EFiled: Nov 03 2015 03:32PM EST
Filing ID 58107767
Case Number 392,2015

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE GENERAL MOTORS COMPANY DERIVATIVE LITIGATION	)))))))	Case No. 392, 2015 Court Below: Court of Chancery of the State of Delaware (C.A. No. 9627-VCG) PUBLIC VERSION -- Filed: November 3, 2015

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October 19, 2015

Table of Contents

Table of Authorities

Cases

Statutes

Rules

Nature of Proceedings

This is a shareholder derivative action in which plaintiffs seek to prosecute a claim on behalf of General Motors Company against its directors, regarding a defective ignition switch in several GM models that necessitated a large safety recall. Plaintiffs did not make a pre-suit demand on GM's board, contending instead that demand was excused based on alleged actions by the board under the standard set forth in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), and alleged inaction by the board under *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). The Court of Chancery concluded that the complaint failed to allege particularized facts sufficient to excuse demand on either ground and dismissed the complaint pursuant to Court of Chancery Rule 23.1.

On appeal, plaintiffs have abandoned their claim that demand is excused based on actions taken by the board, and "claim error by the Vice Chancellor only with regard to the allegations charging Board inaction." (Pl. Br. 2) In order to excuse demand based on board inaction, plaintiffs must allege with particularity that a majority of the board faces a substantial likelihood of liability for breach of fiduciary duty for failing to act. Further, as the Court of Chancery recognized, because GM's certificate of incorporation exculpates the directors from liability for breaches of the duty of care, the board's alleged inaction must constitute a breach of the duty of loyalty if demand is to be excused.

The crux of plaintiffs' claim that GM's board breached its duty of loyalty is a *Caremark* claim that the board failed to oversee GM. To establish a substantial likelihood of liability under such a theory, this Court has held that a plaintiff must plead that the directors "utterly failed" to implement a reporting system, or consciously failed to monitor such a system. *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006). In either case, a plaintiff must show the directors "*knew* that they were not discharging their fiduciary obligations." *Id*. (emphasis added).

As the Court of Chancery explained, plaintiffs' claim cannot withstand their own allegations and the board material cited in their complaint, which show that GM's directors created and monitored an oversight system that provided them, among other things, information on vehicle safety, recalls, warranty claims, and reporting to the National Highway Traffic Safety Administration ("NHTSA"), GM's regulator. Among other things, the board created a Chief Risk Officer position to lead GM's risk management efforts, and board committees met frequently to review risk management. One of the risks the directors reviewed, on numerous occasions, was the "Quality" Risk, which expressly included vehicle safety. Under the risk management system the board implemented, management also would elevate for board consideration any issues that needed board attention.

Plaintiffs do not contest what the board material shows. Instead, they argue that there was additional information the directors should have reviewed, and that

the failure to do so constitutes an utter failure to oversee GM. In the Court of Chancery's words, plaintiffs "complain that GM could have, should have, had a *better* reporting system, but not that it had *no* such system." (Pl. Ex. A at 38 (emphasis in original))

But a claim that the directors should have instituted a better reporting system does not suggest a breach of the duty of loyalty. Boards of large, complex companies cannot anticipate every piece of information that, in retrospect after something has gone wrong, they would have wanted to see beforehand. GM's board ensured there was a risk management system in place, reviewed significant risks and data to monitor management's performance, and directed that significant additional information be elevated to the board as needed. Plaintiffs do not allege that GM's directors knew any of these processes were failing, let alone that the directors ignored any red flags regarding vehicle safety generally, or the ignition switch defect specifically.

The Court of Chancery correctly ruled that plaintiffs have not alleged particularized facts establishing a reasonable doubt that the directors fulfilled their duty of loyalty. As a result, the complaint does not plead that the directors face a substantial likelihood of personal liability that would excuse demand.

Summary of Argument

1. **Denied**. The Court of Chancery properly accepted the complaint's well-pled allegations as true and drew reasonable inferences in plaintiffs' favor. The Court of Chancery was neither required nor permitted to draw the additional inferences urged by plaintiffs, which are contrary to this Court's precedent and do not logically follow from well-pled allegations of fact in the complaint and the documents incorporated therein.

2. **Denied**. The Court of Chancery correctly held that the complaint does not allege facts demonstrating that the directors knew they had a duty to act but consciously failed to do so, or otherwise acted in bad faith. Not only do the documents cited in the complaint show that the board was aware the company had systems in place to monitor vehicle quality and safety, the complaint alleges no facts showing that the board had any reason to believe those systems were not functioning properly.

3. **Denied**. The Court of Chancery correctly held that the complaint does not plead facts creating a reasonable doubt that the directors could have exercised disinterested business judgment in responding to a demand because they face a substantial likelihood of liability for failure to oversee GM. To the contrary, as the court correctly held, the complaint and the documents it cites establish that the directors created and monitored a system of reporting and oversight.

Statement of Facts

General Motors Company ("GM") is a Delaware corporation headquartered in Detroit. (A28 ¶13) GM was formed in July 2009 when it acquired certain assets of General Motors Corporation ("Old GM") out of bankruptcy. (*Id*.) Plaintiffs here are GM shareholders. (A27-28 ¶¶11-12) The defendants are eleven of the twelve GM directors at the time the complaint was filed, as well as five former directors. (A30-36 ¶¶19-38)

A. GM Recalls Vehicles For An Ignition Switch Defect

In February 2014, GM recalled certain 2003-2007 vehicles due to a defect in the ignition switch. (A52-53 ¶¶86-87) GM notified NHTSA of the ignition switch defect on February 7, 2014. (A52 ¶86) Over the following weeks, the recall was expanded to add other models and model-years. (A53-54 ¶¶89-90) GM recalled the vehicles because under certain conditions the ignition switch can move out of the "run" position while the vehicle is in motion. (A42-43 ¶57) If that occurs, the engine turns off and the airbags may not deploy in the event of an accident. (*Id*.)

