interest of…stockholders." A077. When Knauf forwarded this rejection, Berkshire told Knauf it was willing to vote against the Board, possibly publicly. A077-A079.

C. USG's Stock Rises; Berkshire Pushes Knauf

In late 2017 and early 2018, between Knauf's Initial Proposal and its forthcoming Second Proposal, USG's 52-week high price and median and highest analyst targets organically increased. A078. USG also held an "Investor Day," during which it disclosed projections that "had been thoroughly vetted by management…and…[we]re achievable." A080.

Meanwhile, emboldened by Berkshire's support, Knauf demanded a meeting with Defendants "as a major stockholder," during which it previewed its Second Proposal and threatened to approach stockholders publicly – an idea suggested by Berkshire. A078-A081. On March 15, 2018, when Knauf delivered its $42.00/share Second Proposal, it warned: "Should you choose not to engage in good faith discussions with us we may reconsider our behavior." A081.

When Defendants met to discuss the Second Proposal, their bankers found it at the low end of their DCF and below the average premium analysis and noted that Knauf was likely not valuing lower corporate tax rates or synergies worth [redacted] [redacted] A082. Defendants again recognized Berkshire's divergent interests and "that they could not substitute the judgment of one shareholder for what they believed to be in the best interest of all shareholders, particularly given th[at shareholder's] different posture" – yet they later did. A082-A083. Defendants determined to reject the Second Proposal as "wholly inadequate," again based on "intrinsic value," but noted "the possibility of a change in [Knauf's] behavior" and possible hostile actions. A082-A084.

D. Berkshire Forces Knauf Public

After Knauf delivered its Second Proposal, Berkshire privately proposed granting Knauf an option to purchase its stock for $42.00/share. A081-A082, A084-

A085, A088. Although Knauf was not ready to go public or hostile, Berkshire forced its hand by publicly disclosing the proposed option – against Knauf's wishes. A085-A088. The market reacted with shock: analysts' takeout prices were as high as $52.00/share, well above the Second Proposal and option. A088-A089.

On March 26, 2018, the same day that Berkshire disclosed the option proposal, Defendants formally rejected Knauf's Second Proposal as "wholly inadequate" based on the "intrinsic value of our long-term strategic plan." A088-A089. Publicly, Defendants stated that "Knauf's opportunistically timed proposal is wholly inadequate as it does not reflect USG's intrinsic value" and USG's "[standalone] strategy…*will deliver significantly more value*." A088-A089.

E. <u>The Withhold Campaign</u>

On April 5, 2018, Defendants' advisors "reiterated that Knauf's proposed price was not within a range to support…engaging in a diligence process…and it did not appear that Knauf would be willing to propose a price per share that would be reflective of the Board's view of intrinsic value." A090-A091, Likewise, Knauf's advisors were telling it that its Second Proposal was too low and that events between the First and Second Proposals (inducing tax law changes) *materially increased USG's value by as much as $2.70/share*. A091-A094.

On April 10, 2018, Knauf publicly announced a campaign to withhold support for four Board members up for reelection at USG's 2018 meeting ("Withhold Campaign") – an idea Berkshire suggested. A094-A095. Two days later, on April 12, 2018, in a coordinated effort, Berkshire publicly stated its intent to support Knauf's Second Proposal and to vote against the Board. A098-A099. Both Knauf and the market recognized the import of Berkshire's support and that Defendants would have little choice but to capitulate. A099-A102.

Over the next weeks, Knauf and Defendants mounted public outreach campaigns. Knauf repeatedly highlighted Berkshire's support. A102-A113, A119. Meanwhile, Defendants repeatedly stated that Knauf's takeover attempts undervalued USG; were opportunistic; did not compensate *all* shareholders for USG's intrinsic value; and were "substantially below our intrinsic value." A064, A067, A073-A075, A082-A084, A088-A091, A095-A098, A111-A127 (¶¶64, 70, 83, 86, 100, 102, 112, 116, 123-25, 147-48, 150-51, 154-55, 158, 160, 162, 164-166).

More important – as the Trial Court found – Defendants also consistently determined privately that USG's inherent, standalone value was $50.00/share and that a sale to Knauf thus was not in shareholders' best interests, and ***repeatedly***

considered issuing a public statement on intrinsic value, but "determined not to."
Id.; Opinion, 51-58.

F. Defendants Cave While *Privately* Valuing USG Above the Buyout

Despite this private determination and their repeated public statements that they "w[ould] not yield to this pressure and [were] committed to acting in the best interests of all USG stockholders," A096-A097, once Defendants realized that their largest shareholders were working together and they suffered a stunning defeat at their annual meeting, they succumbed and agreed to a sale at a price ***they knew did not reflect USG's intrinsic value***.

On April 25, 2018, Scanlon informed the Board that they would likely lose the Withhold Campaign, as 45% of shareholders had indicated they would vote against the Board's nominees. A111-A112. Defendants acknowledged this as "*a key turning point*" and considered "providing the Board's view of value either to [Knauf] or publicly," but deferred. A111-A112.

On April 30, 2018, Defendants were again told that they would likely lose the Withhold Campaign. A119-A120. Although they again concluded that the Second Proposal did not reflect intrinsic value, Defendants authorized Scanlon to begin negotiations with Knauf between $48.00-$51.00/share, a range determined after a "detailed discussion" of intrinsic value. A120-A121. Notably, though, the Board

"urged management to continue to press to get as many votes for the director nominees as possible, and ***management recommended against publicly stating Defendants' view on intrinsic value***, and Defendants determined not to. A120-A122 (again determining not to on May 3).

Later that day, Knauf stated that Defendants would surely "want resolution prior to the annual meeting…to avoid a vote against the Company's four director nominees." A121. The next day, USG publicly announced authorization to begin negotiations; Scanlon called Buffett. A121. Market analysts noted the acquiescence and predicted the cheap sale that would come: "Our best guess is Knauf will pay a small 'obstinance tax' (less than $2) that allows the board to *save face* and *claim* it protected shareholders from a *heist*." A121-A122.

Then, two days before the meeting, in a televised interview, Buffett stated that this was likely the first time in 53 years he/Berkshire voted against a slate and spoke negatively about Defendants. A122-A123. Two days later, 75% of shares voted were cast against USG's nominees. A123-A124. Defendants Armario, Haggerty, and Hernandez were not re-elected but continued to serve as holdover directors; Dana Cho was not elected. A123-A124. ***No Defendant was actually removed from the Board.***

On the same day, Scanlon told the Board that USG's recent performance "further supported management's belief that it would meet or exceed plan for the year," noted that there was an "upside…*beyond what was disclosed* at Investor Day," and disclosed that there was also an "upside potential that was *not identified*" (none of which was disclosed to shareholders). A124. Despite these facts, Defendants recognized "the impact of Warren Buffett's public comments." A124.

