**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

CITY OF CORAL SPRINGS POLICE OFFICERS' PENSION PLAN, derivatively on behalf of BLOCK, INC.

Plaintiff Below/Appellant,

v.

JACK DORSEY, ROELOF BOTHA, AMY BROOKS, PAUL DEIGHTON, RANDY GARUTTI, JIM MCKELVEY, MARY MEEKER, ANNA PATTERSON, LAWRENCE SUMMERS, DAVID VINIAR, and DARREN WALKER,

Defendants Below/Appellees,

and

BLOCK, INC.,

Nominal Defendant Below/ Appellee.

No. 161, 2023

Court Below:

Court of Chancery
C.A. No. 2022-0091-KSJM

**Redacted Public Version**
**Filed: July 12, 2023**

**APPELLANT'S OPENING BRIEF**

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## NATURE OF PROCEEDINGS

Plaintiff appeals from the Court of Chancery's Rule 23.1 dismissal of Plaintiff's derivative complaint alleging breaches of fiduciary duty by Jack Dorsey (Block's founder, Chairman, CEO, and controlling stockholder) and ten of his fellow directors in connection with Block's 2021 acquisition of TIDAL, a private music streaming company (the "Acquisition").

Block—a financial technology company with no plans to enter the music industry—agreed to pay more than $300 million to buy a majority of TIDAL, notwithstanding that TIDAL was then widely considered to be a failed business. The only apparent explanation for a deal between the two fundamentally-unrelated companies was the close friendship between their respective leaders: Dorsey and Shawn "Jay-Z" Carter, who led TIDAL. Informed commentators described the Acquisition as "*a deal that looks like a way for Jack Dorsey to move money from his publicly traded company to a company owned by a guy he likes to hang out with*" or, more colorfully, a "*a $300 million bar tab to hang out with Jay-Z*." Block's stock fell 7% upon the announcement, destroying billions of dollars in value.

Plaintiff pursued a books-and-records investigation, which revealed Block's bailout of TIDAL was proposed by Dorsey while he was in the middle of a Hamptons vacation with Carter and at a time when TIDAL was in utterly shambolic condition:

it was failing financially, generating mounting losses and accumulating massive unpaid debts; its major contracts had expired; it had captured no real market share; it had cycled through five CEOs in five years; [redacted] it had recently required a $50 million personal loan from Carter; it faced an ongoing criminal investigation; and its acquisition was projected to impose an 8-10% drag on Block's profitability for years to come.

The proposal was so unusual and extreme that Dorsey—despite his mammoth power and influence as Block's iconic founder, Chairman, CEO, and controller—could not find a single ally among his own employees. <u>*No unconflicted member of Block's senior management team supported the deal*</u>. They were instead in open rebellion, exerting "*substantial push back*" against the proposal.

But Dorsey got what he wanted. Block did the deal at a $350 million valuation: greater than *6x* what Carter paid for TIDAL just five years earlier and a *5x* multiple over a nearly-contemporaneous sale of a similarly-situated competitor.

The Court below correctly held it "reasonably conceivable that Dorsey used corporate coffers to bolster his relationship with Carter" (Op. 18)—*i.e.*, textbook disloyalty. But it dismissed the complaint upon a finding that all of Dorsey's fellow directors at the time of the Acquisition—including four who sat on a Transaction

Committee that directly approved the deal—could consider a demand. In so holding, the Court failed to credit Plaintiff's allegations that these directors acted in bad faith.

The Court recognized the Acquisition was plagued by "obvious problems" and was "a terrible business decision" (Op. 1), but ultimately reasoned that "Plaintiff asks the court to presume bad faith based on the merits of the deal alone" (Op. 25). This incorrectly discounted Plaintiff's myriad allegations demonstrating egregious process failures. In sum, the process did not reflect that the Board or Committee truly cared whether the deal made sense and were willing to reject it if it did not. All that mattered was that Dorsey wanted it.

At the first meeting where the proposal was ever raised, without receiving any written analysis whatsoever, the Board immediately authorized Dorsey to submit a letter of intent. Though the Board recognized the need for a Committee to create at least the appearance of an independent process, it permitted Dorsey to submit the LOI before the Committee was established. Once established, the Committee exercised no actual oversight. It hired no advisors, instead receiving all information through Dorsey. It did not seek involvement in the negotiations, instead permitting Dorsey to personally negotiate all terms vis-à-vis his friend. When it learned Block's unconflicted managers opposed the deal, it declined to even meet with, or otherwise solicit the views of, the dissenting executives. [redacted]

[redacted] Ultimately, it rubber-stamped the deal by written consent without a final meeting or fairness opinion.

At most, the Committee appears to have asked Dorsey and his team a series of questions, received answers constituting glaring red flags that the deal was being driven entirely by Dorsey's conflict, and then failed to conduct any appropriate follow-up. The Court below aptly summarized a representative sampling:

> As plaintiff sees it, the problem was not that the Transaction Committee failed to ask questions—it is that the answers did not seem to matter.
>
> Before its October meeting, the Transaction Committee asked whether any other members of senior management supported the acquisition; in response, the committee learned that there were none, aside from Dorsey. The Transaction Committee asked whether the artist commitments, which formed the basis for at least half of management's valuation of TIDAL, were legally enforceable; in response the committee learned that Block would have "no recourse" if the artists decided to walk away. The Transaction Committee asked for near- and long-term plans for integrating TIDAL into Block's business; in response, the committee learned that management had not created these plans and that this remained "one of the biggest risks."
>
> After the October meeting, the Transaction Committee went dark for three months while Dorsey negotiated the purchase price.

(Op. 25). It was as if the Committee were buying a car from their controller's friend and, upon being told "*we found it at the bottom of a lake, the brakes don't work, we haven't looked at the engine yet, and your unconflicted mechanics don't think you should buy it—but your controller thinks you should buy it and pay 5x bluebook value*," responded: "*great, we don't need any more information, we'll take it!*"

Pleading bad faith is difficult under Delaware law, and it should be. But it should not be impossible. Delaware protects the ability of directors to gamble on risky decisions that may turn out poorly, so long as the directors honestly believe the decision is in the best interests of their corporation. But Delaware *does not* protect directors who, faced with an obviously value-destroying frolic pushed by their conflicted controlling stockholder, let him have it because they cannot muster the will to oppose his whims. That is bad faith, and the exceptional facts alleged by Plaintiff support a sufficient inference it is precisely what happened here.

Alternatively, were the Court to find Plaintiff's allegations sufficient only to support that Dorsey's fellow directors breached their duty of care, it should still reverse as to Plaintiff's claim against Dorsey. As explained by three leading experts, including two former members of this Court, the decision in *UF&CW Union v. Zuckerberg*, 262 A.3d 1034 (Del. 2021), has left "Delaware law taking the Kafkaesque position of allowing allegedly careless directors to block a lawsuit over a transaction that would otherwise be unfailingly subject to judicial review for substantive fairness." *See* Lawrence A. Hammermesh, Hon. Jack B. Jacobs, and Hon. Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 358 (Oct. 29, 2021).

