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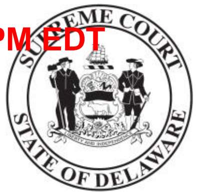

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DELAWARE COUNTY EMPLOYEES' RETIREMENT FUND and CITY OF STERLING HEIGHTS GENERAL EMPLOYEES' RETIREMENT SYSTEM, derivatively and on behalf of SIMON PROPERTY GROUP, INC.,	:	
	:	No. 199, 2015
Plaintiffs Below, Appellants,	:	
	:	APPEAL FROM THE OPINION AND ORDER DATED MARCH 27, 2015 OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN C.A. No. 10249-VCL
v.	:	
MELVYN E. BERGSTEIN, LARRY C. GLASSCOCK, KAREN N. HORN, ALLAN HUBBARD, REUBEN S. LEIBOWITZ, DANIEL C. SMITH, J. ALBERT SMITH, JR., HERBERT SIMON, DAVID SIMON, and RICHARD S. SOKOLOV,	:	
Defendants Below, Appellees,	:	
and	:	
SIMON PROPERTY GROUP, INC.,	:	
Nominal Defendant Below, Appellee.	:	

APPELLANTS' OPENING BRIEF

COUNSEL LISTED ON FOLLOWING PAGE

DATED: June 8, 2015

CHIMICLES & TIKELLIS LLP
Pamela S. Tikellis (Del. No. 2172)
Scott M. Tucker (Del. No. 4925)
Tiffany J. Cramer (Del. No. 4998)
222 Delaware Avenue, Suite 1100
Wilmington, DE 19899
(302) 656-2500

GRANT & EISENHOFER P.A.
Stuart M. Grant (Del. No. 2526)
Michael J. Barry (Del. No. 4368)
Nathan A. Cook (Del. No. 4841)
David M. Haendler (Del. I.D. # 5899)
123 Justison Street
Wilmington, DE 19801
(302) 622-7000

Attorneys for Delaware County Employees' Retirement Fund and City of Sterling Heights General Employees' Retirement System, Plaintiffs Below-Appellants

TABLE OF CONTENTS

TABLE OF AUTHORITIES iii
NATURE OF PROCEEDINGS 1
SUMMARY OF ARGUMENT 2
STATEMENT OF FACTS 4
A. THE SPG BOARD GRANTS SIMON A RETENTION AWARD WITHOUT CONSIDERING THE APPROPRIATENESS, NECESSITY OR SUBSTANCE OF THE AWARD OR ITS TERMS 4
1. THE SPG BOARD GRANTS SIMON THE $150 MILLION AMENDED AWARD 4
2. THE SPG BOARD MADE NO EFFORT TO ANALYZE THE APPROPRIATENESS OF THE AMOUNT OF THE AWARD, THE "PERFORMANCE METRICS" OR THE RETROACTIVE BONUS 5
B. THE SPG BOARD'S SOLE FOCUS IN APPROVING THE AMENDED AWARD WAS TO AVOID AN IMMINENT ADVERSE JUDGMENT 7
1. DEFENDANTS GRANT SIMON THE ILLEGAL, ULTRA VIRES ORIGINAL AWARD AND FACE AN IMMINENT ADVERSE JUDGMENT IN THE ORIGINAL ACTION 7
2. DEFENDANTS WORK QUICKLY TO AMEND THE ORIGINAL AWARD WITH A MYOPIC VIEW TO PREVENTING AN ADVERSE JUDGMENT IN THE ORIGINAL ACTION 8
ARGUMENT 12
I. THE CHANCERY COURT ERRED IN APPLYING *RALES* WHEN OVER HALF OF THE BOARD APPROVED THE AMENDED AWARD 12
A. QUESTION PRESENTED 12
B. SCOPE OF REVIEW 12
C. MERITS OF THE ARGUMENT 12
II. THE CHANCERY COURT ERRED IN HOLDING THAT THE AMENDED AWARD WAS ENTITLED TO THE DEFERENCE OF THE BUSINESS JUDGMENT RULE. 16
A. QUESTION PRESENTED 16
B. SCOPE OF REVIEW 16

C. MERITS OF THE ARGUMENT 16

1. THE COMPLAINT ALLEGED THAT DEFENDANTS BEHAVED DISLOYALLY IN APPROVING THE AMENDED AWARD 16

2. THE CHANCERY COURT ERRED IN HOLDING THAT THE DEFENDANTS' ASSUMED RELIANCE ON THE PRIOR ILLEGAL *ULTRA VIRES* DECISION SATISFIED THEIR FIDUCIARY OBLIGATIONS WITH RESPECT TO THE AMENDED AWARD....19

3. THE COMPLAINT DEMONSTRATES THAT THE AMENDED AWARD INCLUDED A $7 MILLION CORPORATE GIFT TO SIMON 21

4. THE EXISTENCE OF A SECTION 102(B)(7) PROVISION IN SPG'S CHARTER IS IRRELEVANT FOR PURPOSES OF THE SECOND PRONG OF *ARONSON,* AND DOES NOT BAR CLAIMS FOR INJUNCTIVE RELIEF....24

III. THE CHANCERY COURT ERRED IN CONCLUDING THAT A MAJORITY OF THE BOARD WAS INDEPENDENT AND DISINTERESTED....27

A. QUESTION PRESENTED....27

B. SCOPE OF REVIEW....27

C. MERITS OF THE ARGUMENT....27

1. THE CHANCERY COURT ERRED IN CONSIDERING ONLY THE FOUR MEMBERS OF THE COMPENSATION COMMITTEE FOR PURPOSES OF THE FIRST-PRONG OF *ARONSON*....27

2. DEFENDANTS FACED A SUBSTANTIAL LIKELIHOOD OF LIABILITY ARISING FROM THEIR BREACH OF THE DUTY OF LOYALTY....29

3. THE THREAT OF MONETARY LIABILITY IS NOT THE *SINE QUA NON* OF ESTABLISHING A LACK OF DISINTERESTEDNESS....30

4. THE CHANCERY COURT ERRED IN FAILING TO CONCLUDE THAT DEFENDANTS WERE INTERESTED SINCE THEY OBTAINED A UNIQUE BENEFIT FROM THE AMENDED AWARD 31

5. ALL MEMBERS OF THE BOARD FACED A RISK OF BEING FORCED TO DISGORGE ADVANCED LEGAL FEES IF THE PRIOR ACTION WAS NOT MOOTED 344

TABLE OF AUTHORITIES

Page(s)

CASES

Aldina v. Internet.com Corp.,
2002 WL 3158492 (Del. Ch. Nov. 6, 2002) 19

Apple Computer, Inc. v. Exponential Tech., Inc.,
1999 WL 39547 (Del. Ch. Jan. 21, 1999)..21

Arnold v. Soc'y for Sav. Bancorp., Inc.,
678 A.2d 533 (Del. 1996) 26

Aronson v. Lewis,
473 A.2d 805 (Del. 1984) ....passim

In re Barnes & Noble S'holders Deriv. Litig.,
C.A. No. 4813-VCS (Del. Ch. Oct. 21, 2010) 14

Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart,
845 A.2d 1040 (Del. 2004) 12, 16, 27

Beneville v. York,
769 A.2d 80 (Del. Ch. 2000) 28

Brehm v. Eisner,
746 A.2d 244 (Del. 2000) 12, 16, 27

Cal. Pub. Emp. Ret. Sys. v. Coulter,
2002 WL 31888343 (Del. Ch. Dec. 18, 2002) 26

Calma v. Templeton,
2015 WL 1951930 (Del. Ch. Apr. 30, 2015)..28

Cede & Co. v. Technicolor,
634 A.2d 345 (Del. 1993) 24

Chen v. Howard-Anderson,
87 A.3d 648 (Del. Ch. 2014) 25

Conrad v. Blank,
940 A.2d 28 (Del. Ch. Sept. 7, 2007) 30

In re Cornerstone Therapeutics Inc. S'holder Litig.,
2015 WL 2394045 (Del. May 14, 2015) 24