Shortly after GM announced the recall, GM's board retained Anton Valukas, former U.S. Attorney for the Northern District of Illinois, to investigate why it took as long as it did to recall vehicles containing the defective ignition switch. (A43 ¶58) Following his investigation, Mr. Valukas issued a report to the board concluding that there were a number of problems at both GM and Old GM that led to

the failure to initiate the recall sooner. However, as plaintiffs allege, the Report also concluded that "the Board of Directors was not informed of any problem posed by the Cobalt ignition switch until February 2014." (A44 ¶62)

Following the recall, NHTSA opened an investigation and, on May 16, 2014, GM entered into a consent order with NHTSA to resolve the investigation. (A54 ¶90) In the consent order, GM admitted that the company took more than five working days from learning of the ignition switch defect to report it to NHTSA and agreed to pay a $35 million fine. (A54 ¶¶90-91) GM also agreed to pay a fine of $7,000 per day from April 4, 2014 until it provided NHTSA a copy of the Valukas Report (which was not completed until May 26, 2014).[1] (A55 ¶95) The consent order did not allege or admit any misconduct by GM's directors.

In addition to the NHTSA fines, plaintiffs allege that GM took charges of $1.5 billion for recall costs (A24 ¶¶2-3); is the subject of product liability suits and government investigations that expose GM to potential liability (A24-25 ¶¶4-5); and established a fund to compensate accident victims and their families (A26 ¶8). Plaintiffs seek to hold the directors personally liable for these alleged harms.

[1] Plaintiffs' brief mischaracterizes their own allegations, asserting that this fine was connected to GM's responses to NHTSA's inquiries into individual crashes. (*E.g.*, Pl. Br. 9) Neither the consent order itself nor any allegation in the complaint supports this assertion (which is untrue). (B134-49 (Consent Order))

B. The Directors' Oversight Of GM

Before plaintiffs filed the complaint, GM produced to them, in response to a Section 220 books and records demand, board material relating to vehicle safety, quality, defects, recalls, and risk oversight. The complaint cites only a small fraction of what GM produced, but even the documents plaintiffs selected show that GM's board established a reporting system and monitored that system's outputs.

1. The Directors' Oversight Of GM's Risk Management

The complaint alleges failure of oversight beginning in November 2010. (A27 ¶10) However, the complaint and the board material it cites establish that the directors actively oversaw GM's risk management. As an initial matter, plaintiffs cite board material showing that on August 3, 2010, the board created the Finance and Risk Committee, a board committee whose responsibilities included risk management oversight. (A73-74 ¶¶152-53) Soon after that, "[i]n October 2010, the Board created the position of CRO [Chief Risk Officer], who was to be tasked with the responsibility of coordinating the Company's risk management and mitigation strategies for the agreed upon top risks which the Company faced." (A75 ¶155)

On October 4, 2010, the Finance and Risk Committee met with the new Chief Risk Officer. The minutes of the meeting detail GM's risk management system, in which "each member of the Company's Executive Committee will appoint a functional Risk Officer for their organization that will report to [the] Chief Risk

Officer." (B56)[2] "Each functional Risk Officer" would then "identify and mitigate the top risks in his/her functional area and update his/her Executive Committee Member as well as the Chief Risk Officer on risk management issues." (*Id*.)

The Finance and Risk Committee met with the Chief Risk Officer again on December 6, 2010. The CRO reported that the potential "top risks" had been winnowed to a list of 25 through discussion with GM's Risk Officers and ratified by GM's Executive Committee. (B41) Additionally, the CRO reported that the "Functional and Regional Risk Officer construct is now in place and operational with regular meetings and communications established." (B51) He also reported that these Risk Officers were focused on "[c]oordinating the risk management plans and remediation for the key risks." (*Id*.)

On March 14 and May 16, 2011, the CRO updated the Finance and Risk Committee on GM's top 25 risks, and on progress made regarding risk management initiatives. (B67, B68-80, B83-84) At the May 16 meeting, the CRO reported on the structure of GM's risk management organization, which included the board, senior management, and risk officers for each department. (B70) He explained that GM had a monthly Risk Officers Meeting that included the Chief Risk

[2] All of the GM board material cited herein was cited in the complaint and filed with the briefing in the Court of Chancery. (*See, e.g.*, A63 ¶120 (citing B53-64)) These documents are integral to plaintiffs' claims and, accordingly, the Court can consider them. *See, e.g.*, *Allen v. Encore Energy Partners, L.P.*, 72 A.3d 93, 96 n.2 (Del. 2013). The table of contents to defendants' appendix indicates where in the complaint each document is cited. Where pages were redacted entirely as non-responsive, those pages have been omitted.

Officer and the Regional and Functional Risk Officers responsible for the risks identified. (B72) He also informed the committee that management was "develop[ing] action plans" to mitigate GM's top 25 risks and would report its plans to the board. (B73) The CRO concluded that GM had made "[s]ignificant progress in laying the foundation for an effective and sustainable risk management program." (B76) He "emphasized that open communication has been established across the Company regarding risk matters and that *issues are escalated to Executive Committee members or the Board as needed*." (B83, emphasis added)

In November 2011, the board appointed a new Chief Risk Officer. (A82 ¶174) The Finance and Risk Committee met with the new CRO that same month, where, similar to his predecessor, he reported that "significant progress" had been made regarding risk management, including implementation of "Risk Management Infrastructure," a "Global Risk Officers Network," and an "Emerging Risk Scanning Process." (B86-87)

On March 19, 2012, the Finance and Risk Committee received another report from the CRO on the top 25 risks, which reviewed each risk in detail and provided management's assessment of that risk. (B92-97)