Emboldened, Knauf rejected USG's $50.00/share counterproposal, indicated it was willing to pay $43.50/share, and communicated that "it did not intend to stop pursuing an acquisition of USG." A125-A126. Scanlon countered at $47.00/share and "reiterated" to Knauf "***that the Board believes that the intrinsic value of the Corporation is $50 a share***"; Knauf reacted "negative[ly]." A125-A126.

On May 24, 2018, Defendants noted the "current tone of negotiations"; that, while Knauf was limited to making only one public statement during its standstill period, Berkshire was not; and "likely next steps by Knauf and other shareholders [Berkshire] in the event that the parties are unable to reach terms." A126-A127. Although their bankers informed them that USG's DCF valuation had *increased* since their last presentation, and management reiterated that "USG's long-range plan is *realistic and achievable*," Defendants approved the negotiation of a transaction as low as $44.00/share. A126-A127.

As a last-ditch effort, the Board authorized outreach to other potential bidders that expressed interest after Knauf went public. A118-A119, A128. However, these bidders were unable to pursue a transaction *at that time*, and Defendants were too pressured to wait. A118-A120, A128.

On June 5, 2018, Knauf communicated its "best and final" offer of $44.00/share – $43.50/share from Knauf and a $0.50/share dividend paid by USG. A128-A129. On June 6, 2018, following a discussion of Knauf's "perseverance," Defendants resolved to agree. ***Notably, in determining to do so, they specifically "discussed whether Knauf would be obligated to vote for the Corporation's director nominees at the next annual meeting."*** A129. On June 10, 2018, the Board approved the Buyout. A130.

G. Subsequent Events

Analysts noted that Buffett got what he wanted. A133. Over the next quarters, USG announced significant year-over-year increases. A133-A134, A145-A146. The Buyout was approved September 26 and closed April 24, 2019. A134.

II. <u>PROCEDURAL HISTORY</u>

On August 31, 2020, the Trial Court granted Defendants' Motion to Dismiss, finding, *inter alia*, that the Complaint:

(1) Adequately alleged the vote was not fully informed because Defendants determined USG's intrinsic value was $50.00/share, considered disclosing this fact, but elected not to; but

(2) Did not adequately allege a non-exculpated breach of fiduciary duty.

Opinion, 38-86.

Plaintiffs moved for reargument on the grounds that, *inter alia*, Scanlon was not protected by USG's exculpatory provision. A344-A354. On December 1, 2020, the Trial Court denied reargument, reasoning that the Complaint did not contain a care claim against Scanlon as an officer (an absence of pleading) or, even if it could "be so read" to contain such a claim, Plaintiffs waived it. Reargument Opinion, 2-4.

Accordingly, Plaintiffs sought leave to amend to include a separate count against Scanlon as an officer. A463-A595. On March 11, 2021, the Trial Court denied leave, contradicting its Reargument Opinion by reframing the Complaint's shortcoming as a purported "insufficiency of pleading" rather than an "absence of a pleading." Leave Opinion, 6-8.

On March 19, 2021, the Trial Court issued a Final Order.

ARGUMENT

I. THE TRIAL COURT ERRED IN DISMISSING *ALL* DEFENDANTS ON EXCULPATION GROUNDS BECAUSE DEFENDANTS' DECISIONS TO KNOWINGLY SELL USG FOR LESS THAN ITS INTRINSIC VALUE AND MISLEAD SHAREHOLDERS ABOUT USG'S VALUE BOTH IMPLICATE THE DUTY OF LOYALTY/BAD FAITH

A. Question Presented

Did the Trial Court err when it found the Complaint's allegations that Defendants (a) agreed to sell USG for less than their determination of intrinsic value and (b) deliberately chose not to disclose that determination insufficient to state a claim for breach of the duty of loyalty and/or bad faith? A213-A219, A232-A251, A258-A267; *see also* A061-A131, A134-A146 (allegations).

B. Scope of Review

A ruling on a motion to dismiss is subject to *de novo* review. *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings, LLC*, 27 A.3d 531, 535 (Del. 2011).

C. Merits of Argument

The Trial Court found that Plaintiffs adequately alleged that Defendants determined USG's "precise intrinsic value" was $50.00/share; Defendants repeatedly considered disclosing that determination, but deliberately chose not to; and the Proxy was thus materially deficient. Opinion, 51-58. This conclusion is supported by well-pled factual allegations. *Id.*; A213-A219 (citing A073-A075,

A082-A084, A088-A091, A095-A098, A111-A127 (¶¶83, 86, 100, 102, 112, 116, 123-25, 147-48, 150-51, 154-55, 158, 160, 162, 164, 166)).

However, the Trial Court failed to view the Complaint's allegations through the lens of *Revlon* enhanced scrutiny (*infra* §I.C.1.) and then contradictorily determined – as a matter of law – that Defendants' ***knowing and deliberate*** decision to (1) sell USG for less than its intrinsic value and then (2) mislead shareholders about that value, could not amount to a non-exculpated breach of fiduciary duty because it was not reasonably conceivable that the Board acted in bad faith, lacked independence, or was interested. *Infra* §§I.C.2-I.C.3; Opinion, 79-86. In so holding, the Trial Court improperly drew motive inferences against Plaintiffs and in Defendants' favor. *Infra* §I.C.4. These conflicting *factual* determinations cannot be reconciled with each other, decades of jurisprudence, or the well-pled allegations, and the dismissal should be reversed as to all Defendants.

1. The Trial Court Failed to Apply Enhanced Scrutiny

As an initial matter, the sufficiency of the Complaint should have been "considered through the lens of enhanced scrutiny because Company stockholders received cash for their shares." *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *119. This "lens" obligates courts "to view end-game transactions with inherent

skepticism" on a motion to dismiss and to "assess the facts as pled" in light of such skepticism. *Id*. at *129-30.

The Trial Court failed to give Plaintiffs the benefit of that "lens." The words "enhanced scrutiny" do not appear in the Opinion, and the Trial Court suggested that "the *Revlon* standard of review" was not relevant because it is "applicable principally outside the damages context." Opinion, 80. That was reversible error. *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *82, *119, *123; *In re Plx Tech. Stockholders Litig.*, 2018 Del. Ch. LEXIS 448, at *4-5 (Del. Ch. Feb. 16, 2018).[2]

2. The Trial Court Erred in Finding Defendants' Knowing Decision to Sell USG for Less Than Its Intrinsic Value Was – as a Matter of Law – Not Disloyal and/or Bad Faith

"[E]nhanced scrutiny requires that the fiduciary defendants[']…motivations were proper and not selfish' and that 'their actions were reasonable in relation to their legitimate objective.'" *Columbia Pipeline*, 2021 Del. Ch. LEXIS 39, at *85. "[W]hat typically drives a finding of breach 'is *evidence of self-interest…or a similar non-stockholder-motivated influence that calls into question the integrity of the process*.'" *Id.* at *88.