Dalton v. American Inv. Co.,
1981 WL 7618 (Del. Ch. June 4, 1981)....14

DiRienzo v. Lichtenstein,
2013 WL 5503034 (Del. Ch. Sept. 30, 2013)....28

Emerald P'rs v. Berlin,
726 A.2d 1215 (Del. 1999) 26

Frontier Oil v. Holly Corp.,
2005 WL 1039027 (Del. Ch. Apr. 29, 2005)....18

Gantler v. Stephens,
965 A.2d 695 (Del. 2009) 34

Gotham Partners, LP v Hallwood Realty Partners, LP,
2000 WL 1476663 (Del. Ch. 2000)....35

Green v. Philips,
1996 WL 342093 (Del. Ch. June 19, 1996)....22, 23

Hamilton P'rs., L.P. v. Highland Capital Mgmt., L.P.,
2014 WL 1813340 (Del. Ch. May 7, 2014)....18

In re Jefferies Grp. Inc. S'holders Litig.,
C.A. No. 8059-CB (Del. Ch. Nov. 4, 2013) 33

In re Jefferies Group, Inc. S'holders Litig.,
C.A. No. 8059-CB (Del. Ch. Sept. 16, 2014)....14

Khanna v. McMinn,
2006 WL 1388744 (Del. Ch. May 9, 2006)....24, 28

Lampers v. Bergstein,
C.A. No. 7764-VCL (Del. Ch. Mar. 25, 2014)....22

Lewis v. Fuqua,
502 A.2d 962 (Del. Ch. 1985) 33

Lewis v. Vogelstein,
699 A.2d 327 (Del. Ch. 1997) 23

Mennen v. Wilmington Trust Co.,
C.A. No. 8432-ML (Del. Ch. Apr. 27, 2015) 33

In re MFW S'holders Litig.,
67 A.3d 496 (Del. Ch. 2013) 33, 34

Omnicare, Inc. v. NCS Healthcare, Inc.,
818 A.2d 914 (Del. 2003) 18

In re Oracle Corp. Deriv. Litig.,
824 A.2d 917 (Del. Ch. 2003) 32, 33

Paolino v. Mace Sec. Int'l, Inc.,
2009 WL 4652894 (Del. Ch. Dec. 8, 2009)..35

Rales v. Blasband,
634 A.2d 927 (Del. 1993) ....passim

Ryan v. Gifford,
918 A.2d 341 (Del. Ch. 2007) 13, 14

In re Southern Peru Copper Corp. Sec. Litig.,
52 A.3d 761 (Del. Ch. 2011) 17

Stone ex rel. AmSouth Bancorporation v. Ritter,
911 A.2d 362 (Del. 2006) 18

In re Tri-Star Pictures, Inc., Litig.,
1995 WL 106520 (Del. Ch. Mar. 9, 1995) 13

VonFeldt v. Stifel Fin. Corp.,
1999 WL 413393 (Del. Ch. June 11, 1999)..35

In re Walt Disney Co. Deriv. Litig.,
825 A.2d 275 (Del. Ch. 2003) 20, 33

In re Walt Disney Co. Deriv. Litig.,
906 A.2d 27 (Del. 2006) 35

Weiss v. Swanson,
948 A.2d 433 (Del. Ch. 2008) 15

STATUTES AND RULES

8 *Del. C*. § 102(b)(7) ....passim

8 *Del. C*. § 220 5

Ct. Ch. R. 12(b)(6) 35

Ct. Ch. R. 23.1..passim

NYSE Listed Co. Manual § 303A.08 8

NATURE OF PROCEEDINGS

This stockholder derivative action challenges an amended compensation award valued at over $150 million given to David Simon ("Simon") by the Board of Directors of Simon Property Group, Inc. ("SPG" or the "Company") on December 31, 2013 (the "Amended Award"). The Verified Derivative Complaint for Breach of Fiduciary Duties, filed October 17, 2014 (the "Complaint"), contained particularized allegations that in adopting the Amended Award the Board of Directors (the "Board") of SPG did not conduct any investigation regarding, *inter alia*, the cost of the award to the Company, the need for the award, the adequacy of the performance metrics therein, or whether the award provided appropriate incentives to Simon. Rather, Defendants adopted the Amended Award *solely* to prevent the imminent entry of an adverse judgment that they had breached their fiduciary duty in awarding Simon, three years earlier, an illegal and *ultra vires* "retention award" worth $120 million (the "Original Award") that violated the terms of a stockholder-approved compensation plan. On March 27, 2015, the Court of Chancery issued a bench ruling[1] and order[2] granting Defendants' motion to dismiss for failure to plead sufficient facts to excuse demand under Court of Chancery Rule 23.1. Plaintiffs appeal from that judgment.

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[1] Attached hereto as Exhibit A.
[2] Attached hereto as Exhibit B.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in holding that under the circumstances of this case, demand futility must be evaluated under the test articulated in *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993) rather than *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). *Aronson* applies where at least half of the Board that would consider a litigation demand approved the transaction at issue. The SPG Board consists of ten members, four of whom sat on the Compensation Committee of SPG (the "Compensation Committee) that voted to approve the Amended Award. Two additional Board members participated in the process by which the Amended Award was granted but declined to vote, and Simon also approved the Amended Award. Thus, seven of the ten directors approved the award, and *Aronson* applies.

2. The Chancery Court erred in holding that the Amended Award was entitled to deference under the business judgment rule. The Chancery Court erred in disregarding Plaintiffs' particularized allegations that Defendants behaved disloyally in approving the Amended Award by promoting their own and Simon's interests over those of Company. The Chancery Court also erred in holding that the Board's consideration of the illegal, *ultra vires* Original Award was sufficient for Defendants to meet their fiduciary obligations in approving the Amended Award. Prior approval of an illegal award with no performance component cannot establish that Defendants acted appropriately in assessing the Amended Award or

the performance-based metrics therein. The Amended Award also included a $7 million retroactive bonus that the Chancery Court previously had found bestowed no benefit on SPG whatsoever. At a minimum, the Chancery Court erred in holding that the Complaint did not adequately allege waste. The Chancery Court also misapplied *Aronson* by holding that presuit demand was not excused due to a Section 102(b)(7) provision in SPG's charter. Such a provision is irrelevant under the second prong of *Aronson*. The provision merely allows indemnification for monetary liability arising from a breach of the duty of care; it does not eliminate the underlying breach. Even if the Section 102(b)(7) provision was relevant (which it is not), it does not apply because the Complaint alleged a breach of the duty of loyalty and sought relief other than monetary payments.

3. The Chancery Court also erred in applying *Rales* and the first prong of *Aronson*. It erred in evaluating only the independence of members of the Compensation Committee instead of the whole Board. It also erred in holding that directors' independence could be compromised only by a showing of a risk of monetary liability in prior litigation, instead of considering Defendants' breach of loyalty in connection with their approval of the Amended Award and other factors that impaired their ability to independently assess a litigation demand. Finally, Defendants did face a risk of monetary liability in both the prior litigation through disgorgement and, more importantly, this Action arising from disloyal conduct.

STATEMENT OF FACTS

A. THE SPG BOARD GRANTS SIMON A RETENTION AWARD WITHOUT CONSIDERING THE APPROPRIATENESS, NECESSITY OR SUBSTANCE OF THE AWARD OR ITS TERMS

SPG is a real estate investment trust and America's largest mall owner. A16-17. Simon, the son and nephew of SPG's co-founders Melvin and Herbert Simon ("H. Simon"), has served as the Company's CEO since 1995 and Chairman of the Board since 2007. A17. Simon has been a director of SPG since 1993. A17.