Were the Court to find Plaintiff's allegations fall short of demonstrating bad faith but are sufficient to impugn the care of Dorsey's fellow directors, this case would present an exemplar of that "Kafkaesque" problem. The Court below found it well-pled that the Acquisition was a "terrible business decision" with "obvious problems" (Op.1) that resulted from disloyalty by Block's controlling stockholder (Op. 18) and, though it did not directly address whether his fellow directors acted without due care, recognized that the Board's process "[did] not generate tremendous confidence" (Op. 25). It nevertheless granted dismissal, finding Dorsey's fellow directors—including those who personally approved the Acquisition following that suspect process—could be trusted to consider a demand. That is untenable as a matter of common sense. This Court should restore balance to Delaware's law concerning demand futility by holding that, in cases where a plaintiff adequately pleads a challenged transaction resulted from disloyalty by a controlling stockholder, demand is excused as to any director who is adequately alleged to have acted without due care in permitting the challenged transaction.

## SUMMARY OF ARGUMENT

1. The Court of Chancery erred by finding Plaintiff failed to plead bad faith on the part of the Outside Director Defendants. Plaintiff's allegations support that all ten of Dorsey's fellow directors at the time of the Acquisition—Defendants Botha, Brooks, Deighton, Garutti, McKelvey, Meeker, Patterson, Summers, Viniar, and Walker (the "Outside Director Defendants")—acted in bad faith and, therefore, face a substantial likelihood of liability. This inference is particularly strong as to the four members of the Transaction Committee, who directly approved the Acquisition (Botha, Brooks, Meeker, and Walker). Because the Demand Board consists of twelve directors (Dorsey, Carter, and the Outside Director Defendants) and the Court below correctly found demand excused as to Dorsey and Carter, a finding that Plaintiff adequately alleged bad faith as to any four of the Outside Director Defendants would mandate reversal.

2. The Court of Chancery erred by not considering whether Plaintiff's allegations supported an inference of gross negligence on the part of the Outside Director Defendants. This Court should hold that, in cases where a plaintiff adequately pleads a challenged transaction resulted from disloyalty by a controlling stockholder, demand is excused as to any director who is adequately alleged to have acted without due care in permitting the challenged transaction. Even if Plaintiff's

allegations fall short of an inference of bad faith, they would still support an inference of gross negligence against the Outside Director Defendants (or, at minimum, against the four members of the Transaction Committee). Accordingly, were the Court to adopt such a standard, it would be appropriate to reverse the decision below and allow Plaintiff to proceed at least on its well-pled claim for breach of the duty of loyalty against Dorsey.

## STATEMENT OF FACTS

### I. Dorsey Proposes That Block Bail Out His Friend's Failed Company And The Board Immediately Authorizes An LOI

Dorsey founded Block (formerly known as "Square") and is Block's Chairman, CEO, President, and controlling stockholder. (A20, ¶17). Block is a financial technology company which had no interests in, or any plans to enter, the music-streaming industry prior to the Acquisition. (A28, ¶38).

Dorsey is a close personal friend of Carter, an internationally-famous musician and business mogul. Around the time of the Acquisition, the two vacationed together no fewer than three times within the span of a year and collaborated on numerous common projects. (A26-28, 65-67; ¶34-36, 107).[1]

In 2015, Carter led a group of fellow musicians in acquiring an obscure Norwegian music-streaming company for approximately $56 million and rebranding it as TIDAL. Carter was TIDAL's public face and, with a 27% ownership interest, its largest individual stockholder. (A22, ¶29).

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[1] Post-filing, additional evidence demonstrating the strength of Dorsey and Carter's relationship has continued to emerge. (*See* A413, n.6). Indeed, as of the very filing of this brief, the two appear to be vacationing together once again. *See* DAILYMAIL.COM, "*Beyonce and husband Jay-Z relax as they join Twitter co-founder Jack Dorsey at a very luxurious villa in Lake Como*" (June 26, 2023), available: https://www.dailymail.co.uk/tvshowbiz/article-12235329/Beyonce-Jay-Z-join-Twitter-founder-Jack-Dorsey-lavish-villa-Lake-Como.html.

By 2020, the venture was a failure. TIDAL had not acquired any meaningful market share, had cycled through five CEOs in five years, was generating multimillion-dollar losses each quarter, had racked up $127 million in past-due expenses, was operating under semiformal or expired agreements with key counterparties, [redacted] faced numerous high-profile controversies and an ongoing criminal investigation, and had required a $50 million personal loan from Carter just to survive. (A23-26, ¶30–33).

Carter and his partners wanted out. As the *New York Post* reported in 2020, quoting an industry insider: "*[Carter] has been trying to dump [TIDAL] for a long time… The question is, can [he] dump it?*" (A26, ¶33). Dorsey took action to bail out his friend. But, rather than use his own vast resources, he decided to use Block's.

Dorsey and Carter spent much of August 2020 together in the Hamptons, including on August 24, 2020 when the two were spotted enjoying a yacht ride together off the coast. (A26-28, ¶34-36). The very next day, August 25, 2020, Dorsey joined a Block Board meeting by videoconference and informed his fellow directors for the first time that he wanted Block to acquire TIDAL. (A27-28, ¶37).

The proposal came out of the blue. Block and its Board had never before even considered entering the music-streaming industry. It was thus a proposal with significant strategic implications for the company. (A28, ¶38). It was also a proposal that was undeniably material financially. Though the minutes are minimalist, they indicate "proposed valuations" were discussed. Assuming those valuations approximated the ultimate deal price, the Board would have appreciated that [redacted] (A28-29, ¶39). And, of course, it was a proposal to buy a company consumed by well-publicized controversies and led by a close friend of Block's controller. It was, therefore, a proposal demanding careful attention, in-depth consideration, and reasonable scrutiny on the part of the Board. (A29, ¶40).

Yet, on Dorsey's oral recommendation—at the very first meeting where the deal was ever raised, having neither engaged nor consulted with any advisors, and having received no written analysis whatsoever—the Board immediately authorized Dorsey to "negotiate" an LOI. (A29, ¶41; A124-127 (minutes)).

The very next day, Dorsey submitted an LOI valuing TIDAL in excess of $550 million, a valuation approximately *ten times* what Carter and his partners had paid to acquire TIDAL just five years earlier. (A31, ¶45). He would not, however, inform his fellow directors he had done so until more than a month later. (A33, ¶49).