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[2] Plaintiffs do not contend that there are separate *Revlon* duties or that a finding of unreasonableness *alone* is sufficient. *Contra* Opinion, 79-80. Rather, Plaintiffs contend that the allegations must be viewed *through the lens of enhanced scrutiny* and that the Trial Court erred in not applying that lens when assessing the sufficiency of the Complaint's allegations.

"'[W]hen there is a reason to conclude that debatable tactical decisions were motivated…by a fiduciary's consideration of his own financial or other personal self-interests, then the core animating principle of *Revlon* is implicated.'" *Id*. Directors must "treat stockholder welfare as the only end, considering other interests only to the extent that doing so is rationally related to stockholder welfare." *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *121.

> "[T]he predicate question of what the board's true motivation was comes into play, and *the court must take a nuanced and realistic look at the possibility that personal interests short of pure self-dealing have influenced the board*…. The sole responsibility of the directors in such a sale is for the shareholders' benefit," and "[t]he board may not allow any impermissible influence, inconsistent with the best interests of the shareholders, to alter the strict fulfillment of th[is obligation]."

Id. at 122-23.

A board breaches its duty of loyalty and/or acts in bad faith in the context of a *Revlon* sale when it agrees to a sale despite *knowing* a sale is not best for shareholders – *i.e.*, when pursuing a standalone strategy is in shareholders' best interests. Stated differently, "good faith requires that you act to promote the best interests of the corporation and the stockholders. ***If a sale is not the right thing and you believe a sale is not the right thing, you're not supposed to sell.***" *Riche v. Pappas,* Del. Ch., No. 2018-017, Laster, VC (Oct. 2, 2018), Transcript, 25-26; *accord In re Rural Metro Corp. Stockholders Litig.*, 88 A.3d 54, 80-81, n.4 (Del. Ch.

2014) (deal must be weighed against "long-term" value); *In re PLX Tech. Stockholders Litig.*, 2018 Del. Ch. LEXIS 336, at *65 (Del. Ch. Oct. 16, 2018) ("best transaction reasonably available is not always a sale; it may mean remaining independent and not engaging in a transaction").

Here, the Trial Court concluded that there were "no facts from which it can be reasonably inferred that the Board's actions were the result of anything other than the corporate merits of the subject" and that there was "no reasonable basis from which to conclude that the Board's decision to accept the later $44.00 offer was the result of 'extraneous consideration or influences.'" Opinion, 65-66. That determination is contrary to the well-pled facts and reasonable inferences that flow from them.

The Complaint adequately alleged that after: (1) it became clear Knauf and Berkshire were coordinating, (2) Berkshire publicly offered to sell its shares for $42.00/share and publicly supported Knauf's Withhold Campaign, (3) Knauf threatened to unseat Defendants when it did not get its way, (4) Knauf successfully won the Withhold Campaign, and (5) Defendants suffered a stunning defeat, Defendants suddenly (a) abandoned the standalone plan ***they had just determined to be in shareholders' best interests and superior to Knauf's offers***, (b) ***disregarded their own view of USG's intrinsic value***, (c) rushed or abandoned other bidders

because of pressure to sell, and (d) quickly agreed to the Buyout, thereby going – in a few weeks – from determining USG was worth $50.00/share to accepting $44.00/share. *Supra*. Defendants' decision to ***knowingly*** sell USG for less than its intrinsic value cannot be deemed – as a matter of law on a motion to dismiss – reasonable and in good faith. Rather, Defendants' actions were littered with "evidence of self-interest…[and] similar non-stockholder-motivated influence[s] that call[] into question the integrity of the process." *Columbia Pipeline*, 2021 Del. Ch. LEXIS 39, at *88. Even though Defendants ***knew*** the Buyout did not reflect intrinsic value – that a "sale [wa]s not the right thing" (*Riche,* Transcript, 25-26) – once defeated, they knowingly acted adverse to stockholders' interests by agreeing to the Buyout.

These allegations are the hallmark of a bad faith claim when viewed through the lens of *Revlon* enhanced scrutiny. *In re PLX Tech. Inc. S'holders Litig.*, Del. Ch., No. 9880, Laster, VC (Sept. 3, 2015), is instructive. There, the board engaged in a process at the insistence of a large shareholder that threatened to pursue a proxy contest; the board and management recognized it was an inopportune time to sell and that standalone options would generate greater value; but the board acceded to the shareholder and sold. *PLX*, Transcript, 5, 9-14, 17, 19. Based on these facts – similar to those here – the Court found plaintiffs adequately alleged that board

members agreed to sell because of "badgering" from the shareholder (and not because they believed it was best), and that "it [wa]s reasonably conceivable that the plaintiffs could prove at trial that the board's actions fell outside the range of reasonableness." *Id.* at 23, 28, 32-33, 46-47, 51.

The Trial Court erred by disregarding and/or misapplying the above-referenced, well-established law. Instead, the Trial Court relied heavily on *Lyondell* and found Plaintiffs' allegations insufficient to constitute disloyalty/bad faith. Opinion, 81-85. However, *Lyondell* does not require a plaintiff to plead directors "utterly fail[ed] to attempt to fulfill their fiduciary duties" to sufficiently plead bad faith, as the Trial Court held. Opinion, 81 n.340 (citing *Chen*, *v. Howard-Anderson*, 87 A.3d 648, 685 (Del Ch. 2014)). Rather, "***a different line of Delaware precedent***...holds that '[a] failure to act in good faith may be shown…where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation.'" *Chen*, 87 A.3d at 684.

Accordingly, if Plaintiffs' allegations "support[] an inference that the directors made decisions that fell outside the range of reasonableness for reasons other than pursuit of the best value reasonably available, which could be no transaction at all," then they have sufficiently pled disloyalty/bad faith. *Id.* at 685. As outlined above, Plaintiffs pled facts that lead to the reasonably conceivable

conclusion that Defendants' radical about-face and acquiescence to the Buyout were driven by a "nonstockholder-related influence." *Id*. At the very least, they raise a question of fact as to the reasons for Defendants change of heart that cannot be resolved on a motion to dismiss. *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *129-30 (where a "nuanced and realistic look at the possibility that personal interests short of pure self-dealing…influenced the board" makes it "reasonably conceivable that…Defendants placed [other] interests…above…their obligation to maximize stockholder value," bad faith is adequately pled); *Riche*, Transcript, 26 (allegations "raise[] fairly litigable questions about the degree to which the directors were motivated…by personal or professional interests. It's not possible ever to look into the mind of a director. You have to base it on the circumstances and the facts. It's certainly not possible at the motion to dismiss stage.").