1. THE SPG BOARD GRANTS SIMON THE $150 MILLION AMENDED AWARD

On December 31, 2013, SPG and Simon entered into an amended and restated Series CEO LTIP Unit Award Agreement. A20, 149. The Amended Award granted Simon 1,000,000 long-term incentive performance units ("LTIP Units"), valued at over $150 million, divided into three tranches. A20, 149-50. Simon will receive the LTIP Units so long as SPG attains certain per share levels of consolidated funds from operations ("FFO")[3] "increased or decreased to give effect" to various categories of adjustments ("Adjusted FFO") in calendar years 2015, 2016 and 2017 (the "Performance Targets"). A20-21, 150. SPG represented that the "performance criteria" in the Amended Award were "designed to incentivize Mr. Simon to continue and improve upon" SPG's performance and

[3] The Amended Award defines FFO as "funds from operations per share and shall be determined by using the consolidated FFO per share disclosed by the Company in its earnings releases and filings with the SEC during the performance periods." A20-21.

were consistent with SPG's "pay-for-performance philosophy." A26. But the reality is that the targets were formulated in such a way so as to practically guarantee that Simon will receive the full Amended Award.

In fact, by the date when the award was granted, SPG already had attained an FFO[4] level which if simply maintained would result in Simon "earning" over 78% of the total award without improving the Company's FFO by a single cent. A23, 151. The Amended Award also provided Simon with 46,439 shares of SPG common stock, worth over $7 million (the "Retroactive Bonus"), that were the result of dividends from the *ultra vires* Original Award, granted to Simon by the SPG Board three years earlier. A20, 23, 149-50.

2. THE SPG BOARD MADE NO EFFORT TO ANALYZE THE APPROPRIATENESS OF THE AMOUNT OF THE AWARD, THE "PERFORMANCE METRICS" OR THE RETROACTIVE BONUS

The illusory nature of the Performance Targets and inclusion of the Retroactive Bonus emanated from the SPG Board's approval of the Amended Award without considering the actual merits of that award. Specifically, Plaintiffs' investigation under 8 *Del. C.* § 220 ("Section 220") revealed that the Amended Award was approved without anyone on the SPG Board discussing or receiving or

[4] Maintaining FFO is not difficult – Defendants' expert has noted that FFO "has historically been very stable except for the time period covering the financial crisis and its immediate aftermath." A205. Additionally, the Company had in previous years undertaken actions, including the early retirement of debt, which increased the Company's FFO without actually improving the Company's financial situation. A37. Thus, the supposed "Performance" Targets could be easily met without Simon having actually improved the Company's performance.

requesting any presentations analyzing the appropriateness of the Performance Targets, the use of any performance metric other than FFO, the likelihood that SPG would achieve the targets set therein, any analysis of SPG's projected financial performance during the term of the Amended Award, or the cost to the Company of the Amended Award. A35-36, 38-39, 154. At no point during the actual formulation of the Amended Award did anyone on the SPG Board consider, or receive any analysis of the appropriateness of granting Simon a $150 million award, the purpose of granting Simon a $150 million award, or the possibility that Simon would leave SPG or be adequately incentivized absent such a large award. A29-30, 33-35, 37-40, 146, 150. The SPG Board never even evaluated the performance metric actually used in the Amended Award, "Adjusted FFO". The SPG Board was completely ignorant of and made no effort to understand the differences between FFO and Adjusted FFO. A21-26, 32-40.

Defendants never considered the probability that Simon would receive all of the LTIP Units in the Amended Award (A25, 155), and was only informed several months *after* approving the grant that Simon's likelihood of receiving *all* of the LTIP Units granted under the Amended Award was between 94.7% and 96.8%. A26. Similarly, the SPG Board never received or requested any presentations valuing the 46,439 shares subject to the Retroactive Bonus, the propriety of granting the Retroactive Bonus not tied to a performance measure, or analyzing

how these shares would incentivize Simon to improve SPG's future performance. A38, 40, 155. The SPG Board was not even made aware of the Retroactive Bonus until shortly before the Amended Award was approved. A38, 155.

B. THE SPG BOARD'S SOLE FOCUS IN APPROVING THE AMENDED AWARD WAS TO AVOID AN IMMINENT ADVERSE JUDGMENT

1. DEFENDANTS GRANT SIMON THE ILLEGAL, *ULTRA VIRES* ORIGINAL AWARD AND FACE AN IMMINENT ADVERSE JUDGMENT IN THE ORIGINAL ACTION

On July 6, 2011, the Compensation Committee granted Simon the Original Award, which consisted of a package of 1 million LTIP Units worth $120 million that would vest over eight years if Simon simply showed up for work or died. A13, 140. To do so, the SPG Board illegally amended the Company's 1998 Stock Incentive Plan (the "1998 Plan") without stockholder approval to remove the then-existing requirement that all equity awards thereunder be tied to specific metrics of corporate financial performance ("Illegal Amendment"). A28, 140. Plaintiffs challenged the Original Award by arguing that the Illegal Amendment was invalid because any "material" changes to equity-compensation plans must be approved by stockholders, and thus the Original Award was *ultra vires*. A28, 141 (the "Original Action").

On October 14, 2013, during arguments on cross-motions for summary judgment ("Summary Judgment Hearing"), then-Chancellor, now Chief Justice, Strine indicated that he considered the Illegal Amendment to be material under the

NYSE Listed Co. Manual § 303A.08, such that Defendants faced an imminent judicial determination that they breached their fiduciary duties in adopting the Illegal Amendment and issuing the *ultra vires* Original Award. A51, 142-43.

2. DEFENDANTS WORK QUICKLY TO AMEND THE ORIGINAL AWARD WITH A SINGULAR GOAL OF PREVENTING AN ADVERSE JUDGMENT IN THE ORIGINAL ACTION

Almost immediately after the Summary Judgment Hearing, on October 31, 2013, SPG's seven Outside Directors[5] discussed with SPG's outside counsel ways to address the claims asserted in the Original Action and avoid an adverse judgment. A29, 143, 153. From this point forward, Simon and the SPG Board worked to amend the Original Award with one goal in mind: to moot the Original Action while allowing Simon to keep everything he was promised under the illegal Original Award. Two term sheets created by the SPG Board, and provided to Simon, each acknowledged that its purpose was to moot the Original Action. The November 22 Term Sheet[6] specifically stated that its purpose was to moot the Original Action by modifying the Original Award to conform to the 1998 Plan, and the December 13 Term Sheet acknowledged that SPG and Simon were agreeing to modify the Original Award "to resolve claims being contested in the [Original

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[5] The "Outside Directors" consist of Defendants Melvyn E. Bergstein ("Bergstein"), Larry C. Glasscock ("Glasscock"), Karen Horn ("Horn"), Allan Hubbard ("Hubbard"), Reuben Leibowitz ("Leibowitz"), J. Albert Smith ("A. Smith"), and Daniel A. Smith ("D. Smith").

[6] "November 22 Term Sheet" refers to a document titled Term Sheet Proposed Modifications to 2011 CEO Retention Award, and "December 13 Term Sheet" refers to the draft term sheet provided to the Compensation Committee on a December 13, 2013 meeting.

Action]." A29-31, 35-36. Although Leibowitz primarily discussed the Amended Award directly with Simon, *all* of the Outside Directors were informed of, and actively participated in, the process to amend the Original Award. A145.

In November and December 2013, the Compensation Committee considered "Term Sheets" that proposed to establish "performance criteria" for Simon's compensation award (and thus moot the Original Action), and identified the Company's FFO as the designated performance metric. A29-33. Yet the *only* information provided to the Board was SPG's actual FFO from 2010 -- *three years prior*. Although this was clearly outdated, the SPG Board never discussed or considered using SPG's 2013 FFO results in establishing the performance goals for the Amended Award.[7] A33, 157. Instead, the meeting was focused on the discussions with Simon and how the proposed modifications to the Original Award would moot the Original Action. A32-33, 145.