On March 18, 2013, the CRO gave a report to the Audit Committee, which had assumed responsibility for oversight of risk management. (B103, B108-15)

Although plaintiffs do not refer in the complaint to the documents produced by GM reflecting meetings with the CRO or updates on the company's top risks after March 2013, they do not allege that no such updates were provided.[3]

2. The Directors' Oversight Of Vehicle Safety

The documents cited in the complaint show that, as part of their risk oversight, GM's directors oversaw vehicle quality and safety. For instance, a Quality Update in the March 2010 board material reviewed GM's quality initiatives and provided metrics by which the directors could monitor vehicle quality and safety. (A305-27) Among those metrics was the number of vehicles recalled as a percentage of vehicles on the road, for both GM and its peers, which showed that GM's recall rate was in line with or better than its peers. (A313) The Quality Update also included data on warranty claims, which showed a consistent trend downward in the volume of claims over a multi-year period. (A311) Since warranty claims are initiated by vehicle owners, the decreasing volume of warranty incidents indicated

[3] Plaintiffs assert that the Chief Risk Officer "often notified the Board that it lacked the needed information gathering processes, risk analysis, lines of reporting and risk mitigation structure that an organization the size of GM should possess." (Pl. Br. 11) No allegations or board documents support this assertion. Instead, plaintiffs mischaracterize the documents by selecting isolated slivers of sentences and ignoring the remainder. For instance, plaintiffs argue that in 2013 "the Board learned that GM had established a corporate culture of dishonesty." (*Id.* at 12) The document plaintiffs cite does not support this assertion; it is an appendix to a presentation that defines as a risk—not a reality—that "GM may not have a high performance culture, grounded in strong ethical behavior, that provides accurate performance feedback and ratings to employees, promotes accountability, innovation, adaptability and appropriate risk taking and regards customers and diversity as key business imperatives." (B115, cited at A89 ¶187 & Pl. Br. 12) This document, which is titled "Appendix: Risk Definition," does not say that employees were acting unethically or that GM had a "culture of dishonesty," with respect to safety or anything else.

that the relatively low rate of recalls was not a function of GM failing to address defects, but rather of GM making vehicles with fewer manifested defects.

The March 2010 board materials also described GM's process for identifying and addressing vehicle defects. (A325) The process had three levels of review, and included representatives from Quality, Engineering, Legal, and other departments, with increasing seniority at each review level. (*Id*.) Final recall decisions were made by senior quality and engineering executives. (*Id*.) Plaintiffs do not allege that the directors had any information before February 2014 indicating that this process was not working as intended.

At its December 6, 2010 meeting, the Finance and Risk Committee reviewed the Quality Risk, which was defined as the risk that "[m]ajor or chronic product problems result in a large product recall and warranty expenses and significant negative publicity." (B49) The CRO reported that a senior product development engineer, all of the GM regional presidents, and a public relations executive had been assigned as executive "owners" of the Quality Risk. (B45)

In January 2012, the full board received a report on vehicle quality and safety. (A332-39) Most significantly, the report updated the board on GM vehicle recalls, explaining that "11.3 Million vehicles were recalled globally at a cost of $301 Million ($USD) through Nov. 2011." (A339) While this was a substantial number, the report explained that GM's recall rate was the lowest among the major

car manufacturers. (*Id*.) Plaintiffs allege no facts they contend should have led the board to conclude that the company was failing to initiate additional needed recalls.

At the March 19, 2012 meeting of the Finance and Risk Committee, the CRO again reported on the Quality Risk, which included "[q]uality incidents resulting in customer death/injury." (B94) The report informed the Committee that the Vice President for Global Quality was the "executive owner" of this risk (*id.*; A31-32 ¶22), and detailed nine actions being taken to mitigate the Quality Risk. (B95) Most importantly, it offered the CRO's "Overall Assessment" of the risk as: "Managed to an Acceptable Level." (B94) Under the heading "Required Action by Management/Board," the CRO concluded: "None." (B95)

On March 18, 2013, the Audit Committee received a report from the Chief Risk Officer that put the Quality Risk in the highest tier of GM's top 25 risks, which meant that the risk was "Closely followed & presented to Board/Committees." (B110) The Quality Risk was defined as the risk that "[m]ajor or chronic product problems could occur, resulting in negative public image, *large product recall campaigns* and/or significant, unexpected increases in warranty expenses." (B114 (emphasis added)) The CRO did not report to the directors that any issues relating to this risk were being inadequately addressed or required board attention.

3. The Directors' Oversight Of NHTSA Reporting

The complaint and the board material it cites also describe both GM's system for reporting required information to NHTSA and board oversight of GM's NHTSA reporting. The complaint alleges that "[s]ince the inception of the TREAD Act," GM (and Old GM before it) has maintained a "TREAD database" which contained the data required to be reported to NHTSA. (A49-50 ¶77) The database, which collected information from numerous sources, "was organized to track and report data in categories created by NHTSA covering 24 different systems in a vehicle[], such as airbags or steering, and fire and rollovers." (A50-51 ¶79, ¶82) As the complaint acknowledges, GM had "a specific team assigned to prepare NHTSA-required reports" utilizing this database. (*Id*. ¶82)

The board material cited in the complaint includes data on GM's reporting to NHTSA. Specifically, the March 2010 board material showed 100% on-time compliance with NHTSA information requests for the preceding eight years, 2002 through 2009. (A326)[4] It also described the process by which NHTSA's Office of Defect Investigation investigates potential defects that may culminate in recalls by

[4] This record contradicts plaintiffs' assertion that "there is nothing in the Section 220 record substantiating that, post-2009 (after new GM emerged), the Board monitored either the Company's responses to NHTSA inquiries or the Company's TREAD Act reporting obligations." (Pl. Br. 9) Additionally, plaintiffs note that Vice Chancellor Glasscock asked after argument on defendants' motion to dismiss for record support that the directors received information about GM's NHTSA reporting during the period 2010 to 2014. (*Id*. at 24) Plaintiffs assert that "Defendants failed to provide such record support." (*Id*.) This is inaccurate; defendants provided to Vice Chancellor Glasscock the same information presented here. (A300-03)

a manufacturer. (A327) The complaint does not allege that the board received any information before 2014 suggesting that GM's NHTSA reporting systems were not functioning properly, that the information describing GM's timely NHTSA reporting was inaccurate, or that NHTSA had sanctioned GM for failing to comply with its reporting requirements.

