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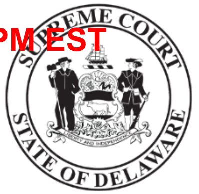

IN THE SUPREME COURT OF THE STATE OF DELAWARE

SANDRA LIFSCHITZ, HENRY FELT and DIANE FELT,	:	
Plaintiffs Below, Appellant,	:	
v.	:	C.A. No. 301,2020
STEVEN A. KANDARIAN, CHERYL W. GRISÉ, CARLOS M. GUTIERREZ, GERALD L. HASSELL, DAVID L. HERZOG, R. GLENN HUBBARD, EDWARD J. KELLY, III, WILLIAM E. KENNARD, JAMES M. KILTS, CATHERINE R. KINNEY, DENISE M. MORRISON, WAYNE DANIEL, STEVEN J. GOULART, JOHN C.R. HELE, JOHN M. KEANE, ALFRED F. KELLY, JR., ROBIN LENNA, MARIA R. MORRIS, HUGH B. PRICE, KENTON J. SICCHITANO, LULU WANG, and WILLIAM A. WHEELER,	:	**Appeal from the Court of Chancery of the State of Delaware C.A. No. 2019-0452-SG**
Defendants Below, Appellees	:	
and	:	
METLIFE, INC.,	:	
Nominal Defendant Below.	:	

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TABLE OF CONTENTS

NATURE OF PROCEEDINGS 1

SUMMARY OF ARGUMENT..6

STATEMENT OF FACTS..8

A. THE PARTIES..8

1. Plaintiffs..8

2. Director Defendants..8

a. MetLife’s Audit Committee 8

b. Officer Defendants 9

B. THE DEMAND BOARD 9

C. AFFIRMATIVE DUTIES AND RESPONSIBILITIES..9

D. METLIFE’S BUSINESS 10

1. Generally 10

2. The Pension Risk Transfer Business 11

3. Protocols Utilized in PRTB from the 1980s-2018 To Determine Whether Annuitants Were Alive Were the Same Protocols Prohibited Under the 2012 RSA 12

E. The NYDFS Investigation and 2012 RSA Were Unmistakable RED FLAGS that MetLife’s PRTB..14

1. The NYDFS Investigation 14

2. The Multi-State Insurance Commissioners Investigation and the RSA..16

3. The Auditor's Report 20

F. METLIFE HAS SUSTAINED LOSS AND DAMAGE AS A RESULT OF FIDUCIARY BREACHES 21

G. STAGE OF THE PROCEEDINGS 22

ARGUMENT 23

I. The Regulatory Action and RSA Are Red Flags That Indicate MetLife Was Engaged in Violations of Positive Law 23

A. Question Presented 23

B. Scope of Review and Legal Standard 23

C. Merits of Argument 24

1. The Regulatory Action and RSA Constitute Red Flags that Put the Board on Notice MetLife Was Violating Positive Law 25

2. The Board Consciously Disregarded the Regulatory Red Flags, Which Amounts to Bad Faith 29

II. Plaintiffs Adequately Alleged that Red Flags Were Waived Before the Audit Committee, Which Was Obligated to Alert the Full Board 34

A. Question Presented 34

B. Scope of Review and Legal Standard 34

C. Merits of Argument 34

1. The Auditor's Report Alerted the Audit Committee to Violations of Law in Time to Act 34

2. The Complaint Pleads Facts Supporting the Reasonable Inference that the Board was Apprised of the Auditor's Report 40

3. Alternatively, Demand is Excused if the Audit Committee failed to Report Red Flags to the Full Board 43

CONCLUSION 46

TABLE OF AUTHORITIES

CASES **Pages(s)**

Brehm v. Eisner,
746 A.2d 244 (Del. 2000) 41

David B. Shaev Profit Sharing Account v. Armstrong,
2006 WL 391931 (Del. Ch.) 43

Grobow v. Perot,
539 A.2d 180 (Del. 1988) 24

Guttman v. Huang,
823 A.2d 492 (Del. Ch. 2003) 43

Hughes v. Xiaoming Hu,
2020 WL 1987029 (Del. Ch.) 43

In re Abbott Labs. Deriv. S'holders Litig.,
325 F.3d 795 (7th Cir. 2003) 41

In re Caremark Int'l. Inc. Deriv. Litig.,
698 A.2d 959 (Del. Ch. 1996) .... *passim*

In re Chemed Corp. S'holder Derv. Litig.,
2019 WL 3215852 (D. Del.) 25

In re China Agritech, Inc. S'holder Derivative Litig.,
2013 WL 2181514 (Del. Ch.) .... *passim*

In re Clovis Oncology, Inc. Deriv. Litig.,
2019 WL 4850188 (Del. Ch.) .... *passim*

In re Facebook Sec. 220 Litig.,
2019 WL 2320842 (Del. Ch.) 30

In re Tyson Foods, Inc.,
919 A.2d 563 (Del. Ch. 2007) 31

Louisiana Mun. Police Empl.'s Ret. Sys. v. Pyott,
46 A.3d 313 (Del. Ch. 2012) 24

Marchand v. Barnhill,
212 A.3d 805 (Del. 2019)...*passim*

Oklahoma Firefighters Pension & Ret. Sys. v. Corbat,
2017 WL 6452240 (Del. Ch.)...25