But the FFO information presented to Compensation Committee and the other SPG directors was not only stale, it was irrelevant. The Performance Targets actually used in the Amended Award are tied to SPG's ***Adjusted*** FFO in 2015-2017. A36-37, 157. No member of the SPG Board ever requested or considered any information comparing SPG's Adjusted FFO results to the Performance

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[7] Had the Compensation Committee questioned the use of 2010 actual FFO results and received SPG's ***2013*** FFO results, it would have been apparent that for Simon to receive the entire Amended Award, SPG's FFO need only grow by compound annual growth rate of 2.6%, way ***below*** its historical norm. A25, 157.

Targets,[8] how changing the performance metric in the Amended Award to Adjusted FFO impacted the value of the Amended Award or the performance goals thereunder, or how Simon could direct the inputs into the Adjusted FFO calculation by using his position as CEO to implement corporate actions, such as retiring debt early. A34-37, 39, 40, 157-58. Months after Defendants approved the Amended Award, the Chancery Court held that changing "FFO" to "Adjusted FFO" increased the cost of the Amended Award to the Company by approximately $20 million. A179. No one on the SPG Board ever considered this.

Further, Defendants were not notified of the Retroactive Bonus until December 19, 2013. A38, 155. But instead of discussing the appropriateness and necessity of the Retroactive Bonus, the focus of that meeting was a myopic discussion of how the Amended Award would affect the Original Action. A38-39. At the conclusion of the meeting, the Compensation Committee, with A. Smith and Glasscock present, adopted a resolution approving and authorizing the execution and delivery of the proposed amended award to Simon. A38-39, 147.

On December 30, 2013, after Leibowitz discussed the Amended Award with Simon, the members of the Compensation Committee (except Bergstein) and A. Smith held a telephonic meeting to consider changes which set the bar even lower for Simon. A39-40, 147. At the conclusion of this meeting, having never

[8] Notably, between 1999 and 2013, SPG has adjusted FFO eight times, and seven of those adjustments resulted in an increase to the Company's actual FFO. A37.

considered the use of any performance metric other than FFO, received or reviewed any material valuing the Amended Award, analyzing the FFO performance targets or the Retroactive Bonus, the Compensation Committee (with A. Smith present) again adopted a resolution approving the proposed amended award. A40, 147.

Thus, although only the Compensation Committee formally voted on the Amended Award, other Board members participated in the process. A. Smith, Glasscock, and Horn each knew by October 31 that steps would be taken to amend the Original Award in order to moot the Original Action. A41. They were invited to Compensation Committee meetings on December 13, 16 and 19 (with A. Smith also invited to a December 30 meeting) and they received all of the materials for those meetings. A38-39, 41, 146-47. Glasscock attended the December 19 meeting, and A. Smith attended the December 16, 19 and 30 meetings. A38-39. On December 31, 2013, pursuant to the express terms of the Original Award and the 1998 Plan, Simon approved the Amended Award. A147.

On December 31, 2013, the same day SPG and Simon entered into the Amended Award, Defendants moved to dismiss the Original Action on mootness grounds. A147. The Chancery Court granted that motion on March 28, 2014. A148.

ARGUMENT

I. THE CHANCERY COURT ERRED IN APPLYING *RALES* WHEN OVER HALF OF THE BOARD APPROVED THE AMENDED AWARD

A. QUESTION PRESENTED

For purposes of assessing demand futility, does *Aronson* or *Rales* apply where the Complaint alleges with particularity facts showing at least six members of a ten-member board of directors considered and deliberated on the challenged compensation award, but that two of those directors declined to vote, and a seventh director - the compensation recipient - acted in concert with the rest of the board to structure and approve the challenged award to eliminate the threat of an adverse judgment against the whole board? This issue was preserved for appeal. A160-65.

B. SCOPE OF REVIEW

This Court's review of the decision on a motion to dismiss under Chancery Court Rule 23.1 is subject to *de novo* and plenary review. *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). The Court must accept all well-pleaded allegations as true and draw all reasonable inferences in Plaintiffs' favor. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

C. MERITS OF THE ARGUMENT

"Where at least one half or more of the board in place at the time the complaint was filed approved the underlying challenged transactions, which approval may be imputed to the entire board for purposes of proving demand

futility, the *Aronson* test applies." *Ryan v. Gifford*, 918 A.2d 341, 353-54 (Del. Ch. 2007). SPG has a ten member Board of Directors. A17-19. The Complaint alleged that the four-member Compensation Committee and two additional Board members – A. Smith and Glasscock – participated in the process by which the Amended Award was granted. A18, 38-41. Thus, six directors—*i.e.*, a majority of the Board—were involved in the decision to grant the Amended Award, such that "the *Aronson* test applies." *Ryan*, 918 A.2d at 353-54. In addition, the Amended Award was formally approved by the Compensation Committee and Simon; *i.e.*, half of the Board. A31, 34-40. Although ultimately evaluating demand futility under both *Aronson* and *Rales*, the Chancery Court held "I think it's more appropriate to apply *Rales*". Ex. A at 65. The Chancery Court was wrong.

In adopting *Rales*, the Chancery Court did not even consider the Complaint's allegations that two directors not on the Compensation Committee, A. Smith and Glasscock, also participated in the deliberations regarding the Amended Award, but decided not to vote on the matter. A29, 38-39, 41. Delaware law does not permit directors to escape liability by refraining to vote on an unlawful transaction where they were involved in "formulating, negotiating or facilitating the transaction complained of…" *In re Tri-Star Pictures, Inc., Litig.*, 1995 WL 106520, at *3 (Del. Ch. Mar. 9, 1995). It cannot be, then, that a director's active involvement in a challenged action must be ignored if he or she simply steps out of

the room when the vote is called.[9] Indeed, a contrary rule would permit directors to manipulate the standard of review applied to their decisions. The premise underlying *Aronson* is that where a majority of a board of directors acts, the action of that majority can be imputed to the board as a whole. *Ryan*, 918 A.2d at 353. If the majority of a corporate board in fact considers, deliberates on and approves a challenged transaction, why should the rule of *Aronson* be disregarded simply because one or two of those directors does not technically vote on the matter? Moreover, as participants in the process, A. Smith and Glasscock had a fiduciary duty to speak up about the flaws in the Amended Award, and their knowing refusal to act also counsels the application of *Aronson*.[10]

Furthermore, the Chancery Court held that Simon's participation could be ignored "because he was a contractual counterparty." Ex. A at 74. Although Simon was not part of the Compensation Committee, his active involvement was essential, since the Original Award could not have been amended without Simon's

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[9] *See also Dalton v. American Inv. Co.*, 1981 WL 7618, at *3 (Del. Ch. June 4, 1981) (Court holding that "[a]t this stage, however, I do not find that [the defendant directors] are entitled to have judgment entered in their favor as a matter of law simply on the naked fact that, on the corporate minutes, they did not vote on the merger plan under attack."); Ruling Regarding Defendants' Motion For Summary Judgment in *In re Jefferies Gr'p., Inc. S'holders Litig.*, C.A. No. 8059-CB (Del. Ch. Sept. 16, 2014) (Transcript), at 5-6 (declining to grant summary judgment to directors who participated in challenged transaction but recused themselves from final vote).

[10] *See* Ruling Regarding Defendants' Motion To Dismiss in *In re Barnes & Noble S'holders Deriv. Litig.*, C.A. No. 4813-VCS, (Del. Ch. Oct. 21, 2010) (Transcript) at 161 (a fiduciary should not be "rewarded for being placed in a situation of helpless conflict and not speaking up or doing anything about it.").

explicit consent. A41, 48.[11] But more importantly, Simon did not participate as a mere "contractual counterparty." Rather, Simon acted *in concert with* the Compensation Committee to create an Amended Award that would moot the Original Action while at the same time ensuring that Simon received 100% of what he was initially promised. A29-31, 35-36. Thus, this was not a situation where Simon acted independently, separate from and opposed to the Compensation Committee. Rather, he acted *with* the four members of the Compensation Committee in furtherance of a common goal – the mooting of the Original Action.