Contrary to this standard, the Opinion attempts to excuse Defendants' conduct, arguing that the Board did not "simply capitulate[] after its defeat" but instead engaged in "robust negotiations" and, "[a]fter the Withhold Campaign's success was a forgone conclusion," and "against the ropes after being trounced by its two largest stockholders," "sought a sale at a price above what Knauf had offered." Opinion, 66-67, 84. ***But "a sale at a price above what Knauf had offered" is not the same thing as "a price that reflects intrinsic value,"*** which the Trial Court

found Defendants determined was above what they accepted and recommended to shareholders. For this reason, Plaintiffs' allegations support the converse reasonably conceivable conclusion that the sale was motivated, not by what was best for stockholders, but rather by a "nonstockholder-related influence."[3]

In sum, Plaintiffs sufficiently alleged that Defendants believed a sale at $44.00/share was not in stockholders' best interests, because USG was worth $50.00/share. ***But they agreed to a sale at a price below what they determined was fair***. While it's not possible "to look into the mind of a director" at this stage, viewed through the enhanced scrutiny lens and "in the light most favorable to Plaintiffs, and drawing all inferences in their favor, the alleged facts were sufficient to *plead* disloyalty/bad faith." *Riche,* Transcript, 26-28.

3. The Trial Court Erred in Finding Defendants' *Knowing* Decision to Withhold USG's Intrinsic Value Was – as a Matter of Law – Not Disloyal and/or Bad Faith

Defendants knowingly sold USG for less than its $50.00/share intrinsic value. Then, in a distinct breach, they deliberately misled shareholders about USG's value while recommending the Buyout and misrepresenting that it was "more favorable" than USG "on a standalone basis." Opinion, 52 n.249. Although the Trial Court

[3] The Opinion's speculation regarding Defendants' motives is addressed *infra* §IC.4.

correctly found that Defendants ***knowingly*** withheld material information, it conflictingly found that this deliberate conduct did not adequately allege a non-exculpated breach. These conflicting determinations cannot be reconciled with each other or the facts.

In excusing Defendants' deliberate failure to disclose their intrinsic value determination, the Trial Court relied on its prior finding that it was not reasonably conceivable that Defendants lacked independence, were interested in the Buyout, or acted in bad faith, and, from there, gave Defendants the benefit of the doubt in determining that there could be "no reasonable inference that the disclosure deficiency emanated from extraneous influences or considerations." Opinion, 75-76. In so finding, the Trial Court relied on two faulty rationales.

<u>First</u>, it found that Defendants' disclosure of the negotiation ranges undercut any bad motive. Opinion, 77-78. This conclusion is belied by the Trial Court's own *Corwin* analysis, where it specifically noted the *meaningful difference* between disclosing "negotiating price" and "a view of intrinsic value." Opinion, 54-55. Specifically, the Trial Court initially (correctly) rejected Defendants' argument that they sufficiently disclosed their view of intrinsic value "by disclosing (i) that [the Board] authorized Scanlon to begin negotiations within a range of $48.00 to $51.00 per share and (ii) USG's first counterproposal to Knauf of $50.00." Opinion, 54-55.

Yet, in later finding the intrinsic value omission did not constitute bad faith, the Trial Court contradictorily reasoned that the *same disclosures* regarding "negotiation price" belied "any bad faith attempt to conceal 'intrinsic value.'" Opinion, 78.

In other words, the Trial Court found that (i) the "negotiation price" disclosures were ***so substantively different*** from disclosing Defendants' "precise intrinsic value of USG" that they were insufficient to trigger *Corwin*, but that (ii) those ***same disclosures were simultaneously similar enough*** to disclosing "precise intrinsic value" that it was not reasonably conceivable that Defendants consciously tried to hide the ball. There is a significant tension between those two propositions, and the first is correct and mandates rejection of the second. Because there is a substantive difference between (i) "negotiation price" disclosures and (ii) the Defendants' determination of intrinsic value that was withheld from stockholders, it cannot be said that Defendants' deliberate decision to make only the former while withholding the latter did not rise to the level of a conscious disregard of duty.

Second, the Trial Court relied on a faulty tautology, concluding that "it is not reasonably conceivable that the directors would have demonstrated a conscious indifference to their fiduciary duties by not disclosing their view of intrinsic value, while at the same time disclosing to USG's stockholders *that the Board had chosen not to make that very disclosure*." Opinion, 78. The Court concluded: "[i]t is near-

inconceivable" that Defendants "would have professed [their] bad faith to USG's stockholders in the Proxy," such that it is "not reasonably conceivable that [their] non-disclosure rises to the level of conscious disregard." Opinion, 78-79.

This reasoning is premised on an incorrect inference – namely, that the "only reasonable inference is that the Board's approval of a $48.00 to $51.00 negotiating range represented its view of a *realistic* transaction price, not an *overblown* opening gambit that *risked driving Knauf away*, as such a position could have been catastrophic to a negotiated (rather than hostile) transaction." Opinion, 78. That inference – drawn in Defendants' favor – is demonstrably wrong, as Defendants knew "that $47 was 'a walk away price for Knauf,'" such that $48.00-$51.00 was not "realistic" (to Knauf) and did risk driving Knauf away. A126-A127.

There is also a significant difference between telling stockholders (i) "we decided not to disclose our view of intrinsic value" and (ii) "our view is that intrinsic value is $6.00 above the Merger Consideration." Without knowing that Defendants' dollar value view of intrinsic value was $50.00/share – a fact Plaintiffs learned in expedited discovery but that stockholders never knew – the former disclosure was not an obvious "profess[ion]" of bad faith. Opinion, 78. For all stockholders knew, the withheld intrinsic value could have been at or below the Merger Consideration,

especially given Defendants' representation that the Merger Consideration was "more favorable" than USG "on a standalone basis." Opinion, 52 n.249.

Indeed, the disclosure the Trial Court cited actually ***perversely allowed Defendants to continue to hide the ball from stockholders regarding intrinsic value while*** providing them a basis for the *Corwin* defense they ultimately made. The cited disclosure was precisely the type of "partial and elliptical disclosure" that defendants use to mount *Corwin* defenses when plaintiffs don't have access to discovery. *Morrison v. Berry*, 191 A.3d 268, 272 (Del. 2018). This partial and elliptical disclosure did not evince a lack of bad faith. If anything, it is evidence of bad faith, because it allowed Defendants to accomplish their goal of hiding damning material facts while providing themselves ammunition for a *Corwin* defense.