Though the Board immediately authorized Dorsey to pursue a deal with TIDAL through the LOI stage, it appears to have recognized a need to create at least the *appearance* of oversight by independent directors. Thus, at the conclusion of the August 25, 2020 meeting, the Board resolved to establish a facially-independent Transaction Committee. (A29, ¶42). The Transaction Committee, comprised of Botha, Brooks, Meeker, and Walker, was established by unanimous written consent on August 28, 2020—*i.e.*, two days after Dorsey submitted his $550 million LOI. (A30-31, ¶43-44; A128-134 (UWC)). The Committee would not meet or be informed that the LOI was submitted for another month. (A32-33, ¶47-49).

## II. The Transaction Committee Defers To Dorsey, Providing No Actual Oversight Of The Acquisition Process

The Transaction Committee would ultimately hold just three brief meetings, and only a single meeting *after* receiving meaningful information concerning TIDAL but *before* authorizing entry into a term sheet. [redacted] At each, the Committee simply received updates and encouraged Dorsey to stay the course. Though TIDAL was in a new line of business, the Committee did not retain outside advisors at any point. Instead, it was content to receive all of its information through Dorsey, despite his conflict. The Committee also allowed Dorsey to personally negotiate all terms of the Acquisition vis-à-vis his friend. It never sought any direct involvement or provided Dorsey with any specific negotiating input or instructions. [redacted] (A211-214 (first meeting minutes); A288-291 (second meeting); A355-358 (third meeting)).

### A. The Transaction Committee's First Meeting

The Transaction Committee's first meeting, held by videoconference on September 29, 2020, was a non-event. The Committee received no specific financial information concerning TIDAL either before or at the meeting and, accordingly, was not equipped to meaningfully consider the deal. The meeting lasted all of thirty-five minutes. The Committee did not make any determinations or provide Dorsey with any specific instructions. (A32-34, ¶47-50).

### B. The Transaction Committee's Second Meeting

The Transaction Committee's second meeting, held by videoconference on October 20, 2020, was more consequential. It was the first meeting at which the Transaction Committee had any meaningful information concerning TIDAL and it would be the last meeting before a term sheet was signed.

In advance, on October 14, 2020, the Committee received a report from management that raised numerous glaring red flags concerning TIDAL's poor prospects and disastrous financial condition, yet which nevertheless stated an "[e]xpected purchase price" of $550 to $750 million based on paper-thin financial analysis. It reported, among other things, that TIDAL: (i) had generated negative EBITDA of $39 million in 2019 and required the $50 million personal loan from

Carter; (ii) had just 2.1 million paying subscribers, which rendered it essentially a non-entity in comparison to its key competitors, which had between 55 and 138 million paying subscribers; (iii) had only "semi-formal arrangements" or "expired agreements" with music labels, and the leeway allowed by these labels could be expected to dissipate following an acquisition by Block; (iv) was in the middle of an ongoing criminal probe by the Norwegian government into allegations of fraud; and (v) had botched the rollout of exclusive music releases, threatening its entire business model. (A35-38, ¶53–56; A215-249 (report)).

Then, at the October 20, 2020 meeting itself, the Committee received a presentation that contained even more troubling information, divulging that TIDAL had posted multimillion-dollar losses in each of its previous ten quarters while also accumulating more than $127 million in unpaid liabilities, and that the Acquisition was expected to create a "*[f]inancial drag*" on Block's other businesses, [redacted] and "*dilute overall [Block] earnings for at least the next 3 years, if not longer*" with the "*[p]otential to create volatility in [Block's] stock price.*" It also reported that [redacted] (A40-44, ¶59-64; A250-287 (presentation)).

The presentation also included a section entitled "Committee Q&A," ostensibly providing answers to questions the Transaction Committee had submitted to Dorsey and his team in advance of the meeting. The Court below aptly summarized a representative sampling of this "Q&A":

> Before its October meeting, the Transaction Committee asked whether any other members of senior management supported the acquisition; in response, the committee learned that there were none, aside from Dorsey. The Transaction Committee asked whether the artist commitments, which formed the basis for at least half of management's valuation of TIDAL, were legally enforceable; in response the committee learned that Block would have "no recourse" if the artists decided to walk away. The Transaction Committee asked for near- and long-term plans for integrating TIDAL into Block's business; in response, the committee learned that management had not created these plans and that this remained "one of the biggest risks."

(Op. 25, describing slides available in the Appendix at A273, A267, and A268). Simply put, the answers were effectively all indicative that the proposed Acquisition was not in Block's best interests and should have been taken as glaring red flags that the Acquisition would be a "terrible business decision" (Op. 1) and was, in fact, being driven entirely by Dorsey's conflict.

The first response highlighted by the Court below—which divulged that Dorsey was the sole member of Block's executive team advocating for the deal—should have been the most concerning of all. The relevant slide is below:

[redacted]

(A273; A44-46, ¶65–67).

That the conflicted Dorsey was "*the only one*" advocating for the deal—*i.e.*, that Block's iconic founder, Chairman, CEO, and controlling stockholder could not find even a single ally from among his own employees to back the proposal, even for cynical reasons, and that those employees were openly exerting "*substantial push back*" and declining to support the deal—was remarkable. Notably, the slide made clear these dissenters included the leaders of Block's two existing business units, who were the next most senior executives below Dorsey. (A44-45, ¶66). This, particularly in combination with the other highly concerning information received by the Transaction Committee, constituted the ultimate red flag of truly extraordinary circumstances demanding attention, intervention, and supervision by the members of the Transaction Committee.

Yet, the information conveyed at the Transaction Committee's second meeting does not appear to have mattered to the Committee at all. It did not follow-up on the highly concerning answers to the questions it had previously submitted and presumably viewed as important. Upon learning Dorsey was "*the only one*" supporting the deal, the Committee declined to meet with, or otherwise solicit the views of, the dissenting executives. Upon learning half of management's valuation of TIDAL was based on expired or unenforceable agreements, it did not ask for a revised valuation. Upon learning management had not prepared any integration plans, it did not instruct management to create such plans. It did not request any more information. It did not rethink its hands-off process and consider hiring outside advisors or, perhaps, [redacted] It did nothing. (A47-48, ¶68-70).

At the conclusion of the meeting, the Committee simply instructed Dorsey to continue pursuing the Acquisition and to "update" the Committee as matters progressed. (A47, ¶68). This was significant, as Dorsey's presentation noted his imminent intent to enter a term sheet valuing TIDAL at nearly $500 million. (A43,

¶64). Notably, the Committee authorized Dorsey to move forward notwithstanding that [redacted] (A46-47, ¶68).

The full Board met the next day and received an update on the Acquisition—indicating the full Board was surely apprised of the remarkable information conveyed to the Committee. (A48-49, ¶71-72; A292-302 (minutes)). Thereafter, neither the Committee nor the Board held another discussion concerning the Acquisition for more than three full months. (A54-55, ¶80-82).