Six of the ten member SPG Board actively participated in Compensation Committee meetings to discuss the terms and "negotiation" of the Amended Award (A29, 32, 34, 38-39, 41) and a seventh, Simon, worked with the Compensation Committee to structure an award that would moot the Original Action but ensure that he got 100% of what he was promised in the illegal and *ultra vires* Original Award (A20, 26, 31, 36-39). Accordingly, *Aronson* applies.

[11] *See Weiss v. Swanson*, 948 A.2d 433, 441 (Del. Ch. 2008) (*Aronson* applied when the challenged transactions were approved by the compensation committee and the company's Chief Executive Officer because collectively the group constituted a majority of the company's board of directors).

II. THE CHANCERY COURT ERRED IN HOLDING THAT THE AMENDED AWARD WAS ENTITLED TO THE DEFERENCE OF THE BUSINESS JUDGMENT RULE.

A. QUESTION PRESENTED

Does the business judgment rule apply where the Complaint alleges with particularity facts demonstrating that, in approving a performance-based compensation award worth over $150 million the Board did *nothing* to evaluate the need for the award, the amount of the award, the appropriateness of the performance metrics selected or the potential cost of the award to the Company? This issue was preserved for appeal. A173-83.

B. SCOPE OF REVIEW

This Court's review of the decision on a motion to dismiss under Chancery Court Rule 23.1 is subject to *de novo* and plenary review. *Brehm*, 746 A.2d at 253. The Court must accept all well pleaded allegations as true and draw all reasonable inferences in Plaintiffs' favor. *Beam*, 845 A.2d at 1048.

C. MERITS OF THE ARGUMENT

1. THE COMPLAINT ALLEGED THAT DEFENDANTS BEHAVED DISLOYALLY IN APPROVING THE AMENDED AWARD

The Complaint alleged that in approving the Amended Award the Defendants acted *solely* to moot the Original Action while ensuring that Simon received (well more than) 100% of what the SPG Board promised him in the illegal and *ultra vires* Original Award. A29-32, 44-45. This is disloyal conduct, to

which the business judgment rule does not apply. *See In re Southern Peru Copper Corp. Sec. Litig.*, 52 A.3d 761, 786 n.68 (Del. Ch. 2011) ("The bottom line requirement of loyalty is that a director act in the best interests of the company and its stockholders, ***rather than for any other reason.***") (Emphasis added).

In granting Defendants' motion to dismiss, the Chancery Court ignored the motivating factors that drove the Defendants' conduct. Instead, the Chancery Court focused only on the alleged independence of the SPG directors, and held (incorrectly, as discussed below) that the members of the Compensation Committee did not have any fiduciary obligation to evaluate the actual terms of the Amended Award in order to satisfy their duty of care. Ex. A at 73-78. But by disregarding Plaintiffs' allegations of Defendants' motives, the Chancery Court ignored particularized allegations demonstrating that Defendants deliberately elevated their own interests and those of Simon over the interests of the Company.

Plaintiffs argued: "The directors did not care that the amended plan was supposed to ensure performance. The two things that they cared about [were] extricating themselves from the first case and getting David Simon the money he was promised. And when you do that, when those are your only two interests, you breach your fiduciary duty of loyalty." Ex. A at 31. Importantly, this is not a situation where a corporate board is alleged to have improperly weighed competing interests in setting compensation, perhaps implicating business judgment. Plaintiffs

specifically alleged, based on their Section 220 investigation, that in adopting the Amended Award the Defendants failed to consider the interests of the Company *at all.* A29-32, 44-45. This necessarily means that in approving the Amended Award the Defendants subjugated the interests of the Company (paying compensation sufficient to motivate strong corporate performance) to their own (mooting the Original Action) and those of Simon (getting 100% of what he was illegally promised), thus breaching their duty of loyalty. "[A] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest." *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006).

This is true regardless of how the SPG Board acted in connection with granting the illegal Original Award in the first place. "It is a general principle of Delaware law that directors of Delaware corporations have 'continuing fiduciary duties' to evaluate whether an agreed-upon transaction is still in the best interests of the corporation's stockholders" and a Board must re-evaluate decisions as circumstances change. *Hamilton P'rs., L.P. v. Highland Capital Mgmt., L.P.*, 2014 WL 1813340, at *11 n.115 (Del. Ch. May 7, 2014).[12] Thus, before approving the

[12] *See also Frontier Oil v. Holly Corp.*, 2005 WL 1039027, at *28 (Del. Ch. Apr. 29, 2005) ("Revisiting the commitment to recommend the Merger was not merely something that the Merger Agreement *allowed* the Holly Board to do; it was the *duty* of the Holly Board to review the transaction to confirm that a favorable recommendation would continue to be consistent with its fiduciary duties.") (emphasis added); *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003) ("The fiduciary duties of a director are unremitting and must be effectively

Amended Award, Delaware law affirmatively required Defendants to determine whether the costs of and performance metrics in the Amended Award were actually in the best interests of the Company. Because Defendants disregarded the Company's interests and focused exclusively on extricating themselves from the Original Action and ensuring Simon received everything promised in the illegal award, *regardless of the Company's performance*, their decision to approve the Amended Award was not entitled to deference under the business judgment rule. Presuit demand was excused as a matter of law. *See Aldina v. Internet.com Corp.*, 2002 WL 3158492, at *6 (Del. Ch. Nov. 6, 2002) (acquiescing in an unfair deal for the benefit of a controlling stockholder breaches the duty of loyalty).

2. THE CHANCERY COURT ERRED IN HOLDING THAT THE DEFENDANTS' ASSUMED RELIANCE ON THEIR PRIOR ILLEGAL *ULTRA VIRES* DECISION SATISFIED THEIR FIDUCIARY OBLIGATIONS WITH RESPECT TO THE AMENDED AWARD.

The Complaint alleged, in detail, that Defendants made no effort to evaluate (a) whether any incentive compensation to Simon was appropriate, necessary or in the best interests of SPG; (b) the performance metrics used in the award; (c) the likelihood SPG would achieve the performance targets; and (d) the cost of the Amended Award. A32, 40. The Chancery Court, however, ignored Plaintiffs' detailed allegations of improper motive and ruled that Defendants' fiduciary

discharged in the specific context of the actions that are required with regard to the corporation or its stockholders as circumstances change.").

obligations did not require them to make *any* of these most basic inquiries. Ex. A. at 75-78. Instead, the Chancery Court held that because the Defendants, three years prior, had determined that it was appropriate to grant Simon a *non-performance-based retention award* worth approximately $120 million, they had no obligation to evaluate the merits of the purportedly performance-based Amended Award worth approximately $150 million. The Chancery Court flatly acknowledged Defendants' failure to exercise appropriate business judgment in approving the Amended Award, but held that such failures were cured by reliance on the Defendants' prior *illegal* decision:

> Ironically, it actually might be different if there had been no prior award. …Absent the prior award, one could analogize the failure to analyze the performance metrics and failure to really focus on the FFO in 2013 as similar to [the allegations that excused demand under the second prong of *Aronson* in *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275 (Del. Ch. 2003)].

Ex. A at 77-78. There are several problems with the Chancery Court's analysis.

First, as discussed above, Defendants had an independent and affirmative fiduciary obligation to evaluate the need for and details of the Amended Award at the time it was granted and before agreeing to its terms. *See supra* n. 12, and accompanying text.

Second, because the Original Award was *ultra vires*, that illegal decision could not serve as a valid basis for the grant of a subsequent award purportedly based on performance. *Ultra vires* actions "are legal nullities incapable of cure."

Apple Computer, Inc. v. Exponential Tech., Inc., 1999 WL 39547, at *6 (Del. Ch. Jan. 21, 1999). The fact that the Board was fulfilling an illegal promise to Simon when it adopted the Amended Award cannot be the basis for a finding that it acted with due care. Thus, the Chancery Court's holding that "the committee already had made a business decision in 2010 to grant what … the compensation committee believed was appropriate compensation for Mr. Simon" was simply incorrect. The Board's action in 2010 was *illegal* and was not a valid "business decision."