At bottom, it simply cannot be said that it is inconceivable that Defendants' ***knowing*** decision to withhold material information regarding value could not possibly have been a result of anything other than negligence. The Trial Court found Defendants considered disclosing their view on intrinsic value, but ***deliberately*** "determined not to." Opinion, 55-56. It is therefore conceivable that Defendants acted disloyally/in bad faith.

Moreover, while the reason for Defendants' decision may be explained by several motives (*infra* §I.C.4), Plaintiffs need not allege the *reason* behind

Defendants' material omission to plead bad faith. Rather, they need merely allege a *knowing* material omission.

Pattern Energy is instructive. There, the Court found that plaintiffs had adequately alleged material nondisclosures. 2021 Del. Ch. LEXIS 90, at *156-57. The Court found – just as the Trial Court found here – that the "allegations indicate that the Director Defendants knew the truth" and that, as a result, "Plaintiff ha[d] adequately alleged that the Director Defendants ***failed to correct a Proxy they knew to be false and misleading.***" *Id.* at 157. Accordingly, "the Director Defendants'…failure to correct the Proxy's alleged false and misleading statements[] are actionable ***as bad faith***." *Id.* at 158.

Simply put, allegations that a fiduciary *knowingly* withheld material information are sufficient to plead bad faith. *Id.*; *see also Columbia Pipeline*, 2021 Del. Ch. LEXIS 39, at *153 (where "disclosure violations also concerned [defendants] own actions, supporting an inference that *they knew the Proxy was false when issued*," the complaint "supports a reasonable inference that [defendants] breached the subsidiary element of the duty of loyalty by failing to act in good faith."); *In re Hansen Med., Inc. S'holders Litig.*, 2018 Del. Ch. LEXIS 197, at *28-29 (Del. Ch. June 18, 2018) (reasonably conceivable that fiduciary breached duty of loyalty where allegations supported inference that fiduciary knew proxy was

misleading); *Wilson v. Great Am. Indus.*, 855 F2d 987, 995 (2d Cir. 1988) (a "finding that nondisclosure [of material fact] was a deliberate decision demonstrates a *culpable state of mind far in excess of negligence*"). Vice Chancellor Glasscock has previously recognized this proposition, but refused to apply it here. *Morrison v. Berry*, 2019 Del. Ch. LEXIS 1412, at *48 (Del. Ch. Dec. 31, 2019) ("knowingly-crafted deceit *or* knowing indifference to duty…show bad faith").

In sum, the Trial Court found that Defendants knowingly chose to withhold material information, but then conflictingly found as a matter of law on a motion to dismiss that knowingly omitting material information could not possibly implicate the duty of loyalty/bad faith. These two findings are incompatible, the Trial Court did not apply the correct standard, and the dismissal should be reversed as to all Defendants for this independent reason.

4. The Trial Court Improperly Inferred Motive in Defendants' Favor

The Trial Court's Opinion hinges on erroneous inferences regarding Defendants' motives for knowingly selling USG for less than its inherent value and deliberately hiding that value from stockholders. The Trial Court erroneously disregarded Plaintiffs' allegations, pretended to know the minds of Defendants, made excuses for Defendants' conduct, and drew inferences in their favor.

Specifically, as to motive, Plaintiffs adequately alleged that Knauf threatened to unseat Defendants if it did not get its way, demonstrated its ability to – *and did* – take retributive action, and Defendants reacted by abandoning their standalone plan, acceding to the Buyout they determined offered no "strategic value" and did not reflect their determination of USG's intrinsic value, and knowingly withheld that value from shareholders. *Supra*. In further support of Defendants' motive, Plaintiffs adequately alleged that the Non-Scanlon Defendants "rationally feared" Knauf, Berkshire, and another proxy loss because (1) such a publicized loss – to Warren Buffet, no less – would have significantly affected their reputations and other business interests, positions, and board memberships; and (2) this potential harm outweighed any nominal increase in consideration they may have secured. A136-141.

The Trial Court discredited these allegations for three erroneous reasons. First, it concluded that it was "not reasonably conceivable that the Non-Scanlon Defendants capitulated to Knauf in selfish defense of their outside reputational interest because USG's directors had already lost a public fight with Knauf" and thus "any reputational loss that could come from a public loss to Knauf had already occurred." Opinion, 69. However, no Defendant was actually removed following the Withhold Campaign loss, and the well-pled allegations support the reasonably

conceivable conclusion that the sale was motivated by Defendants' desire not to lose a second election *where they would actually be removed* and to simply end the ordeal and put this episode behind them by getting Knauf to "pay a small 'obstinance tax' (less than $2) that allow[ed] the board to *save face* and claim it protected shareholders from a heist." A121-A122.

This reasonably conceivable conclusion is not some concept divined by Plaintiffs' counsel, but instead a prediction by contemporaneous commentators, who accurately foretold exactly what came to transpire. A121-A122. As predicted, when Defendants were told they would lose the Withhold Campaign, they changed position and agreed to negotiate. It is therefore conceivable that they would change their position *again* in response to a second proxy contest – especially when Knauf said it would keep pursing an acquisition, Defendants knew Berkshire would continue to support Knauf, and the next proxy contest would have real consequences and *they would actually be removed*. A126-A127.

Consistent with this "rational fear," on the day Defendants agreed to the Buyout following their *initial* Withhold Campaign loss, ***Defendants specifically questioned their advisors as to whether "Knauf would [now] be obligated to vote for [Defendants] at the <u>next</u> annual meeting."*** A129. The Trial Court failed to grapple with this significant fact, even though the Opinion acknowledges that "even

‘[g]etting a substantial, but less than a majority, withhold vote is still an embarrassment and often induces board actions.’” Opinion, 59.

Instead, the Trial Court put blinders on and erroneously found that *Revlon* required its analysis to “exclude[] the Board’s rejection of Knauf’s first two offers and its resistance to the Withhold Campaign.” Opinion, 83. The Trial Court thus *admittedly ignored* the vast majority of the allegations in its analysis. But Defendants’ months of resistance and public and private statements and determinations of intrinsic value cannot be excised from the enhanced scrutiny analysis – they are defining facts that place Defendants’ ultimate actions into context, and this Court has long recognized that fiduciaries’ actions do not happen in a vacuum. *Columbia Pipeline* is on point. There, defendants similarly tried “to avoid confronting many of the actions challenged” by “pushing out the date when” *Revlon* applied. 2021 Del. Ch. LEXIS 39, at *100-101. The Court explained that “the operative question” in determining the “temporal starting point for enhanced scrutiny” is “[w]hen is it reasonably conceivable that the situational conflicts that animate enhanced scrutiny could have come into play?” *Id*. at *104-05. Here, such situational conflicts came into play early on, when it was apparent that Knauf had Berkshire’s support – and almost half of USG’s stock – tied up in favor of a sale. It was therefore error for the Trial Court to ignore sixteen months of a seventeen-

month process based on the flawed premise that *Revlon* did not yet apply. Opinion, 83.