4. Information To Be Reported To The Board

In addition to receiving information on specific aspects of GM's business—risk management, vehicle quality and safety, and NHTSA reporting—the board materials show that any issues management believed required board attention were to be raised with the board. Specifically, from the outset of the risk management structure adopted in October 2010, the directors and management agreed that "[p]riority risks will be reported directly to the Board or the most relevant Board Committee." (B31) As part of the risk management structure, therefore, the directors understood that issues would be "escalated to Executive Committee members or the Board as needed." (B83 (May 2011); *see also* B88 (November 2011: "Concerns escalated as needed."))

And management did report to the board on specific vehicle problems that it concluded needed board attention. For instance, when GM had an issue with the batteries in the Chevrolet Volt electric car in 2011, the board received reports on GM's response to the issue and its interactions with NHTSA about that response.

(Valukas Report at 240)[5] Similarly, management reported to the board in 2010 about Toyota's unintended acceleration issue, along with GM management's investigation and determination that GM did not face similar problems. (*Id.*)

Plaintiffs contend that the board did not create mechanisms specifying each particular type of information to be brought to it. But this ignores that the board created a mechanism for *any* information to be brought to it that management determined needed board attention—and that management availed itself of that mechanism. Plaintiffs allege no facts suggesting the board had any reason to believe this system was not operating properly.

In sum, even the documents that *plaintiffs* selected from GM's Section 220 production show director oversight of GM management's efforts to address risk, vehicle safety, and NHTSA reporting. The directors received frequent reports from management that identified risks to the company and discussed management's responses to those risks, and they reviewed data that allowed them to evaluate management's effectiveness. The directors also received reports on potential safety defects that management brought to their attention. These allegations and

[5] GM has not made the Valukas Report public, has not relied on it for the truth of the matters asserted therein, and has not included it in its appendix here. However, NHTSA, to which GM was required to submit the Report, has posted it on its website. Plaintiffs have made the Valukas Report part of the pleadings by relying on it extensively and making numerous substantive factual allegations based on it. (*See, e.g.*, A23, A24 ¶2, A43-48 ¶¶58-71, A64-73 ¶¶123-51) As a result, the factual assertions in the Report—just like any other particularized allegations of fact in the complaint—are treated as true for purposes of evaluating the sufficiency of the complaint. *See Allen*, 72 A.3d at 96.

documents undermine plaintiffs' assertion that the reason the board did not learn of the ignition switch defect until 2014 was that "GM lacked the risk management procedures to escalate this defect to the Board." (Pl. Br. 11)

C. The Court Of Chancery's Decision Dismissing The Action

On June 26, 2015, after full briefing and argument, the Court of Chancery dismissed this lawsuit for failure to plead with particularity that demand on GM's board is excused. The court first dismissed plaintiffs' challenges to the board's actions—challenges that plaintiffs do not pursue on this appeal. (Pl. Ex. A at 29-33) The court then dismissed plaintiffs' inaction argument, explaining:

> The Complaint does not allege a total lack of *any* reporting system at GM; rather, the Plaintiffs allege the reporting system should have transmitted certain pieces of information, namely, specific safety issues and reports from outside counsel regarding potential punitive damages. In other words, GM *had* a system for reporting risk to the Board, but in the Plaintiffs' view it should have been a better system.

(*Id*. at 35-36 (emphasis in original)) Consequently, the court held that "[t]he conduct at issue here, as pled, falls short of an utter failure to attempt to establish information or reporting systems, a conscious failure to monitor existing systems, or conduct otherwise taken in bad faith." (*Id*. at 44)[6]

[6] Plaintiffs misstate the Court of Chancery's ruling, arguing that the court held that the documents cited in the complaint "satisfied the director defendants' fiduciary obligations." (Pl. Br. 3) That is not what the court held. Rather, it held that plaintiffs' allegations and the documents they cited "failed to raise a reasonable doubt that GM's directors acted in good faith or otherwise face a substantial likelihood of personal liability." (Pl. Ex. A at 3)

Argument

I. The Court Of Chancery Properly Accepted Plaintiffs' Well-Pled Allegations As True And Drew Required Inferences In Plaintiffs' Favor.

A. Question Presented

Did the Court of Chancery accept as true plaintiffs' particularized allegations of fact, and draw required inferences in plaintiffs' favor? (A169-70)

B. Scope of Review

This Court's review of the decision dismissing the complaint is *de novo* and plenary. *See Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

C. Merits of the Argument

When a shareholder seeks to assert a claim on a corporation's behalf without first making a demand on the board, Court of Chancery Rule 23.1 requires the shareholder to plead with particularity facts excusing demand. On a motion to dismiss, the court must take well-pled facts as true, and "draw all *reasonable* inferences in the plaintiff's favor." *Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004) (emphasis in original). "All reasonable inferences" does not mean any possible inference, but rather inferences that "logically flow from particularized facts alleged." *Id.*; *see also White v. Panic*, 783 A.2d 543, 552-53 (Del. 2001) (refusing as "too tenuous" the inference that a board knew that an officer "had actually engaged in misconduct" from the board's approval of settlements of eight lawsuits alleging such misconduct). "[I]nferences that are not objectively reasonable cannot be

drawn in the plaintiff's favor." *Beam*, 845 A.2d at 1048. The Court of Chancery properly applied this standard. (Pl. Ex. A at 3 n.3)

Plaintiffs do not identify any well-pled allegations of fact that the Court of Chancery failed to accept as true. Rather, they argue that the court failed to draw "all reasonable inferences that logically flowed from the particularized facts alleged." (Pl. Br. 18) But the only inference to which plaintiffs claim they were entitled is the conclusion that "Board members and the relevant committees failed to act in the face of a known duty to act." (*Id*.) Plaintiffs' arguments in support of this proposed inference are either precluded by this Court's precedent or inconsistent with the allegations and documents in the record.