Third, the Original Award was *ultra vires* precisely because it was *non-performance based.* How could the consideration of a retention award that guaranteed compensation without regard to any metrics of corporate performance legitimately provide a basis upon which corporate directors could, consistent with their fiduciary duties, completely defer in setting a compensation award that supposedly was "designed to incentivize Mr. Simon to continue and improve upon" SPG's performance consistent with SPG's "pay-for-performance philosophy"? A26. It cannot, and to say otherwise (as the Chancery Court held) renders a corporate director's obligation to act with due care a complete farce.

3. THE COMPLAINT DEMONSTRATES THAT THE AMENDED AWARD INCLUDED A $7 MILLION CORPORATE GIFT TO SIMON

The Chancery Court also erred in holding that the Board's award of a "retroactive cash bonus" to Simon was not a corporate gift and was protected by

the business judgment rule. Ex. A at 78-79.[13] Contractual provisions granting a person benefits for no consideration create "a reasonable doubt that the defendants' approval of that agreement was the result of a valid exercise of business judgment." *See Green v. Philips*, 1996 WL 342093, at *6 (Del. Ch. June 19, 1996).

The Amended Award allowed Simon to retain 46,439 shares of SPG common stock that he acquired from the dividends on cancelled units from the illegal Original Award, a benefit worth over $7 million. A23. The Chancery Court found that "***the Company's stockholders did not receive any benefit from that aspect of the changes to Simon's compensation structure.***" A245 (emphasis added). Indeed, during the mootness proceedings the Chancery Court recognized that this provision constituted "fruits of the invalid share tree," an "echo" of the Original Award, and "one thing that [plaintiffs] could still litigate[.]" *Lampers v. Bergstein*, C.A. No. 7764-VCL (Del. Ch. Mar. 25, 2014) (Transcript) at 17:14-18:21.[14]

In granting the motion to dismiss here, however, the Chancery Court held that when approving the Amended Award, the Compensation Committee "got

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[13] A232; (Defense Counsel: "As a practical reality, therefore, what the compensation committee has done, assuming Mr. Simon was not already entitled to the distributions, is to have paid him retroactively cash bonuses on the distribution dates.").

[14] While the court ultimately found that the retroactive recognition of cash bonuses was "permissible" for the purposes of a mootness analysis (A232); at that time the Court did ***not*** make a judicial determination as to whether granting Simon $7 million in "fruits of the invalid share tree" constituted a breach of fiduciary duty on the part of the Board. Ex. A at 71-72 ("We never had a fiduciary duty determination [in the mootness proceedings].").

performance metrics and it got a benefit that this Court already priced in the neighborhood of $6 million." Ex. A at 78-79. The Chancery Court's holding was wrong, and was directly contrary to the facts as alleged in the Complaint. The Chancery Court's suggestion that the Compensation Committee "got performance metrics" as consideration is wholly illogical. The Original Award (the source of the Retroactive Bonus) was illegal precisely because it did not include performance metrics. To hold that the Compensation Committee received as consideration something that was legally required in the first place does not make any sense, and the Retroactive Bonus was not tied to performance metrics at all. Moreover, the Amended Award was purported to be an *incentive* based award that tied compensation to the *future performance* of the Company. How, then, was the Board's decision to allow Simon to retain $7 million from an illegal retention award granted in 2010, without any tie to future performance, legitimately tied to future performance? It was not. SPG received absolutely nothing in return for the Retroactive Bonus. As such, it constituted waste as a matter of law, and could not constitute the valid exercise of business judgment.[15]

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[15] *See Green*, 1996 WL 342093, at *5-6 (holding that contractual provisions granting a director benefits which were "not tied in any way to any consideration that [the director] must provide in return" stated a claim for waste, notwithstanding the fact that separate provisions of that same contract did provide benefits to the corporation); *Lewis v. Vogelstein*, 699 A.2d 327, 337-39 (Del. Ch. 1997) (denying motion to dismiss complaint alleging that "one-time" option grants to directors constituted waste, and noting that "what [is] necessary to validate an officer or director stock option grant [is] a finding that a reasonable board could conclude from the circumstances that the corporation may reasonably expect to receive a proportionate benefit.").

4. THE EXISTENCE OF A SECTION 102(B)(7) PROVISION IN SPG'S CHARTER IS IRRELEVANT FOR PURPOSES OF THE SECOND PRONG OF *ARONSON,* AND DOES NOT BAR CLAIMS FOR INJUNCTIVE RELIEF

The Chancery Court erred in holding that SPG's charter provision authorized under 8 *Del. C*. § 102(b)(7) ("Section 102(b)(7)") prevented a finding that demand was excused under the second prong of *Aronson*. Ex. A at 76. Whether demand is excused under the second prong of *Aronson* depends on whether the challenged transaction was the product of a valid exercise of business judgment. *Aronson*, 473 A.2d at 814. Where directors are deemed to have breached their fiduciary duties, whether of loyalty or care, the challenged decision does not fall under the protection of the business judgment rule. *Cede & Co. v. Technicolor*, 634 A.2d 345, 368 (Del. 1993). Therefore, in determining if demand is excused under the second prong of *Aronson*, "the pertinent question … is whether an underlying breach has occurred and not whether a substantial threat of liability exists, regardless of breach." *Khanna v. McMinn,* 2006 WL 1388744, at *25 n.201 (Del. Ch. May 9, 2006). A Section 102(b)(7) charter provision serves merely to indemnify a director from monetary liability for a breach of the duty of care, it does not eliminate an underlying breach of fiduciary duty. *Khanna,* 2006 WL 1388744, at *25 n.201 ("[C]harter provisions adopted under § 102(b)(7) merely work to exculpate liability, but do not erase the underlying breach of fiduciary duty."). "An exculpatory provision therefore 'will not place challenged conduct

beyond judicial review.'" *Chen v. Howard-Anderson*, 87 A.3d 648, 676 (Del. Ch. 2014) *citing* 1 David A. Drexler et al., *Delaware Corporation Law and Practice*, § 6.02[7] at 6-18 (2013).

This Court's recent decision in *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 2015 WL 2394045 (Del. May 14, 2015) demonstrates that the standard of review applied to a corporate transaction is a separate issue from the question of whether a majority of the Board may be held personally liable with regard to a challenged transaction. That decision demonstrates that entire fairness actions remain viable even where some board members are protected from liability by Section 102(b)(7).[16] If personal liability were the *sine qua non* of demand futility, then judicial review would be completely unavailable, as a majority of a board protected by an exculpatory provision could be dismissed in the absence of a breach of a duty of loyalty. But *Cornerstone* did not overrule *Aronson*. The fact that certain directors may be exculpated from personal liability cannot and does not mean that their underlying breaches – which are not protected by the business judgment rule – are beyond judicial review under the second prong of *Aronson*. Thus, the Chancery Court's holding that demand was not excused because the SPG directors had Section "102(b)(7) protection in place" (Ex. A at 76) is wrong.

[16] *See id.* at *1 (noting that plaintiff may plead facts that "require the transaction to be subject to the entire fairness standard of review" even where some board members may be dismissed due to exculpation clauses).

Even if a Section 102(b)(7) charter provision were relevant to a second prong *Aronson* analysis, which it is not, the Chancery Court was still in error. *First*, an exculpatory charter provision is only relevant at the motion to dismiss stage if the complaint *unambiguously* states a claim solely for a breach of the duty of care. *See, e.g., Emerald P'rs v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999). Here, the Complaint alleges that the Defendants breached their duty of ***loyalty***. A15, 49, 51-53.