The Trial Court's finding is also contrary to decades of jurisprudence, which recognizes that the fear of reputational and financial harm from a proxy contest can create an "*inherent positional conflict,*" *Kalisman v. Friedman*, Del. Ch., No. 8447, Laster, VC (June 7, 2013), Transcript, 40-41, that "can inspire fiduciaries and their advisors to be less than faithful to their contextual duty to pursue the best value," *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 439 (Del. Ch. 2012), and can even result in finding control and disloyalty. *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 307 n.7 (Del. 2015); *PLX*, Tr. at 27; *In re MFW S'holders Litig.*, 67 A.3d 496, 528-529 (Del. Ch. 2013). Former Chief Justice Strine wrote on this "inherent positional conflict," concluding that independent directors are "*highly sensitive* to resisting institutional campaigns…for fear that they will be targeted for withhold campaigns at [their *other*] companies," "***[t]hat fear is rational***," and "[t]hey are robotic in fearing personal embarrassment." Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?*, 126 Yale L.J. 1870, 1925-1926, 1927 n.190 (2017).

<u>Second</u>, and relatedly, because the Trial Court did not find it reasonably conceivable that the Non-Scanlon Defendants feared a second proxy loss, it likewise found it "not reasonably conceivable that the personal give of pushing for a higher

price (*i.e.* putting their reputations on the line) was not worth the get (in the form of increased consideration).” Opinion, 72. This conclusion is also contrary to the well-pled allegations, which demonstrate that Defendants had far more invested in their other positions and careers than in securing incrementally more value for USG:

Director	Annual Other Board Compensation		Buyout-Related Payments		Additional Consideration for Securing $1 More from Knauf
Leer	$746,930		$4,368,178		$100,351
Armario	$206.061		$3,732,305		$85,725
Hernandez	$572,171	**and**	$1,977,980	**vs.**	$45,265
Lavin	$414,995		$1,662,759		$37,803
Haggerty	$462,728		$1,835,372		$41,713
Burke	Unknown		$753,949		$17,324
Kennedy	Unknown		$1,612,996		$36,659

A136-141. Rather than truly grappling with this fact, the Trial Court paid it lip service in a footnote. Opinion, 72 n.315.

Third, and finally, the Trial Court mused that Defendants may have taken the actions they did – not out of fear of a proxy loss – but instead out of "'[f]ear' of a corporate takeover threat," which was "justified" and a "nod to reality, not a disabling extraneous influence." Opinion, 67. Once again, this determination is contrary to the well-pled allegations and the Trial Court's own earlier findings. A122 (Knauf subject to standstill); Opinion, 60 ("it is not reasonably conceivable that the Board knew as a certainty that Knauf would launch a hostile tender offer"). *Indeed, any tender offer would have required an offer above $44.00/share to succeed*

because it would have lacked Defendants' blessing, a fact the Opinion failed to consider.

Furthermore, even *if* Defendants truly believed a hostile offer at less than $44.00/share was an imminent risk and agreed to the Buyout to avoid it – two inferences improperly drawn in Defendants' favor – ***they still owed shareholders a duty to disclose their genuine view that that price was not fair***. Their deliberate decision to withhold that material fact constituted disloyalty/bad faith.

II. THE TRIAL COURT ERRED IN DISMISSING SCANLON AS AN OFFICER

A. <u>Question Presented</u>

Did the Trial Court err in dismissing Scanlon, an officer not protected by exculpation, for her actions in disseminating the Proxy? A268-A269; A213-A219, A232-A251, A258-A269, A325, A333-A335, A344-A354, A367-A368, A437-A449; *see also* A061-A131, A134-A146 (allegations).

B. <u>Scope of Review</u>

The ruling is subject to *de novo* review. *Cent. Mortg.*, 27 A.3d 531 at 535.

C. <u>Merits of Argument</u>

An officer cannot be shielded from monetary liability by an exculpatory provision. *Gantler v. Stephens*, 965 A.2d 695, 709 n.37 (Del. 2009); *Columbia Pipeline*, 2021 Del. Ch. LEXIS 39, at *154. Because Scanlon signed the materially misleading Proxy as an officer, the Trial Court erred in dismissing her.

1. The Complaint's Allegations Regarding Scanlon Were Sufficient to Plead Gross Negligence

The allegations outlined *supra* were also sufficient to plead gross negligence as to Scanlon as an officer. While the Trial Court initially failed to address Plaintiffs' care claim against Scanlon as an officer (*infra* §II.C.2), the Trial Court's eventual justification for dismissing Scanlon – that the Complaint failed to sufficiently allege

that the nondisclosure was "the result of Scanlon's gross negligence" – was erroneous. Leave Opinion, 7-8.

Several recent opinions have found that a fiduciary's knowing withholding of material information constitutes bad faith, *or at least gross negligence*. *E.g., Columba Pipeline*, 2021 Del. Ch. LEXIS 39, at *152-53 ("To support a damages claim, the plaintiffs next must plead facts supporting an inference that Skaggs [CEO/Chairman] or Smith [CFO] *withheld the information knowingly or* because of non-exculpated gross negligence…The disclosure violations also concerned Skaggs' and Smith's own actions, supporting an inference that *they knew* the Proxy was false when issued. The Complaint therefore supports a reasonable inference that Skaggs and Smith breached the subsidiary element of the duty of loyalty by failing to act in good faith…At a minimum, the Complaint supports a reasonable inference that Skaggs and Smith acted recklessly. Because they are not entitled to exculpation in their capacities as officers, the Complaint therefore states claims against them.") (collecting recent similar cases); *see also Wilson*, 855 F.2d at 995.