First, plaintiffs argue that the Court of Chancery erred in finding that "GM has been and will be held liable for any wrongdoing in the engineering and deployment of these ignition switches," but then not finding a reasonable doubt that the directors were disinterested "due to a substantial risk of personal liability in connection with the alleged failures surrounding the same catastrophic event." (Pl. Br. 19) Thus, plaintiffs argue, the court was required to infer that the directors face a substantial likelihood of personal liability because the company itself engaged in wrongdoing for which it faced liability. (*Id*.)

But, as this Court has made clear, such inferences are prohibited, because they conflate actions of a company's employees with actions of its board. In *Stone*

v. Ritter, 911 A.2d 362 (Del. 2006), the Court evaluated a *Caremark* claim seeking an inference that the directors of a bank breached their duty to oversee the bank's compliance with applicable federal regulations based on a $50 million fine assessed by the government against the bank for non-compliance with those regulations. *Id*. at 370-71. The Court rejected the plaintiffs' theory as "seek[ing] to equate a bad outcome with bad faith." *Id*. at 373. The Court held that plaintiffs "fail[ed] to recognize that the directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both." *Id*.

Applying *Stone*, Court of Chancery decisions have consistently rejected the inference "that since the Company suffered large losses, and since a properly functioning risk management system would have avoided such losses, the directors must have breached their fiduciary duties in allowing such losses." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 128 (Del. Ch. 2009); *see also In re Goldman Sachs Grp., Inc. S'holder Litig.*, 2011 WL 4826104 (Del. Ch. Oct. 12, 2011) (refusing to infer director bad faith from allegations that the company was fined $535 million by a regulator); *South v. Baker*, 62 A.3d 1, 8-9, 16 (Del. Ch. 2012) (finding an allegation that a fatal mine accident resulted from management's failure to implement required safety policies insufficient to establish director bad faith).

So too here. Plaintiffs argue that because GM employees acted wrongly in failing to identify the ignition switch defect and initiate a timely recall, which caused the company to suffer adverse consequences, it must logically flow that the directors face a likelihood of liability for breach of their duty of loyalty. The Court of Chancery's refusal to draw this inference was mandated by settled precedent.

Second, plaintiffs assert they were entitled to an inference that the board failed to act in the face of a known duty to act based on two "findings" in the Valukas Report. Plaintiffs first allege the Valukas Report found that "the system put in place by the Board did not require that serious defects detected by GM's legal department, its engineering department, consumer protection organization, or law enforcement agencies be reported to the Board." (Pl. Br. 19) Second, plaintiffs allege the Report concluded that the board "did not discuss individual safety issues or individual recalls except in rare circumstances." (*Id.*)[7]

The first Valukas Report "finding" does not exist. Plaintiffs' brief cites the Court of Chancery's decision (Pl. Ex. A at 9), which in turn cites the complaint (A44 ¶62). But the complaint does not purport to quote the Valukas Report for this

[7] Plaintiffs also cite a New York Times article that said GM's board "took a mostly hands-off approach" to vehicle safety. (Pl. Br. 19-20) (Plaintiffs later remove the "mostly," and incorrectly state it as an absolute proposition. (*Id.*)) This is not a particularized factual allegation; it is a reporter's characterization. No precedent requires the Court to accept as true someone else's characterization of the facts alleged in the complaint. Further, even if accepted at face value, a "mostly hands-off" approach is not an "utter failure" of oversight, especially where, as here, the directors had no reason to believe that the company's vehicle safety programs were deficient.

point, and it does not source the assertion to any specific part of the Report. (*Id*.) And the Report does not contain any such statement. As a result, not only are plaintiffs not entitled to an *inference* from this allegation, the allegation itself is not a well-pled fact the Court can accept as true.[8] Moreover, plaintiffs' assertion that serious defects were not required to be reported to the board is contrary to the record, which establishes that issues related to GM's top risks, including safety, would be elevated to the board as warranted, and that such issues were elevated to the board at times. *See supra* at 14-15. As a result, the record refutes any inference that the board knowingly failed to act by not requiring that serious defects be reported to it.

The Valukas Report's "finding" that GM's board discussed *individual* defects only in rare circumstances does not suggest a bad faith lack of oversight. As an initial matter, the Valukas Report states that the board *did* discuss individual defects sometimes (as it did with the electric-car battery issue in 2011, *see supra* at 14). This alone precludes an inference that the board had no mechanism by which serious defects could be escalated to it. Moreover, it would be impractical in a company the size of GM for the board to address individual defects often; engi-

[8] Because the Report is a matter of public record, this Court should not accept as true plaintiffs' allegation about what it says when the allegation is inconsistent with the Report itself. *See, e.g.*, *In re General Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 169 (Del. 2006) ("The Court of Chancery was not obligated to accept as true allegations that misstated or mischaracterized the entire Consent Solicitation.").

neers and others are generally better equipped to address issues at that level. Rather, it was appropriate for the board to look at aggregate metrics to review vehicle safety and to rely on a reporting system in which management escalated individual issues to the board when warranted. *See supra* at 10-12, 14; 8 *Del. C.* § 141(e) (directors can rely in good faith on management). Thus, the Valukas Report's statement does not permit an inference of director bad faith.