Second, the Court of Chancery failed to consider the fact that the Complaint does not exclusively seek monetary relief. Section 102(b)(7) does not apply to the extent plaintiffs seek equitable relief for any alleged breaches of the duty of care.[17] *See Arnold v. Soc'y for Sav. Bancorp., Inc*., 678 A.2d 533, 535 n.2 (Del. 1996) ("Under 8 *Del. C.* §102(b)(7), directors are not exempt from equitable relief."); *Cal. Pub. Emp. Ret. Sys. v. Coulter*, 2002 WL 31888343, at *17 (Del. Ch. Dec. 18, 2002) (refusing to dismiss claims based on Section 102(b)(7) where "the remedy sought is not limited to damages"). The Complaint explicitly seeks equitable relief in the form of rescission of the Amended Award and cancellation of the associated LTIP Units. A54. As such, dismissal based on the existence of a Section 102(b)(7) provision was improper.

[17] The Complaint sufficiently states a claim for breach of the fiduciary duty of care as it alleges that the SPG Board at a minimum acted with gross negligence in approving the Amended Award, including, *inter alia*, failing to properly account for the appropriateness or necessity of the Amended Award, failing to analyze the performance metrics in the Amended Award, or ensuring the approval of the Amended Award was on a fully informed basis. A15.

III. THE CHANCERY COURT ERRED IN CONCLUDING THAT A MAJORITY OF THE BOARD WAS INDEPENDENT AND DISINTERESTED

A. QUESTION PRESENTED

Are directors interested for demand futility purposes when (a) the challenged transaction resulted in a benefit for the directors not shared with the corporation or other stockholders, (b) the directors' approval of the transaction was motivated solely by the directors' self-interest and occurred without even minimal due care, and (c) the directors faced the potential risk of liability arising from disloyal conduct in approving the Amended Award and being required to repay advanced legal fees incurred in the Original Action? This issue was preserved for appeal. A165-73.

B. SCOPE OF REVIEW

This Court's review of the decision on a motion to dismiss under Chancery Court Rule 23.1 is *de novo* and plenary. *Brehm* 746 A.2d at 253. The Court must accept all well pleaded allegations as true and draw all reasonable inferences in Plaintiffs' favor. *Beam*, 845 A.2d at 1048.

C. MERITS OF THE ARGUMENT

1. THE CHANCERY COURT ERRED IN CONSIDERING ONLY THE FOUR MEMBERS OF THE COMPENSATION COMMITTEE FOR PURPOSES OF THE FIRST-PRONG OF *ARONSON*

In assessing presuit demand under the first prong of *Aronson*, the Chancery Court looked only to the four members of the Compensation Committee. It

reaffirmed its prior conclusion that D. Smith lacked independence for purposes of *Rales*, but determined that the remaining three members of the Compensation Committee were sufficiently independent, and thus held that demand was not excused under the first prong of *Aronson.* Ex. A at 73-74. This was error.

In applying the first-prong of *Aronson*, the Court examines the allegations of interestedness and lack of independence for *all* members of the demand-Board, not a subset thereof.[18] This make sense, given that the relevant question is whether the complaint alleges a reasonable basis to doubt that at least half of the Board can consider a litigation demand, since the affirmative vote of at least half of the Board would be required to pursue litigation.[19] It is thus well established that the demand futility analysis under *Rales* and the first prong of *Aronson* is the same under both standards.[20] In applying *Rales*, the Chancery Court correctly determined that Simon was "directly interested" in the Amended Award and that H. Simon, Sokolov, and D. Smith lacked independence. Ex. A at 65-68. Thus, under the Chancery Court's own analysis, at least four directors lacked independence

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[18] *See, e.g.*, *Calma v. Templeton*, 2015 WL 1951930, at *5 (Del. Ch. Apr. 30, 2015) ("To establish demand futility, Plaintiff must impugn the ability of at least half of the directors in office when the Complaint was filed to have considered a demand impartially. The focus is on the entire board in office, rather than only the directors who approved any decision(s) at issue[.]").

[19] *See Beneville v. York*, 769 A.2d 80, 82 (Del. Ch. 2000) ("[T]he central question is whether there is a sufficient number of impartial directors who can cause the corporation to act favorably on a demand by bringing suit.").

[20] *See DiRienzo v. Lichtenstein*, 2013 WL 5503034, at *29 (Del. Ch. Sept. 30, 2013); *Khanna*, 2006 WL 1388744, at *12.

sufficient to consider a litigation demand. If just one more director is deemed to lack independence or to not be sufficiently disinterested, therefore, presuit demand was excused either under *Rales* or the first prong of *Aronson.*

As discussed in the following sections, in addition to D. Smith, the three remaining members of the Compensation Committee, plus A. Smith and Glasscock (who participated in the Compensation Committee's deliberations but declined to vote), breached their duty of loyalty in approving the Amended Award and faced a substantial likelihood of liability in this litigation. And *all* of these directors faced substantial risk of reputational harm and financial liability in connection with the Original Action, rendering them interested in the Amended Award as the mechanism to moot the claims asserted in that action. Thus, they were incapable of independently considering a litigation demand here.

2. DEFENDANTS FACED A SUBSTANTIAL LIKELIHOOD OF LIABILITY ARISING FROM THEIR BREACH OF THE DUTY OF LOYALTY

In evaluating whether a majority of the SPG Board was sufficiently disinterested to consider a presuit demand (under either *Rales* or the first prong of *Aronson*), the Chancery Court focused exclusively on whether the Defendants were interested in the decision to "moot" the Original Action, ignoring entirely Defendants' potential liability for breaching their duty of loyalty in approving the Amended Award. Referring to the Original Action, the Chancery Court said that

"for demand futility purposes, a court has to determine whether there was a sufficient risk of personal liability *in the first action* that would compromise the directors' ability to make a decision." Ex. A at 72 (emphasis supplied). But whether Defendants faced personal financial liability in the Original Action sufficient to render them "interested" in the decision to moot those claims is a different inquiry from whether Defendants, as a result of breach of their duty of loyalty in approving the Amended Award, faced a substantial threat of liability *in this case* so as to compromise their ability to consider a presuit demand. And the Chancery Court never made this inquiry. As discussed above (*supra* §II.C.1), because the Complaint alleged with particularity facts demonstrating that in approving the Amended Award the Defendants elevated the interests of Simon over those of the Company, the Complaint successfully alleged a breach of the duty of loyalty, and each of the Defendants who participated in that decision faced joint and several liability for the value of that compensation award. *See Conrad v. Blank*, 940 A.2d 28, 40 (Del. Ch. Sept. 7, 2007) (finding demand excused where members of a compensation committee faced a substantial threat of liability for knowingly approving improper option grants).

3. THE THREAT OF MONETARY LIABILITY IS NOT THE *SINE QUA NON* OF ESTABLISHING A LACK OF DISINTERESTEDNESS

Even if directors do not face personal financial liability on a claim, this does not mean that they are disinterested in the transaction. It cannot be that if a director

acts with gross negligence and in plain breach of his or her duty of care in approving a corporate action, he or she would nonetheless be considered capable of considering a demand to commence litigation challenging that transaction. Section 102(b)(7) does not give a director the ability to sit in judgment of his or her own breach of fiduciary duty. To say that a director may even intentionally violate his or her fiduciary duty, but then is not conflicted to consider whether to prosecute litigation arising out of that breach—*e.g.*, as here, for rescission or against a corporate officer who does not have the benefit of Section 102(b)(7) exculpation — ignores reality. Indeed, it would prevent the Delaware courts from reviewing an entire class of corporate transactions injuring stockholders — namely, derivative actions for rescission of corporate transactions that are the result of gross negligence. As a result, the Chancery Court failed to credit Plaintiffs' allegations that the SPG directors were not disinterested because they approved the Amended Award solely to moot the Original Action to avoid inevitable reputational harm from an adverse decision, while getting Simon the money they illegally promised him, and while remaining wholly uninformed about the merits of, necessity for, or costs of the Amended Award.