Baker Hughes is on point. There, the plaintiffs alleged that Craighead (Chairman/CEO) breached his disclosure duty. 2020 Del. Ch. LEXIS 321, at *32-38. After finding plaintiffs sufficiently pled disclosure violations that vitiated *Corwin*, the Court considered whether plaintiffs could pursue damages against

Craighead as an officer. *Id*. at *39, 40-43. The Court noted that the complaint contained "numerous allegations concerning Craighead's involvement in the negotiation of the Merger, which is unsurprising given his multiple roles as Chairman of the Board, CEO, and President." *Id*. at *42. And because Craighead signed the proxy as Chairman/CEO (and thus presumptively knew of the material omission), the Court concluded: "[a]lthough not overwhelming, *this allegation is sufficient* to support a reasonably conceivable claim that Craighead breached his duty of care with respect to the preparation of the Proxy he signed as…CEO." *Id*. at *43. It elaborated that, while "[p]erhaps discovery will show that the failure to" disclose the material information "was inadvertent or handled by advisors on which Craighead reasonably relied, [] *those factual questions cannot be resolved on the pleadings*." *Id*.

Pattern Energy similarly held that a disclosure claim could proceed against a CEO/director (Garland) who "was involved in preparing and disseminating the Proxy[,]" "was the Company's CEO throughout the sales process and 'an integral figure' during merger negotiations," and, "*most significantly…signed the Proxy*." 2021 Del. Ch. LEXIS 90, at *178. Thus, it was "reasonable to infer that Garland was involved in preparing the disclosures in the Proxy in his capacity as an officer." *Id*. The Court concluded: "Plaintiff has pled that the Proxy was materially misleading

and that Garland, who prepared the Proxy, ***was aware of its inaccuracies, and has therefore stated a claim for breach against him***." *Id.* at *188. Likewise, *City of Warren Gen. Emples. Ret. Sys. v. Roche* also found that plaintiffs adequately alleged a CEO "breached her fiduciary duty of care" and could be "liable for materially misleading disclosures and omissions" where she was "involved in preparing" and "signed the Proxy." 2020 Del. Ch. LEXIS 352, *1-4, *54 (Del. Ch. Nov. 30, 2020).

Similar to *Baker Hughes*, *Pattern Energy*, and *Roche*, the Complaint here contained numerous allegations concerning Scanlon's involvement in the negotiations of the Buyout. *See, e.g.,* A074, A076-A077, A095-A096, A125-A126, A146-A147 (allegations regarding Scanlon's failure to ensure Proxy set forth interactions with Knauf and Defendants' view regarding intrinsic value); A091, A119-A121, A123-A127, A129-A130, A142 (allegations regarding role leading negotiations and as conduit between Knauf and Board). Moreover, and "significantly," *Pattern Energy*, 2021 Del. Ch. LEXIS 90, at *178, Scanlon signed the Proxy's introductory letter and disseminated it as an officer. A601-A603. And, most significantly, there is no dispute that Scanlon "was aware of [the Proxy's] inaccuracies," *Pattern Energy*, 2021 Del. LEXIS 90, at *188, yet she chose not to fix them.

The Trial Court's tardy determination that the Complaint failed to sufficiently plead Scanlon's gross negligence was thus contrary to the recent weight of authority on officer liability. *Supra*. It was also contrary to the Vice Chancellor's own prior opinion in *Morrison*. There, although he found that the material omission did not "support an inference of a subsequent concealment of misconduct or a bad faith intent to harm," he found the complaint sufficiently pled a care-based disclosure claim against both a general counsel and CEO, because it could be inferred "that the omitted facts were omitted with [their] knowledge" and thus it could be inferred that they "knew [they were] creating a misleading proxy," or were "at least indifferent to [their] contrary duty to stockholders," such that they "conceivably acted with gross negligence." 2019 Del. Ch. LEXIS 1412, at *63-64, *70 ("crafting such a narrative to stockholders, while possessed of the information evincing its inadequacy, represents gross negligence"). As to the CEO, the Vice Chancellor explained: "[w]hile Anicetti, as CEO, may not have been as intimately involved in the drafting as [General Counsel], given his role as a director, I can infer that he possessed the same knowledge" regarding "what was being omitted." *Id*. at *70. The Vice Chancellor elaborated that he could "readily infer that Anicetti attempted and failed to create a proper proxy, and breached no duty[,]" but because he could "reasonably infer gross negligence as well, *at the pleading stage [he] must do so*." *Id*.

The Trial Court simply refused to apply the same principles here, evincing a desire to end this case on exculpation grounds despite its oversight of the care claim. That was reversible error, as the Complaint contained allegations regarding Scanlon's actions as an officer, she signed the Proxy, and she was admittedly aware of the Proxy's material deficiency but deliberately elected not to fix it.

2. The Complaint *Pled* a Care Claim Against Scanlon as an Officer, Which Defendants Ignored

The Trial Court failed to address Plaintiffs' care claim against Scanlon as an officer in its initial Opinion, instead dismissing *all* Defendants because it determined that the nondisclosure did not constitute bad faith. Opinion, 63-86 (considering Scanlon's liability only as director and whether "the maldisclosure was 'intentional and constitute[d] *more than* an error of judgment or gross negligence'").

When Plaintiffs sought reargument based on this oversight, the Trial Court held that the issue "was not adequately before [it]" because (1) "[i]t does not appear that the Complaint alleges Ms. Scanlon, as a corporate officer, was grossly negligent in the dissemination of disclosures," (*i.e.*, an absence of pleading) and (2) to the extent the Complaint "may be so read," Plaintiffs failed to brief the issue and waived it. Reargument Opinion, 2-3.

Yet when, based on the Reargument Opinion, Plaintiffs sought leave to amend to include a separate count against Scanlon as an officer, the Trial Court backtracked,

contradicted itself, and re-framed the purported deficiency, *not* as an "absence of pleading," but as an issue of "insufficient pleading," writing that the Complaint *had alleged* the care claim against Scanlon and the Court had rejected it for lack of sufficient allegations of gross negligence. Leave Opinion, 7-8.

To the extent the Reargument Opinion's statements regarding an absence of pleading/waiver still stand, the Complaint plainly pled a care claim against Scanlon as an officer – as the Trial Court subsequently conceded in justifying its denial of leave – and Plaintiffs did not waive that claim.

The Complaint was sufficient to put Defendants on notice that Plaintiffs were challenging Scanlon's conduct as an officer *and* director and pursuing care *and* loyalty claims against her. It:

- Identified Scanlon as a defendant as CEO and President *and* as a director. A043.
- Identified her as a member of "management," the negotiations she conducted as such, and her actions as management's conduit to the Board who also relayed "management's belief" regarding value. A063, A070-A071, A073-A074, A076-A082, A087, A091, A095-A096, A111-A112, A119-A121, A123-A124, A126-A127, A129-A130, A144-A145.
- Noted that the Buyout press release identified Scanlon as "president and chief executive officer," not a director. A132.
- Alleged that Defendants owed duties of care and candor "as officers and/or directors" and that they "separately" and "knowingly or recklessly" violated those duties by "fail[ing] to provide USG's public stockholders with all material information." A047-A049, A147-A148.