Plaintiffs also make the separate argument that the Court of Chancery "made an unsupported inference in defendants' favor" by finding that vehicle quality includes vehicle safety, and therefore that the board's oversight of vehicle quality was oversight of vehicle safety. (Pl. Br. 20) But this was not an inference the Court of Chancery drew; it is what the documents plaintiffs put before the Court say explicitly. The board material that plaintiffs cite repeatedly described the Quality Risk as including the risk of large product recalls, "incidents resulting in customer death/injury," and significant unexpected warranty expense. (B49, B94, B114) The material not only made clear that the Quality Risk included vehicle safety, but presented specific data on vehicle safety, such as recall numbers (A339), warranty claims (A334), GM's defect investigation process (A325), and actions taken by GM to mitigate the risk of vehicle safety incidents (B95). Thus, the Court of Chancery did not infer anything—it read and relied on the documents plaintiffs discussed in the complaint.

II. The Court Of Chancery Correctly Held That Plaintiffs Did Not Plead With Particularity That GM's Board Knew Its Reporting System Was Inadequate Or Otherwise Acted In Bad Faith.

A. Question Presented

Did the Court of Chancery correctly hold that the complaint lacks particularized allegations suggesting that a majority of GM's board knew the board's system of reporting was inadequate or otherwise acted in bad faith? (A183-90)

B. Scope of Review

This Court's review of the decision dismissing the complaint is *de novo* and plenary. *See Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

C. Merits of the Argument

A plaintiff seeking to excuse demand based on board inaction must plead with particularity facts sufficient to create "a reasonable doubt that, as of the time the complaint [was] filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993).[9] Moreover, "the directors are entitled to a *presumption* that they were faithful to their fiduciary duties," and a plaintiff alleging demand futility has the burden of pleading particularized facts to

[9] Plaintiffs assert that the *Aronson* standard applies. (Pl. Br. 22) But *Aronson* applies only to challenges to board action, not inaction. *Rales*, 634 A.2d at 934. Plaintiffs' brief is clear that on appeal they have abandoned their challenges to the board's actions, and are pursuing only alleged board inaction. (Pl. Br. 2)

overcome the presumption. *Beam v. Stewart*, 845 A.2d 1040, 1048-49 (Del. 2004) (emphasis in original).

Plaintiffs' pleading burden is heightened further because GM has adopted a provision exculpating its directors from liability for breaches of the duty of care. *See* 8 *Del. C.* § 102(b)(7); (B116-33). When a company adopts such a provision, a shareholder can plead a substantial likelihood of director liability only by alleging "particularized facts that, if proven, would show that a majority of the defendants knowingly engaged in 'fraudulent' or 'illegal' conduct or breached 'in bad faith'" their fiduciary duties. *Wood v. Baum*, 953 A.2d 136, 141 (Del. 2008).

This Court has explained that a shareholder seeking to meet this pleading burden with respect to board oversight must allege with particularity either that "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations." *Stone*, 911 A.2d at 370. In either case, plaintiffs must "plead particularized facts that demonstrate that the directors acted with scienter, *i.e.*, that they had actual or constructive knowledge that their conduct was legally improper." *Wood*, 953 A.2d at 141. This is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *Stone*, 911 A.2d at 372. The Court of Chancery was correct that plaintiffs' allegations are insufficient.

1. Plaintiffs Have Not Pled With Particularity That The Directors Knowingly Acted In Bad Faith Prior To Learning Of The Ignition Switch Defect.

Plaintiffs argue that the directors face a substantial likelihood of liability because the board did not (1) "inquire as to why people were dying or seriously injured in GM vehicles"; (2) "assure itself that the regulators were receiving the required information on a timely basis"; and (3) have a "mechanism by which it would receive notice of the possibility of punitive damages in connection with deadly crashes." (Pl. Br. 23) From this, plaintiffs argue, the Court of Chancery should have found reason to doubt that the board fulfilled its duty of loyalty.

Plaintiffs' allegations do not meet the standard for oversight liability articulated in *Stone*. Plaintiffs do not even attempt to plead that GM's directors "utterly failed" to implement a reporting or information system. Nor do they allege that the directors consciously failed to monitor or oversee its outputs. Precisely the opposite, the complaint and the documents cited in it demonstrate that the board both created a system of reporting and monitored it.

Plaintiffs point to certain information they believe it was bad faith for the directors not to obtain, but that is insufficient under this Court's precedent. "[T]he duty to act in good faith to be informed cannot be thought to require directors to possess detailed information about all aspects of the operation of the enterprise." *Stone*, 911 A.2d at 368. "There is a critical difference between showing that a

board was not receiving information—the most that is pled here—and pleading that a board was consciously disregarding 'red flags' that its information systems were failing." (Pl. Ex. A at 41)[10] The Court of Chancery correctly held that the complaint contains "no sufficiently pled allegation that the Board was aware that its risk management system was not functioning as it should." (*Id.* at 31)

Isolating specific pieces of information that the directors "should have requested" is easy with the benefit of hindsight. That is precisely why *Stone* requires more. For example, plaintiffs argue it was bad faith for the directors not to inquire "why people were dying or seriously injured in GM vehicles." (Pl. Br. 23) But plaintiffs do not allege the directors were aware of crashes or deaths related to the faulty ignition switch. Absent such allegations, there is no basis to assert the directors should have known to ask the question. According to NHTSA, there were approximately 30,000 fatal crashes in the U.S. each year from 2010 through 2013.[11] Because GM has a large market share, thousands of those crashes involved GM vehicles—as is also true with other major manufacturers. It is not only impossible for the directors to investigate each crash, it is outside their expertise.