4. THE CHANCERY COURT ERRED IN FAILING TO CONCLUDE THAT DEFENDANTS WERE INTERESTED SINCE THEY OBTAINED A UNIQUE BENEFIT FROM THE AMENDED AWARD

All Defendants are interested because mooting the Original Action gave

Defendants a unique benefit.[21] The Chancery Court, however, concluded that Supreme Court precedent did not permit it to consider non-monetary benefits to Defendants in conducting a demand excusal analysis. The Chancery Court acknowledged that there are "risk[s] of soft conflicts and structural bias in the boardroom when dealing with CEO comp[ensation][.]" Ex. A at 58. However, the Chancery Court explained that, "if that is a path that the law is going to go down, it's a path that the Delaware Supreme Court has to opt for." Ex. A at 59.

This Court's precedent demonstrates that the Chancery Court can, and must, consider non-monetary interests of directors in considering demand excusal. Directorial interest exists where "a director cannot be expected to exercise his or her independent business judgment without being influenced by the adverse personal consequences resulting from the decision." *Rales*, 634 A.2d at 936.[22] "At bottom, the question of independence turns on whether a director is, ***for any substantial reason***, incapable of making a decision with only the best interests of the corporation in mind. That is, the Supreme Court cases ultimately focus on impartiality and objectivity." *In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 938 (Del. Ch. 2003) (emphasis in original, quotation omitted).

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[21] *See, e.g.*, *Rales*, 634 A.2d at 936 ("A director is considered interested where he or she will receive a personal financial benefit from a transaction that is not equally shared by the stockholders.").

[22] *See also Aronson*, 473 A.2d at 816 ("Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.").

The tests announced by this Court for demand futility do not distinguish between "hard conflicts" and "soft conflicts," and precedent establishes that personal, social and reputational harms may be considered.[23] The Chancery Court correctly recognized this principle in holding that H. Simon and D. Smith lacked independence due to familial relations and relationships with favored charities, respectively. Ex. A. at 65-66, 68. But it erred in failing to consider Defendants' personal interest in avoiding reputational harm.

As then-Chancellor Strine explained in *In re MFW S'holders Litig.*, directors have a "self-protective interest in retaining their reputations as faithful, diligent fiduciaries." 67 A.3d 496, 528-29 (Del. Ch. 2013). This is especially so "in a market where many independent directors serve on several boards, and where institutional investors and their voting advisors, such as ISS and Glass Lewis, have computer-aided memory banks available to remind them of the past record of

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[23] *See, e.g., In re Oracle*, 824 A.2d at 937-48 (holding that ties among special litigation committee members, the university where they were tenured professors, and corporate management gave rise to reasonable doubt about the members' independence); *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 291 (Del. Ch. 2003) (holding that where directors act "to protect their personal reputations" at the expense of the corporation, they act disloyally); *Lewis v. Fuqua*, 502 A.2d 962, 966-67 (Del. Ch. 1985) (finding special committee member to be interested due to factors including that he was a member of the Board at the time the challenged actions took place, he had numerous financial dealings with the CEO, and he was the president of a university that had received donations from the corporation and its CEO); *In re Jefferies Grp. Inc. S'holders Litig.,* C.A. No. 8059-CS, at 62 (Del. Ch. Nov. 4, 2013) (Transcript) ("[T]he reality is humans react for a variety of reasons, not just lucre."); *see also Mennen v. Wilmington Trust Co.*, C.A. No. 8432-ML, Slip. Op. at 60-61 (Del. Ch. Apr. 27, 2015) (holding that, in acting in bad faith, trustee was motivated by "pride" and that, "[a]lthough these motivations differ from the typical pecuniary incentives that traditionally underlie disloyal behavior, they are no less real and no less emblematic of bad faith").

directors when considering whether to vote for them or withhold votes at annual meetings of companies on whose boards they serve." *Id.* at 529.

Here, the Complaint alleges with particularity that as defendants in the Original Action, each member of the Board faced a material risk of "adverse personal consequences"—namely, the risk that unless the Original Action were mooted they would have to endure the stigma of a judicial ruling that they had undertaken an illegal act and violated their fiduciary duties. A27-28, 44-45.

At minimum, the allegations of the Complaint give rise to a reasonable inference that the Board members were interested in the mooting of the Original Action. A27-28, 44-45. At the motion to dismiss stage, the Chancery Court "was not free to disregard that reasonable inference, or to discount it by weighing it against other, perhaps contrary, inferences that might also be drawn." *Gantler v. Stephens*, 965 A.2d 695, 709 (Del. 2009). Yet, in dismissing the Complaint, the Chancery Court did exactly that.[24] Accordingly, a majority of the Board (indeed, the entire Board) were direct beneficiaries of the Amended Award, and thereby interested for demand excusal purposes. A44.

5. ALL MEMBERS OF THE BOARD FACED A RISK OF BEING FORCED TO DISGORGE ADVANCED LEGAL FEES IF THE PRIOR ACTION WAS NOT MOOTED

The Chancery Court also erred in concluding that SPG's directors did not

[24] Ex. A at 73 ("I [do not] think that there was really a reputational consequence for the directors involved. They would have said, 'We relied on the lawyers. We screwed up; we trusted our counsel.")

face a sufficient threat of disgorgement of advanced attorneys' fees in the Original Action to justify a finding of interestedness. Ex. A at 73. "Delaware corporations lack the power to indemnify a party who did not act in good faith or in the best interests of the corporation." *VonFeldt v. Stifel Fin. Corp.*, 1999 WL 413393, at *2 (Del. Ch. June 11, 1999). A defendant-director "is always obligated to repay the fees advanced if not ultimately entitled to indemnification." *Paolino v. Mace Sec. Int'l, Inc.*, 2009 WL 4652894, at *14 (Del. Ch. Dec. 8, 2009).

Defendants failed to act in good faith[25] in connection with the Original Award, such that their misconduct was nonindemnifiable and would have required the repayment of advanced attorneys' fees upon a finding that they breached their fiduciary duties. The elimination of this risk thus provided each SPG director with a unique personal financial benefit. A44, 45. By ignoring this risk, the Chancery Court improperly drew an *inference* against Plaintiffs that Defendants could have argued in opposing disgorgement that they reasonably relied on advisors (Ex.A at 73), which was wholly inappropriate in the context of a motion to dismiss under Rule 12(b)(6). *See*, *e.g.*, *Gotham Partners, LP v Hallwood Realty Partners, LP*, 2000 WL 1476663, at *17-19 (Del. Ch. 2000) (exculpation based on good faith reliance on legal advisor represented a triable question of fact).

[25] *See In re Walt Disney Co. Deriv. Litig.,* 906 A.2d 27, 66 (Del. 2006) ("[I]ntentional dereliction of duty [and] a conscious disregard for one's responsibilities ... is properly treated as a non-exculpable, nonindemnifiable violation of the fiduciary duty to act in good faith."); *id.* (explaining that conduct need not be "motivated by subjective bad intent" to be nonindemnifiable).

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GRANT & EISENHOFER P.A.

/s/ Stuart M. Grant
Stuart M. Grant (Del. I.D. # 2526)
Michael J. Barry (Del. I.D. # 4368)
Nathan A. Cook (Del. I.D. # 4841)
David M. Haendler (Del. I.D. # 5899)
123 Justison Street
Wilmington, Delaware 19801
T: (302) 622-7000
F: (302) 622-7100

CHIMICLES & TIKELLIS LLP

/s/ Pamela S. Tikellis
Pamela S. Tikellis (Del. I.D. # 2172)
Scott M. Tucker (Del. I.D. # 4925)
Tiffany Cramer (Del. I.D. #4998)
222 Delaware Ave., Suite 1100
Wilmington, Delaware 19801
T: (302) 656-2500

Attorneys for Delaware County Employees' Retirement Fund and City of Sterling Heights General Employees' Retirement System, Plaintiffs Below-Appellants