- Explained why the Proxy was materially misleading. A146-A147.
- And asserted claims for "an uninformed stockholder vote… including by way of quasi-appraisal." A147-A148.

Moreover, the Proxy was incorporated into the Complaint by reference and the Trial Court took judicial notice of it. Therein, Scanlon signed the Introductory Letter as "President and [CEO]," was identified as USG's negotiator as an officer, "updated the Board" as negotiator, and executed the Merger Agreement as an officer. A601-603, A641, A796.

Baker Hughes is again instructive. Counts I and II in the *Baker Hughes* complaint, which raised claims against (among others) its Chairman and CEO (Craighead), did not distinguish between Craighead's role as an officer and his role as a director. A428-A430. The *Baker Hughes* Court correctly found no problem with this pleading style, which Plaintiffs utilized here. 2020 Del. Ch. LEXIS 321; *cf. Stone & Paper Inv'rs, LLC v. Blanch*, 2020 Del. Ch. LEXIS 225, at *17-18 (Del. Ch. June 29, 2020) (allegations sufficient even though "not a model of clarity"); *VLIW Tech., L.L.C. v. Hewlett-Packard Co.*, 840 A.2d 606, 611 (Del. 2003) (allegation that is "vague or lacking in detail" "nevertheless 'well-pleaded' if it puts the opposing party on notice"). Similarly, the complaint in *Morrison* contained a "Count II" for "breach of fiduciary duty against the other *director* defendants" that contained the allegation against the CEO. A912-A913.

In short, Plaintiffs plainly sued Scanlon for breaches of both her duties of care *and* loyalty as a director *and* officer and raised disclosure claims. And Plaintiffs did not waive this claim by failing to brief it.

Defendants bore the burden of moving to dismiss, *Loudon v. Archer-Daniels-Midland Co.*, 1996 Del. Ch. LEXIS 12, at *7 (Del. Ch. Feb. 20, 1996), and Defendants failed to address Plaintiffs' care claims against Scanlon in *their* motion. Defendants knew that Scanlon was USG's CEO and not protected by exculpation in that capacity. Nevertheless, Defendants blanketly asserted that all Defendants – including Scanlon – were protected by USG's exculpatory provision because it "bar[s] claims based on the duty of care." A190-A191. Of course, that is an incorrect statement of law: exculpatory provisions shield only directors, not officers, from care claims. *Supra.*

Despite this failure, Plaintiffs devoted an *entire section* of their opposition arguing that Section 102(b)(7) did not provide shelter, concluding that "§102(b)(7) does not exculpate officers in their capacity as officers, ***such that exculpation is not available to Scanlon***." A268-A269. This is a straightforward and well-settled legal rule that did not require extensive briefing.

Rather than address this on reply, Defendants demurred, erroneously asserting in a footnote that Plaintiffs had not raised any claims against Scanlon as an officer

because "Plaintiffs' claims relate to the decision *to approve the merger* – a decision made by the Board." A295. But, as outlined above, Plaintiffs pled claims for lack of disclosure separate and apart from their claims regarding the "decision to approve the merger," and Defendants admitted their mistake *later*, arguing in opposition to reargument that "Scanlon's challenged acts – *approving the transaction* ***and the Proxy Statement*** – were exercises of her powers as a director…." A359. Scanlon's preparation and signing of the Proxy *as an officer* plainly were not "exercises of her powers as a director," and, regardless, as *Baker Hughes* made clear, whether Scanlon was acting as an officer or as a director is a "fact intensive" question that is "premature" to address on a motion to dismiss. *Baker Hughes*, 2020 Del. Ch. LEXIS 321, at *43 n.161.

Defendants cannot avoid claims by failing to address them, particularly where plaintiffs flag them in opposition, and the Trial Court's failure to consider – and dismissal of – Plaintiffs' care claims against Scanlon as an officer was error.

III. ALTERNATIVELY, THE TRIAL COURT ERRED IN DENYING LEAVE TO AMEND

A. Question Presented

Alternatively, did the Trial Court err in denying leave to amend? A463-A471.

B. Scope of Review

A ruling on a motion for leave to amend where the governing rule is in dispute is subject to *de novo* review. *See Clark v. State Farm Mut. Auto. Ins. Co.*, 131 A.3d 806, 812 (Del. 2016); *Bäcker v. Palisades Growth Capital II, L.P.*, 246 A.3d 81, 94 (Del. 2021).

C. Merits of Argument

Given Defendants' repeated statements, A190-A191, A295, A355, A357, and the Trial Court's initial determination that the Complaint did not plead a care claim against Scanlon as an officer, Reargument Opinion, 2-3, Plaintiffs sought leave to amend to include a separate count against Scanlon as an officer. Contradicting its past finding, the Trial Court stated that "a breach of Scanlon's duty of care would fall within [Count 1], the dismissal of which was sought in the Motion to Dismiss," such that Rule 15(aaa) applied, and denied leave. Leave Order, 6-7.

To the extent that the Complaint could not be "read" to have pled a care/candor claim against Scanlon as an officer, Plaintiffs' motion for leave was governed by Court of Chancery Rule 15(a). *Tvi Corp. v. Gallagher*, 2013 Del. Ch.

LEXIS 260, at *64 (Del. Ch. Oct. 28, 2013) ("motion to amend, following resolution of a motion to dismiss, as to claims that…were not within the purview of the motion to dismiss" would presumably "be subject to review under Rule 15(a)"). Under Rule 15(a), "justice so require[d]" granting leave. The Trial Court found a disclosure violation, and it is inequitable for Scanlon to evade liability where the Complaint pled a care claim against her as an officer, Defendants did not move for a more definitive statement and simply ignored the issue, Plaintiffs flagged the claim in their opposition, but the claim was not addressed in the Opinion.

Even if *arguendo* Rule 15(aaa) applied, Plaintiffs made a sufficient showing of "good cause" why "dismissal with prejudice would not be just." Plaintiffs are unaware of any rule or case law that required them to break out their claim against Scanlon as an officer into a separate count. To the contrary, as noted above, the Complaint was pled just as in *Baker Hughes* and *Morrison*. *Supra* §II.C.2. Furthermore, if Scanlon believed that the claims against her were too vague or ambiguous, she should have moved for a more definite statement under Rule 12(e). To allow a defendant to avoid a claim that is pled by ignoring it is inequitable and unjust – especially where plaintiffs flag the claim in briefing.

The only just outcome was to afford Plaintiffs leave, and the Trial Court erred.

CONCLUSION

The dismissal should be reversed as to all Defendants, or, at the least, Scanlon. Alternatively, the denial of leave to amend should be reversed.

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Respectfully submitted,

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