In the meantime, Dorsey negotiated a term sheet with Carter. The term sheet was signed on November 10, 2020. (A56, ¶83). Dorsey and Carter vacationed together again in Hawaii the following week. (*Id.*).

### C. The Transaction Committee's Third Meeting

The Transaction Committee held its third and final meeting by videoconference on January 22, 2021, more than two months after the term sheet was signed. (A56, ¶84). Like the Committee's second meeting, the minutes reflect that the meeting lasted for precisely one hour. (A58, ¶89).

At the meeting, Dorsey presented the terms: Block would pay approximately $309 million to acquire an approximate 88% ownership stake in TIDAL at a $350 million valuation, with Carter retaining an 8% stake and his partners retaining 4%. Dorsey reported that the price had been reduced from that contemplated at the second

Committee meeting because, *inter alia*, TIDAL had significantly underperformed its own 2020 forecasts, which were a primary factor in Block's prior valuation analyses. (A56-57, ¶85-86).

Dorsey also provided another presentation which, again, responded to some "questions" ostensibly received from the Committee in advance of the meeting. (A303-354 (presentation)). Once again, the information was extreme and should have been highly concerning to the Committee. The presentation reported, *inter alia*, that TIDAL was estimated to generate negative EBITDA on a standalone basis of $15.8 million in 2021, $24.5 million in 2022, and $32.4 million in 2023. Together with Block's additional expenditures precipitated by the acquisition, Block was projected to incur negative EBITDA of $35.6 million in 2021, $55 million in 2022, and $68.3 million in 2023. The deal was projected to result in an overall 8–10% drag on profitability for Block's foreseeable future. (A57, ¶87).

But the deal was, by then, a *fait accompli*. As the Court below observed, Dorsey's presentation "set forth the acquisition as more of an assumption than an open question" (Op. 11): "We will update the Committee once we have finalized terms we are comfortable with, and unless there are additional remaining questions, we can circulate a UWC to the Committee to approve the transaction." (A58, ¶88).

Which is precisely what happened. On February 11, 2021, the full Board received another brief update from the Transaction Committee. (A59, ¶90). Then, on February 25, 2021, without any further meetings or a fairness opinion, the Committee approved the Acquisition by UWC on terms materially consistent with those presented at the Committee's third meeting: $306 million for an approximate 87.5% ownership stake. (A59, ¶91).

## III. The Acquisition Is Announced, Wiping Out Billions Of Dollars Of Block's Market Capitalization And Drawing Widespread Criticism

Block announced the Acquisition on March 4, 2021 and the deal closed on April 30, 2021. Shortly thereafter, Block also announced that Carter would join the Board as its twelfth member. (A59-60, ¶92).

The market immediately recognized the deal for what it was: a strategically dubious transaction at a wildly inflated valuation, obviously driven by Dorsey's relationship with Carter and reflecting a significant governance failure. Following the announcement, Block's stock dropped by approximately 7%, destroying billions of dollars of value. (A60-61, ¶94). The unfairness of the Acquisition price, moreover, was demonstrable based on the nearly contemporaneous August 2020 sale of music-streaming service Napster, undoubtedly the most relevant precedent transaction. Napster was, like TIDAL, a struggling streaming service—albeit with significantly more paying subscribers and less debt than TIDAL. Generously using the same EV-to-paying-subscribers multiple as Napster, TIDAL should have been valued at around [redacted] (A61-62; ¶96).[2]

Multiple informed commentators opined that the Acquisition made little financial or strategic sense and appeared instead to be "*a deal that looks like a way for Jack Dorsey to move money from his publicly traded company to a company owned by a guy he likes to hang out with*" or, more colorfully, a *"$300 million bar tab to hang out with Jay-Z*" that "*just doesn't make any sense*." (A62-63, ¶99). Carter, however, benefitted greatly from the deal. He cashed out the majority of his stake in TIDAL at a profit, personally receiving proceeds of $63 million (plus $4.5 million in reimbursed transaction-related expenses), while retaining an approximate 8% interest and joining Block's Board. (A64-65, ¶106).

## IV. The Proceedings Below

Plaintiff filed its Complaint on January 27, 2022, alleging breaches of fiduciary duty: (i) by Dorsey in his capacities as Block's CEO, Board Chairman, and controlling stockholder; and (ii) by the Outside Director Defendants in their capacities as directors. (A69-71, ¶112-121).

Block's Board was then identical to its Board at the time of the Acquisition,

[2] In November 2021, Block curiously disclosed that it paid only $237.3 million for an 86.23% ownership interest in TIDAL—a significant decrease from the announced purchase price, yet still a fundamentally-unjustifiable overpayment. Notably, at the same time, Block attributed nearly $198 million of this purchase price to TIDAL's "Goodwill." The reasons for this adjustment are unclear. (A60, ¶93).

except that Carter had been added. The demand board, therefore, consisted of: (i) Dorsey; (ii) Carter; and (iii) the ten Outside Director Defendants. (A64, ¶104).

Defendants moved to dismiss under Rules 23.1 and 12(b)(6) and, following briefing (A73-123 (opening); A382-440 (answering); A441-482 (reply)) and argument (A483-537 (transcript)), the Court issued its decision granting Defendants' Rule 23.1 motion. The Court correctly found demand futile as to Dorsey and Carter (Op. 17-18), but held Plaintiff had failed to plead demand futility as to any of the Outside Director Defendants (*id.* at 26-27).

Plaintiff now appeals.

# ARGUMENT

## I. THE COURT OF CHANCERY ERRED BY FINDING PLAINTIFF FAILED TO PLEAD BAD FAITH ON THE PART OF THE OUTSIDE DIRECTOR DEFENDANTS

### A. Question Presented

Whether Plaintiff adequately alleged bad faith on the part of at least four Outside Director Defendants, such that Defendants' Rule 23.1 motion should have been denied. This issue was raised by Plaintiff (A415-436) and was addressed by the Court (Op. 1-27) below.

### B. Scope Of Review

The Supreme Court's review of a Rule 23.1 dismissal "is *de novo* and plenary." *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). The Court must "consider all the particularized facts pled by the plaintiffs … in their totality and not in isolation from each other, and draw all reasonable inferences from the totality of those facts in favor of the plaintiffs." *Delaware County Emps. Ret. Fund v. Sanchez*, 124 A.3d 1017, 1019 (Del. 2015).

### C. Merits Of Argument

The Court below correctly held Plaintiff satisfied demand futility as to two members of the twelve-member demand board: Dorsey and Carter. (Op. 17-18). It granted dismissal, however, upon a finding that demand was not futile as to any of the ten Outside Director Defendants, who constituted the remainder of the demand board. (Op. 26-27). This decision was incorrect. Plaintiff's particularized allegations support that all ten Outside Director Defendants—or, at absolute minimum, the four members of the Transaction Committee—acted in bad faith and therefore face a "substantial likelihood of liability," excusing demand. *Zuckerberg*, 262 A.3d at 1059 (demand is futile as to any director who "faces a substantial likelihood of liability on any of the claims" and demand is excused where demand is futile as to "at least half of the members of the demand board.").