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[10] *See also* Pl. Ex. A at 36 ("Contentions that the Board did not receive specific types of information do not establish that the Board utterly failed 'to attempt to assure a reasonable information and reporting system exists,' particularly in the case at hand where the Complaint not only fails to plead with particularity that GM lacked procedures to comply with its NHTSA reporting requirements, but actually concedes the existence of information and reporting systems.") (internal footnote omitted).

[11] *See* http://www-fars.nhtsa.dot.gov/Main/index.aspx.

GM's board monitored the safety of GM vehicles by reviewing various types of information regularly, including vehicle recall and warranty data, and also by directing that management escalate any additional issues needing board attention. Nothing about this suggests bad faith: Delaware law expressly permits directors to rely on management's judgments about what information warrants reporting to the board. *See* 8 *Del. C.* § 141(e); *Brehm v. Eisner*, 746 A.2d 244, 261-62 (Del. 2000) (plaintiffs must rebut the board's good faith reliance on others).[12]

Likewise, plaintiffs' argument that the board acted in bad faith by failing to assure itself that GM was providing timely information to NHTSA has no support in the complaint. Plaintiffs do not allege what more they believe the board should have done—it was obviously not in a position to investigate a 200,000-person company to ensure that no employees have information that has not been reported. Plaintiffs concede that GM had in place a detailed structure and team for reporting to NHTSA, and information provided to the board indicated GM was fulfilling its reporting obligations. *See supra* at 13-14. Plaintiffs do not allege the directors learned prior to February 2014 either that NHTSA had asserted GM failed in any respect to fulfill its reporting requirements, or that GM had in fact failed to do so.

[12] Plaintiffs cite *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963), for the proposition that directors can be liable for recklessly ignoring obvious signs of employee wrongdoing or reposing confidence in untrustworthy employees. (Pl. Br. 25) But plaintiffs do not argue, and the complaint does not allege, that GM's directors were aware of or ignored any such signs of wrongdoing.

Finally, plaintiffs argue that it was bad faith for GM's board not to require that any warnings of possible punitive damages from GM's outside counsel be provided to it. Prayers for punitive damages are common in product liability actions, which any manufacturer the size of GM faces daily. To require the board to receive notice of every punitive damages claim in such cases would be impractical. Further, the complaint *does* allege that the board received litigation reports—just not with the specific information plaintiffs allege should have been included. (A48 ¶70) In short, plaintiffs' argument that the board could have overseen GM better does not support a claim for breach of the duty of loyalty.

2. The Court Of Chancery Did Not Ignore The Directors' "Knowledge."

Plaintiffs argue that, although there were no red flags, the Court of Chancery ignored the directors' "knowledge." (Pl. Br. 26-28) But the only such knowledge plaintiffs identify relates to: (1) information about GM's regulatory environment provided to certain directors in November 2009, and (2) information provided by the CRO in his board presentations. (*Id*. at 26-27) Neither comes close to supporting an inference that the directors consciously disregarded their fiduciary duties.

First, plaintiffs assert that the Court of Chancery ignored "the knowledge imparted to the November 2009 Board members," who received a packet of information advising them that GM operated in a strict regulatory environment and was subject to the Safety Act. (Pl. Br. 26-27) The court likely did not refer to this doc-

ument because plaintiffs did not mention it in their brief below. (A124-91) Regardless, alleging the directors knew that GM is heavily regulated says nothing about what the directors knew (or did) about employees' non-compliance with those regulations. Knowledge that GM was subject to federal statutes and rules does not support an inference of bad faith any more than knowledge that the bank in *Stone* was subject to banking regulations supported an inference of director bad faith when the bank violated those regulations. Moreover, as discussed above, the complaint and the documents it cites establish both that the board did oversee GM and that the company had in place a detailed NHTSA reporting system.

Next, plaintiffs assert that the CRO "told all Board members of GM's inadequate risk management procedures." (Pl. Br. 27) This is a mischaracterization of the documents cited in the complaint, as demonstrated above and as the Court of Chancery correctly held. (*See supra* at 7-10; Pl. Ex. A at 41-42) Those documents show the board was repeatedly advised that GM's risk management was strong, and that steps were being taken to make it stronger. (*Id.*) Plaintiffs' naked assertion that "Defendants adopted a 'we don't care about the risks' attitude" (Pl. Br. 25), is unsupported by well-pled allegations of fact.[13]

[13] Plaintiffs also assert that defendant Barra was aware of the ignition switch defect before she became a director in February 2014. (Pl. Br. 15-16) But the documents plaintiffs cite discuss a different issue, not the ignition switch defect. (A31 ¶21) Even if plaintiffs were correct, which they are not, this allegation relates to *one* director, not a majority of GM's eleven-member board.

Unable to meet this Court's standard for pleading bad faith failure of oversight, plaintiffs assert a different rule: They proclaim that, "[a]s a Company in a heavily regulated industry, the Board was required to *ensure* that GM provided regulators with full, accurate, and timely recall information." (Pl. Br. 25 (emphasis added)) This is not the law, nor could it be. Plaintiffs' proposed rule is inconsistent with *Stone*'s articulation of what constitutes bad faith failure of oversight. It is also is inconsistent with *Stone*'s recognition that directors acting in good faith may not be able to ensure the corporation's compliance with applicable regulations.

3. Plaintiffs Have Not Pled With Particularity That The Board Faces A Substantial Likelihood Of Liability For Failing To Act After Learning Of The Ignition Switch Defect.