### 1. The Duty Of Loyalty Requires Independent Directors To Affirmatively Protect The Interests Of Their Corporation When Faced With A Dubious Transaction Proposed By Their Conflicted Controlling Stockholder And CEO

In dismissing Plaintiff's complaint, the Court of Chancery focused on the fact that the Outside Director Defendants are facially independent and were not personally interested in the Acquisition. As its central statement of law, the Court explained: "a board comprised of a majority of disinterested and independent directors is free to make a terrible business decision without any meaningful threat of liability, so long as the directors approve the action in good faith" (Op. 1).

This is true. But the requirement of "good faith" must actually mean something. Even where directors do not face personal conflicts of interest, they still must live up to their "unyielding fiduciary duty to protect the interests of the corporation." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993); *see* *also Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) ("the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict"). Delaware courts have accordingly recognized that even facially independent directors act disloyally where they consciously fail to protect the interests of their corporation and thus act in "bad faith." *See Stone*, 911 A.2d at 369 (citing *In re the Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006)).

The reasons a fiduciary might act in bad faith are various and wide-ranging. *See, e.g.*, *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (bad faith may be motivated by interests "venal, familiar, collegial, or nihilistic"). One familiar scenario, however, emerges above all others as most likely to cause even otherwise well-meaning directors to fall into bad faith: those situations in which directors are faced with a proposal by a dominant person within their corporation.

Delaware case law is replete with recognition of the dominant force controlling stockholders exert. *See, e.g.*, *In re Pure Res., Inc. S'holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002) (describing controlling stockholder as "the 800-pound gorilla," who can "frighten less powerful primates like putatively independent directors"); *In re Orchard Enters., Inc. S'holder Litig.*, 88 A.3d 1, 36 (Del. Ch. 2014) (recognizing "the risk that when push comes to shove, directors who appear to be independent and disinterested will favor or defer to the interests and desires of the majority stockholder"). More recently, scholarship has also identified that even non-controlling "superstar CEOs" exert similar influence.[3]

When faced with a proposed transaction sponsored by such a person—particularly someone like Dorsey, who was *both* Block's controlling stockholder and its "superstar" founder and CEO—directors can be expected to face a range of familiar human instincts and incentives capable of causing them to either: (i) approve a transaction they know or suspect is not in the best interests of their corporation; or (ii) knowingly fail to apply the appropriate degree of fiduciary scrutiny to such a transaction, instead simply deferring to the dominant person.[4] But, though such instincts and incentives may be common and understandable, they do not absolve a

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[3] Assaf Hamdani and Kobi Kastiel, *Superstar CEOs and Corporate Law*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE, Law Working Paper No. 695/2023, at pgs. 1388-89 (Mar. 23, 2023) ("Making directors more independent … might not improve boards' oversight" because "as long as the CEO is perceived as a star and the company depends on her vision and leadership, even nominally independent directors—those who have no business or other ties to the CEOs and who are genuinely committed to shareholders—are less likely to challenge the CEO and may tolerate problematic practices that would normally be met with their resistance.").

[4] Such instincts and incentives might include understandable timidity ("if I go against him, there may be reprisals"), exasperation ("if he wants it this bad, there's no way I can stop it"), conflict avoidance ("I'm not going to rock the boat on this one"), a need to pick one's battles ("this deal isn't that big, it isn't the hill I'm going to die on"), a sense of collegial indebtedness ("he's done so much for the company in the past, I'll just let him have this one"), horse-trading ("I really need his support on [something else], so I'm going to have his back on this one"), or dependency ("he's so important to the company, we have to keep him happy").

director of liability for shrinking from his or her "unyielding fiduciary duty to protect the interests of the corporation." *Cede*, 634 A.2d at 360.

Indeed, outside directors on the board of a corporation with such a dominant person must recognize that it is a core aspect of their fiduciary responsibility to provide an independent check on the dominant person and ensure they do not abuse their power and influence to pursue personal ends inconsistent with the best interests of the corporation. *See, e.g.*, *In re Cornerstone Therapeutics, Inc.*, 115 A.3d 1173, 1184 (Del. 2015) ("Our common law of corporations has rightly emphasized the need for independent directors to be willing to say no to interested transactions proposed by controlling stockholders").

To act loyally, a director faced with a transaction proposed by a conflicted controlling stockholder or influential CEO must carefully scrutinize it and, if he knows or suspects it is not in the best interests of the corporation, *must* muster the will to oppose it. If he instead approves a transaction because it is sponsored by the dominant person, or if he knowingly fails to appropriately scrutinize such a transaction, *that is bad faith and a breach of the duty of loyalty*.

Two recent decisions of the Court of Chancery sustaining disloyalty claims against facially independent directors demonstrate these principles well.

In *CBS*, the Court found the plaintiffs had alleged particularized facts supporting that facially independent directors faced a substantial likelihood of liability and thus could not consider a demand, because their actions "evidenced their inability to push back against the asserted will of the controller," resulting in their approval of a "patently unfair [transaction] in order to appease [the controller]." *In re CBS Corp. S'holder Class Action and Deriv. Litig.*, 2021 WL 268779, at *41-43 (Del. Ch. Jan. 27, 2021, *as corrected* Feb. 4, 2021). The directors in question were members of a committee that had advisors, held numerous meetings, and negotiated—but which unreasonably acceded to the wishes of their controlling stockholder at various critical junctures in the process leading to the "patently unfair" transaction challenged in that action. *Id*.

In *Glazek*, the Court of Chancery similarly sustained disloyalty claims against facially independent directors on a committee who, upon learning their controller had backtracked from certain agreed terms, nonetheless proceeded with the deal. *Berteau v. Glazek*, 2021 WL 2711678, at *23 (Del. Ch. June 30, 2021). The Court found such facts were "indicative of a [committee] that could not 'push back against the will of the controller.'" *Id.* at *22 (*quoting CBS*, 2021 WL 268779, at *41). The defendants protested they had "engaged legal and financial advisors, met ten times … obtained a fairness opinion, and engaged in negotiations with [the controller] that ultimately [improved the deal terms]" (*id.* at *23, n.178), but the Court viewed these efforts as merely "the minimum necessary to confer a scintilla of legitimacy to the [committee] process," and sustained the claims based on the committee's ultimate capitulation. *Id.* at *24.

### 2. Plaintiff Adequately Alleges That The Outside Director Defendants Knowingly Failed To Protect Block's Interests In Connection With Dorsey's Proposed Bailout Of TIDAL

Here, the particularized facts alleged by Plaintiff are even more extreme than those supporting disloyalty claims against facially independent directors in *CBS* and *Glazek*. Dorsey is the archetype of the dominant insider whose influence is capable of overwhelming his fellow fiduciaries. At the time of the Acquisition, he was *both* Block's controlling stockholder and its "superstar CEO." The Outside Director Defendants' actions, from the beginning of the process to its conclusion, reflect nothing but utter deference to Dorsey and a corresponding knowing failure to apply appropriate fiduciary scrutiny to his desired Acquisition.

***First***, when Dorsey called into a Board meeting from his Hamptons retreat with Carter and proposed for the first time that Block acquire Carter's failed company, the full Board *immediately* authorized Dorsey to submit an LOI for a purchase price in excess of a full-year's earnings for Block—notwithstanding that Block and its Board had never before even considered entering the music-streaming industry, had considered no alternatives, and had not received any written analysis whatsoever. Dorsey's desire for the deal and his oral recommendation were enough to warrant immediate delivery of an LOI for a financially and strategically material transaction with Dorsey's high-profile friend. This is not indicative of directors seeking in good faith to meet their "unyielding fiduciary duty to protect the interests of the corporation." *Cede*, 634 A.2d at 360. Rather, it is indicative of a Board willing to immediately accede to whatever Dorsey wanted.

***Second*,** the Board appears to have appropriately recognized that Dorsey's relationship with Carter rendered him conflicted and created the need for at least *the appearance* of a process involving an independent Transaction Committee. Yet, remarkably, the Board allowed Dorsey to go ahead and immediately submit his LOI to Carter without Board review and *before the Transaction Committee was even established*, notwithstanding the obvious reality that the submission of an LOI would at minimum have an anchoring effect on subsequent negotiations. *See Olenik v. Lodzinski*, 208 A.3d 704, 717 n.65 (Del. 2019). This supports an inference that the Transaction Committee was never intended to truly control the Acquisition process, but rather was merely intended "to confer a scintilla of legitimacy," *Glazek*, 2021 WL 2711678 at *24, upon a process with a preordained conclusion.

***Third***, neither the Board nor the Transaction Committee *ever* hired *any* advisors to assist with, or provide independent advice concerning, the Acquisition.

This was a particularly striking failure given that TIDAL was in a completely new line of business that neither Block nor its Board had ever even considered entering before. [redacted] (*See* A229, recognizing [redacted]. Yet, the Committee never hired any independent legal, financial, or industry advisors to assist them. Instead, the Committee was content to receive all of its information filtered through Dorsey, despite his conflict. Seeking at least *some* independent advice is among the most basic and rudimentary steps this Court should expect to see from loyal directors in circumstances like those faced by the Committee. *See CBS*, 2021 WL 268779, at *39 (in a well-run process, an independent committee should "have its own legal and financial advisors").

***Fourth*,** the members of the Transaction Committee never held even a single meeting amongst themselves to have an unfettered discussion. Instead, [redacted] Thus, it is not a stretch to say that the Committee *qua* Committee never even met. Alternatively, it could be said that [redacted] This is not indicative of a Committee truly seeking to protect the interests of the company by providing an independent check on Dorsey. A Committee truly seeking to provide such a check would surely have [redacted] Remarkably, not a single such discussion was ever held.

***Fifth***, the Transaction Committee never sought to involve itself in the negotiations. Instead, it was content to allow Dorsey to personally negotiate all terms of the Acquisition vis-à-vis his good friend and merely receive sporadic and irregular updates. The minutes of the Committee's meetings reflect no instance in which the Committee provided Dorsey with any specific input or instructions. Dorsey's presentation to the Committee at its final meeting before it ultimately approved the Acquisition by unanimous written consent reflects this dynamic. As the Court below aptly observed, "[t]he presentation set forth the acquisition as more of an assumption than an open question" (Op. 11). A Committee acting in good faith would have insisted on at least *some* involvement in the negotiations rather than deferring so entirely to their conflicted controller.

***Sixth***, the Transaction Committee totally ignored clear and blatant red flags strongly indicating that the Acquisition was not in the best interests of the company (or, at absolute minimum, required significant additional diligence). When the Committee was confronted at its second meeting with staggering answers to the "questions" it had asked Dorsey and his team, it utterly failed to follow-up on the troubling information conveyed and instead promptly authorized Dorsey to proceed with a term sheet. Most striking of all, upon learning that the conflicted Dorsey was "*the only one*" advocating for a deal to move forward, that Block's unconflicted senior executives were exerting "*substantial push back*" against the deal, and that neither leader of Block's two existing business units supported the deal, no member of the Transaction Committee even deigned to meet with, or otherwise solicit the views of, the dissenting executives. Nor did this remarkable information cause any director to reassess the Committee's hands-off approach to Dorsey's negotiation of the Acquisition. Instead, the Transaction Committee went dark for more than three full months while Dorsey finalized the terms of the deal. The Board, which was apprised of these circumstances, likewise did nothing. This constituted a stunning failure on the part of the Outside Director Defendants. That *Jack Dorsey*—Block's iconic founder, CEO, Chairman, and controlling stockholder—could not find a single ally within his own company to back him, even for cynical reasons, constituted direct and unambiguous notice of an extraordinary set of circumstances demanding the utmost Board-level attention, intervention, and supervision. It was the brightest red flag imaginable that the Acquisition was *not* a good deal for Block, but rather was being driven by Dorsey's conflict. Yet there is no evidence the

Outside Director Defendants' awareness of this truly extreme set of circumstances created so much as a ripple in the Acquisition process. The Board and Transaction Committee simply permitted Dorsey to stay the course towards the Acquisition, including by personally negotiating the term sheet, without even the slightest effort to investigate or assess the management-level dissent or to reconsider any aspect of their hands-off approach in light thereof. This striking failure is the clearest evidence that the Board and Committee had no intention of actually scrutinizing the Acquisition to determine whether it was in the best interests of the company, but rather were prepared to merely accede to Dorsey's wishes no matter what.

***<u>Seventh</u>***[redacted] Prior to Dorsey's proposal from the Hamptons, Block and its Board had never even considered expanding Block's business into the music-streaming industry. Even assuming that dubious strategy made sense, it was incumbent upon the Board to consider the full range of strategic options, such as shopping for a healthier alternative target or building its own music-streaming service that would be unencumbered by TIDAL's many debts and other problems from the ground up.[5] [redacted] *Cf. CBS*,

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[5] As one informed commenter noted in assessing Dorsey's purported rationale for the transaction upon its announcement, "*If [Block] wants to create new ways to help*

(*continued on next*)

2021 WL 268779, at *41 (committee's docility forced it into "a world where there was only one strategic option to consider, the one proposed by the controller") (quoting *In re Southern Peru Copper Corp.*, 52 A.3d 761, 763 (Del. Ch. 2011)).