Plaintiffs also contend that GM's board faces a substantial likelihood of personal liability because once it learned of the ignition switch defect in February 2014, "it still took no steps … to assure itself that the regulators were receiving full, accurate and timely information." (Pl. Br. 28) The complaint contains *no allegations* about what the board knew or did regarding information requests from NHTSA in the wake of the recalls. In fact, the only allegation in the complaint about what the board did when it learned of the ignition switch defect is an allegation of board *action*: Plaintiffs allege the board retained Anton Valukas to investigate why it took GM so long to recall affected vehicles. (A43 ¶58)

Instead of alleging facts about the board, plaintiffs focus on the fact that NHTSA fined *the company* $7,000 a day from April 4, 2014 until the company provided the Valukas Report to NHTSA. (A55 ¶95) Plaintiffs ask the Court to infer that because NHTSA did not get all the information it sought from GM for a limited period of time, *the board* must have failed in bad faith to oversee GM.[14] But plaintiffs do not allege why GM did not immediately provide NHTSA all the information it requested, much less allege what role, if any, the board played in GM's response to NHTSA. The Valukas Report runs 315 pages, with 1,355 sourcing footnotes. For all the Court knows, given the complaint's lack of allegations, GM could not fulfill NHTSA's request immediately because Mr. Valukas simply could not complete his report as quickly as NHTSA wanted it. There is no allegation that the board delayed completion of the Valukas Report.

Plaintiffs are entitled only to "reasonable" inferences that "logically flow" from the facts alleged. Plaintiffs have not pled facts from which the inference logically flows that the directors, acting in bad faith, caused the company's failure to provide information demanded by NHTSA as fast as NHTSA wanted following the ignition switch recall announcement.

[14] The period of time for which NHTSA fined GM, which began April 4, 2014, was indeed limited. The Valukas Report is dated May 29, 2014, and was posted to NHTSA's website on June 5, 2014. (www.nhtsa.gov/About+NHTSA/NHTSA+Electronic+Reading+Room+(ERR))

III. The Court of Chancery Correctly Held That Plaintiffs Have Not Pled With Particularity Facts Sufficient To Establish A Substantial Likelihood Of Director Liability For Failure To Oversee GM.

A. Question Presented

Did the Court of Chancery correctly hold that the complaint lacks particularized allegations that a majority of GM's board "utterly failed" to establish a system of reporting? (A183-90)

B. Scope of Review

This Court's review of the decision dismissing the complaint is *de novo* and plenary. *See Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

C. Merits of the Argument

Plaintiffs' third argument, that the complaint alleges a "systematic lack of oversight" by the board, largely repackages and repeats the argument in the prior sections of their brief, and fails for the same reasons. (*Compare* Pl. Br. 30-31 *with id*. at 19) As discussed above, the claim that a majority of GM's board faces a substantial likelihood of liability for failing to oversee GM has no support in either the complaint's factual allegations or the documents that it cites. In plaintiffs' own telling, the board *did* create and oversee a system of reporting—it just did not create a system that plaintiffs, in hindsight, deem adequate. That is insufficient to plead demand futility based on failure of oversight.

The new points plaintiffs raise in this section do not rehabilitate their position. Plaintiffs concede that GM had a database and personnel dedicated to

NHTSA reporting, but nevertheless contend GM had "in essence no reporting system at all because what GM needed was a system that assured GM they were in compliance with the law." (Pl. Br. 31) However, a failure to "assure" compliance is entirely different from a good faith attempt to comply. As this Court has explained, "there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties." *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009). Otherwise, any incident of a corporation's regulatory non-compliance would support a claim for bad faith failure of oversight. Such a result is inconsistent with *Stone*'s holding that directors will not be held personally liable for failing to assure compliance by corporate employees—especially when the company has adopted a Section 102(b)(7) provision.

Similarly, plaintiffs argue that the Valukas Report "concluded that 'until 2014, the TREAD reporting team did not have sufficient resources to obtain any of the advanced data mining software programs available in the industry to better identify and understand potential defects.'" (Pl. Br. 32) But plaintiffs do not allege that the board was aware of any insufficient resources, that such resources

were required by the Safety Act (or any other regulation), or that NHTSA complained that GM was not satisfying its reporting duties.[15]

Finally, plaintiffs rely on the Court of Chancery decision in *Rich v. Chong*, 66 A.3d 963 (Del. Ch. 2013), a case that bears no resemblance to this case. (Pl. Br. 33-34) Unlike plaintiffs here, the plaintiff in *Rich* had made a demand on the board, and argued that the directors should be deemed to have improperly rejected the demand because the company had cut off funding for the investigation and the directors charged with investigating had resigned from the board. *Rich*, 66 A.3d at 979. The court agreed, and therefore did not consider whether demand was excused. *Id.* The court then proceeded to evaluate the defendants' motion to dismiss the plaintiff's claim "under the more lenient pleading standards of Rule 12(b)(6)." *Id*. at 979, 981-82. As a result, *Rich*'s analysis of whether the facts pled in that case were sufficient under a notice pleading standard is irrelevant to the different question posed here of whether demand is excused under the heightened pleading standard of Rule 23.1.

Rich is also inapposite because the facts alleged there bear no comparison to the allegations here. Among other things, the company's board chairman allegedly improperly transferred $130 million to unaffiliated third-parties abroad, and the

[15] Plaintiffs allege that "in 2007 and 2010, NHTSA stated that it lacked the data necessary to open a formal investigation" regarding non-deployment of airbags in Chevy Cobalts. (Pl. Br. 33) Plaintiffs do not allege that this perceived lack of information was communicated to GM's board.

court concluded that it "strain[ed] credulity" to believe the other directors were unaware of the misappropriation. *Rich*, 66 A.3d at 984. By contrast, here plaintiffs do not allege that any director engaged in self-dealing, or that the directors were aware of the ignition switch defect or any misconduct by GM management.

Conclusion

For the foregoing reasons, the Court's dismissal pursuant to Rule 23.1 should be affirmed.

Dated: October 19, 2015

Respectfully submitted,

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PUBLIC VERSION --
Filed: November 3, 2015