*        *        *

The Court below, though it recognized the Acquisition was a "terrible business decision" with "obvious problems" (Op. 1), premised its decision on its view that "Plaintiff asks the court to presume bad faith based on the merits of the deal alone." (Op. 25). As the facts detailed above demonstrate, that misapprehension constituted error. Plaintiff alleges myriad stark and troubling *process failures* which, especially when viewed holistically, are more than sufficient to support a reasonable inference that the Outside Director Defendants did not honestly believe the Acquisition was in the best interests of the company, or did not care whether it was, but rather permitted it, without appropriate scrutiny, because Dorsey wanted it.

This inference is particularly strong as to the four members of the Transaction Committee who were specifically tasked with overseeing the Acquisition process and failed to do so. But it extends to the remainder of the Board as well. Every member of the Board was present at the critical initial August 25, 2020 meeting at

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*musicians sell real goods and digital goods, it could just do that. Instead, [Block] is paying $300 million for a failed music service that doesn't help it accomplish any of those goals*." (A61, ¶95).

which the Board unanimously authorized Dorsey's negotiation of an LOI with Carter. And every member of the Board was aware of the existence of the remarkable management-level dissent against the Acquisition and looked the other way.[6] They all "evidenced their inability to push back against the asserted will of [Dorsey]," resulting in a "patently unfair" Acquisition that was permitted merely to "appease" him. *CBS*, 2021 WL 268779 at *41, 43; *see also In re Viacom Inc. S'holders Litig.*, 2020 WL 7711128, at *24 (Del. Ch. Dec. 29, 2020) (sustaining disloyalty claims against directors whose actions "reflect[ed] a desire to placate the controller, not to land the best transaction possible").

Indeed, at least as to the Transaction Committee members, the alleged facts here are even more extreme than those in *CBS* and *Glazek*. The committees in those cases had advisors, held numerous meetings outside the presence of their conflicted controller, and involved themselves directly in the negotiations. *CBS*, 2021 WL 268779, at *12-15; *Glazek*, 2021 WL 2711678, at *23 n.178. Yet, in both cases, the Court sustained disloyalty claims against committee members based on their failure to push back against the will of their controller at critical junctures. Here, by contrast, the Transaction Committee had no advisors, never met outside their

[6] Additionally, Defendant Viniar attended the entirety of the Committee's second and third meetings even though he was not officially a member. (A22, ¶26).

conflicted controller's presence, and were totally absent from the negotiating process. Their failure to push back against Dorsey did not consist merely of capitulation at critical moments, but also included a failure to even take the most basic and rudimentary preliminary steps to even *attempt* to check his influence. This case, moreover, involves extreme and unprecedented facts that were not present in *CBS*, *Glazek*, or any other case known to Plaintiff: the Outside Director Defendants were specifically informed that every member of their senior management team other than their conflicted controlling stockholder and CEO was opposed to the deal, yet utterly failed to do anything whatsoever to investigate or assess that truly extraordinary—*almost unthinkable*—situation. It did not matter to them at all. "By remaining silent under [this] unique set of facts, it is reasonable to infer that each of these directors' ostrich-politik violated their duty of loyalty." *Glazek*, 2021 WL 2711678, at *23 (quoting *CBS*, 2021 WL 268779, at *42).

The Court below did not address this line of cases, even though Plaintiff relied extensively on both *CBS* and *Glazek* in briefing and argument below. (*See* A386-387 (*CBS* and *Glazek* both "*passim*" authorities in briefing); A508-509 (*CBS* and *Glazek* both discussed at argument). Indeed, the Court below never grappled at all with the fact that Dorsey *was Block's controlling stockholder*. The Court mentioned that fact only once in its opinion, in perfunctorily noting that Plaintiff brought

"Count I against Dorsey as a controller." (Op. 13). The Court never considered the implications of Dorsey's control, or the possibility it might influence the Outside Director Defendants to approve a deal they knew was not in Block's best interests. This constituted error. *See CBS*, 2021 WL 268779 at *38 (recognizing a "Court cannot ignore the role of the controller" when evaluating loyalty questions).

Instead, the Court below focused its analysis on only two cases: (i) the Court of Chancery's decision sustaining bad faith claims in *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275 (Del. Ch. 2003); and (ii) this Court's decision affirming the dismissal of bad faith claims in *McElrath v. Kalanick*, 224 A.3d 982 (Del. 2020). The Court found this case to be more analogous to *McElrath*. (Op. 26-27).

The facts alleged in *McElrath* were, however, nothing like those alleged here. This case involves a controlling stockholder's impulsive proposal to buy his friend's failed company, for more than a full-year's earnings, in a business fundamentally alien to Block's existing operations. *McElrath*, by contrast, involved Uber's decision to buy an autonomous vehicle startup—a natural extension of the company's existing ridesharing business, consistent with long-term strategy—for an upfront payment of just $100,000. *McElrath*, 224 A.3d at 986. There was also, of course, no indication Uber's senior management team was uniformly against the deal. Such remarkable facts did not exist in *McElrath*. Further, as to the one troubling aspect of the deal proposed in *McElrath*—the possibility that it might involve intellectual property violations and provoke a lawsuit by Google—Uber's board received relevant diligence, specifically considered the risks, and determined to move forward. *Id.* at 989. These facts are nothing like those alleged here. Plaintiff respectfully submits that *McElrath* would have been decided differently if: (i) the proposed deal was to acquire from the CEO's friend a business that was fundamentally-unrelated to Uber's core ridesharing business; (ii) the proposed deal involved financially-material upfront consideration; and (iii) the board had been told point-blank that their senior management team was in rebellion against the deal and then failed to do anything to investigate or assess that extreme set of circumstances.

This case is, in fact, much more similar to *Disney*. Though that decision predates contemporary scholarship on "superstar CEOs," it involved one. Michael Eisner was not a controlling stockholder, but was a particularly powerful and influential CEO. The allegations upon which bad faith claims were sustained against his fellow directors ultimately comprised a story in which the directors simply acceded to Eisner's desire to hire and then fire his friend Michael Ovitz, and to set the terms of such hiring and firing, without applying appropriate independent fiduciary scrutiny to either decision. The Court of Chancery, in sustaining the claims, criticized the Disney board's deferential hands-off approach as exhibiting a "we don't care about the risks" attitude reflected in "egregious process failures" that were inconsistent with a board truly attempting to discharge its duties in good faith. 825 A.2d at 289. The Court was critical of, among other things, the Disney directors' failure to involve themselves in the negotiations, spend significant time on the matters at issue, or hire any experts. *Id*. at 287-289. It specifically criticized the board's decision to allow Eisner, a "close friend" of Ovitz, to carry out the negotiations on Disney's behalf. *Id.* at 287, n. 30 (recognizing allegations concerning Eisner and Ovitz's friendship "cast[] doubt on the good faith and judgment behind the [Disney] Boards' decisions to allow two close personal friends to control the payment of shareholders' money to Ovitz"). Though no two cases are identical, the ultimate principle of *Disney* applies powerfully here. The Outside Director Defendants committed truly "egregious process failures" fundamentally inconsistent with the actions this Court should expect to see from loyal and engaged directors seeking to discharge their "unyielding fiduciary duty to protect the interests of the corporation." *Cede*, 634 A.2d at 360. This supports an inference of bad faith.

Finally, Plaintiff notes that none of the pleading-stage cases discussed herein involved direct proof establishing the defendant directors' mental state at the time of their suspect decision making. This is unsurprising as, barring almost unimaginable circumstances, no document in the public record or obtained pursuant to a books-and-records demand will ever provide a true *smoking gun* of bad faith. Corporate minutes will never say: "Following discussion, the board voted to approve the transaction notwithstanding grave concerns that it was contrary to the company's best interests, because they could not muster the will to oppose the strongly-held desires of their controller." Proof of such facts concerning a director's mental state will only ever emerge in sworn testimony under skilled cross-examination, or perhaps upon the production of more candid observations in less carefully-curated documents like a director's handwritten notes or unguarded text messages.

In determining whether to permit the discovery necessary to develop such proof, a Court must only ask whether the particularized facts alleged by a plaintiff support a reasonable *inference* that the defendant directors acted in bad faith by knowingly approving, or failing to properly scrutinize, a transaction contrary to corporate interests. *See Sanchez*, 124 A.3d at 1022; *see also Brehm*, 746 A.2d at 268 (Hartnett, J. concurring) ("Plaintiffs must not be held to a too-high standard of pleading because they face an almost impossible burden when they must plead facts with particularity and the facts are not public knowledge"). Here, Plaintiff's particularized allegations support that inference.

## II. THE COURT OF CHANCERY ERRED BY NOT CONSIDERING WHETHER PLAINTIFF'S ALLEGATIONS SUPPORTED A PLEADING-STAGE INFERENCE OF GROSS NEGLIGENCE ON THE PART OF THE OUTSIDE DIRECTOR DEFENDANTS.

### A. Question Presented

Whether, in cases where a plaintiff adequately alleges that a challenged transaction results from disloyalty on the part of a controlling stockholder, demand should be excused as to any director who is adequately alleged to have acted with gross negligence in permitting the challenged transaction; and, if so, whether Plaintiff adequately alleged gross negligence on the part of at least four Outside Director Defendants, such that Defendants' Rule 23.1 dismissal motion should have been denied as to Plaintiff's claim against Dorsey. This issue was raised by Plaintiff (A436-438) but was not addressed by the Court below.

### B. Scope Of Review

The Supreme Court's review of a Rule 23.1 dismissal is "*de novo* and plenary." *Brehm*, 746 A.2d at 253. The Court must "consider all the particularized facts pled by the plaintiffs … in their totality and not in isolation from each other, and draw all reasonable inferences from the totality of those facts in favor of the plaintiffs." *Sanchez*, 124 A.3d at 1019.

### C. Merits Of Argument

Even were the Court to determine Plaintiff's allegations fall short of demonstrating bad faith, they would still support a pleading-stage inference of gross negligence on the part of the Outside Director Defendants—or, at minimum, the four members of the Transaction Committee who specifically approved the Acquisition. *See, e.g.*, *H&N Mgmt. Grp. Inc. v. Couch*, 2017 WL 3500245, at *5–7 (Del. Ch. Aug. 1, 2017) (demand futile based on inferences of gross negligence supported by allegations directors allowed a conflicted manager to lead deal process with "minimal oversight").

In that case, it would be appropriate for the Court to find demand futile and permit Plaintiff to proceed on its well-pled disloyalty claim against Dorsey. This is, admittedly, contrary to the plain text of this Court's *Zuckerberg* decision. Plaintiff respectfully submits, however, that *Zuckerberg*'s jettisoning of the historical safety-valve provided by the "second prong" of *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), has left Delaware's law concerning demand futility unstable.

As explained by three leading experts, this development has left "Delaware law taking the Kafkaesque position of allowing allegedly careless directors to block a lawsuit over a transaction that would otherwise be unfailingly subject to judicial review for substantive fairness." *See* Lawrence A. Hammermesh, Hon. Jack B. Jacobs, and Hon. Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 72 BUS. LAW. 321, 358 (Oct. 29, 2021). The authors propose a reasonable solution: "simply add a fourth element to the three-part demand futility test [] adopted in *Zuckerberg*, excusing demand where the well-pled facts indicate that a majority of directors acted with gross negligence in approving" a conflicted-controller transaction. *Id.* at 359.

In crafting this formulation, the authors appear to envision scenarios where the demand board is identical to the transaction-approving board. The principles motivating the proposal can, however, be easily mapped onto scenarios where the board's composition has changed: demand should be found futile as to any director who acted with gross negligence in connection with the challenged transaction.

Without this supplement to *Zuckerberg*, moreover, "Delaware law will rest on incoherent premises about independent directors" (*id.* at 326)—*i.e.*, that independent directors can, in the demand context, be trusted to independently consider whether to *sue* a controlling stockholder with unique interests in a transaction after the fact, notwithstanding Delaware's well-developed law recognizing the structural power of interested controlling stockholders and "recognizing that it is easier to say no to a colleague on a conflicted transaction than to sue him." *Id.* at 357 (citing *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 940 (Del. Ch. 2003); *Marchand v. Barnhill*, 212 A.3d 805, 820 n.95 (Del. 2019)). That these principles are inconsistent is supported by common sense. As the *Optimizing* authors explain:

> We have no doubt that it is much easier for a parent or friend to discourage a young adult from smoking a joint when that is illegal, or from drinking and driving before they engage in that behavior, than it would be to turn that young adult in to the police if they failed to heed the warning. And if the parent or friend condoned the behavior in the first instance, we think it even more doubtful that they could decide impartially to report the violation to the police.

*Id.* at 360.

This reasoning applies powerfully here. Were the Court to find, for example, that the members of the Transaction Committee acted with gross negligence in approving the Acquisition, it would be unreasonable to think those directors could apply impartial judgment in now deciding whether to *sue* their CEO and controlling stockholder for his role in a deal that they themselves negligently approved. It would be appropriate, therefore, for the Court to find demand futile as to those directors. As noted above, such a finding would mandate reversal when combined with the Court of Chancery's correct finding that demand was futile as to Dorsey and Carter.

## **CONCLUSION**

Plaintiff respectfully requests reversal of the Court of Chancery's decision dismissing Plaintiff's complaint pursuant to Rule 23.1.

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## <u>CERTIFICATE OF SERVICE</u>

I, Thomas Curry, hereby certify that on this July 12, 2023, I caused the foregoing *Redacted Public Version of Appellant's Opening Brief* to be filed and served via File and Serve *Xpress* upon the following counsel of record:

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