Rales v. Blasband,
634 A.2d 927 (Del. 1993)...23, 24

Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong,
66 A.3d 963 (Del. Ch. 2013) 44

Rojas on behalf of J.C. Penney Co., Inc. v. Ellison,
2019 WL 3408812 (Del. Ch.)...25

Saito v. McCall,
2004 WL 3029876 (Del. Ch.)...41

Sandys v. Pincus,
152 A.3d 124 (Del. 2016)..23

Teamsters Local 443 Health Servs. & Ins. Plan v. Chou,
2020 WL 5028065 (Del. Ch.)...*passim*

Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW,
95 A.3d 1264 (Del. 2014)...39, 40, 42

STATUTES

8 *Del. C.* § 220..22

COURT RULES

Court of Chancery Rule 23.1 ....6, 22, 23

Court of Chancery Rule 12(b)(6) 22

Delaware Rule of Evidence 202 32

NATURE OF PROCEEDINGS

Appellants sued current and former members of the Board of Directors (the "Board") and officers of MetLife for allowing the Company to designate living pension annuitants as dead and denying those annuitants their owed pension benefits in violation of positive law. MetLife's Pension Risk Transfer Business ("PRTB"), one of its core businesses, knowingly failed to replace its obsolete "annuitant location" protocols with more reliable protocols that would have prevented MetLife from erroneously designating annuitants to whom it owed benefits as "presumed dead." This practice led to an erroneous release of liability reserves into the Company's net income every year thereby distorting reported financial results.

In 2011, MetLife received a request ("Request") from its primary regulator, the New York Division of Financial Services ("NYDFS"), demanding certain information from MetLife concerning its annuitant and beneficiary locating practices and its payment of benefits to those consumers. (A61). In the course of responding to that request, MetLife uncovered nearly $112 million of unpaid life insurance and annuity benefits which should have been remitted to beneficiaries. MetLife booked a $143 million charge to earnings in late 2011 to account for liabilities in excess of reserves. (*Id.*).

In April 2012, other states insurance regulators' investigation into this conduct culminated with MetLife agreeing to settle with numerous state regulatory agencies,

paying a $40 million fine, and over $450 million restitution to affected consumers over 17 years ("RSA"). (A68; A71-72). The RSA also required MetLife to implement new annuity and beneficiary location protocols for its life insurance business[1] and subject itself to enforcement action for failure to comply with RSA terms. (A71-73). The RSA required MetLife to use the Social Security Advisor database called "Death Master File" ("DMF") to confirm deaths of annuitants/beneficiaries. (A71-72). MetLife was on notice at the time of entering into the RSA that the Company would face further liability for continued violations of positive law addressed under the RSA.

On December 15, 2017, MetLife announced that it would be required to book an enormous increase in MetLife's reserves for PRTB. Shortly thereafter, in a press release dated January 29, 2018, the Company admitted that its improper practices had, among other things: (i) caused the Company to issue financial statements in violation of GAAP for several years; (ii) constituted material weakness in internal control over financial reporting at MetLife under Sarbanes-Oxley Act of 2002; (iii) resulted in an estimated reserve increase of between $525 million and $575 million pre-tax to reverse previously improperly released reserves; and (iv) caused the

[1] MetLife improved its procedures for annuitants who contracted directly with MetLife but ***not*** for the pension risk transfer contracts where annuitants might not know MetLife was responsible for their plans. (A74).

Company to understate its accounting reserves by $510 million, thereby necessitating a charge against earnings to increase accounting reserves related to pension risk transfers in that amount. MetLife stock dropped 11.6% in reaction to the news, which also prompted the filing of multiple lawsuits that would be consolidated as the 2018 Securities Fraud Litigation. (A25). Not mentioned in the announcement was the fate of tens of millions of dollars of bonus executive compensation received by the Officer Defendants based on the inflated financial results ensuing when the reserves were reversed into income year after year.

MetLife's Board ignored numerous signs that MetLife's use of deficient and obsolete annuitant location protocols, prohibited at other MetLife segments under the RSA, were distorting MetLife's financial results. Internal documents reveal that, among other things, on September 26, 2016, more than a year before the late 2017 disclosure of the PRTB scheme was publicly revealed, the Audit Committee of the Board ("AC") was notified that "…control weaknesses were identified over several areas, ***including contract accuracy, manual certificate mailings, and retirement letter mailings (e.g. age 65 and 70.5)***."[2] (A29-30). The documentary record to date contains no evidence that the AC took any further action.

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[2] Unless indicated otherwise herein, all bolding and italicization is added for emphasis.

The consequences to MetLife of its Board's years long dereliction of duties have been severe. On or about January 28, 2019, for the second time in less than ten years MetLife entered into a settlement with NYDFS to resolve allegations relating to the same deficient use of antiquated databases and methods for annuitant location as led to the RSA, but this time as respects PRTB. The settlement requires MetLife to pay a $19.75 million fine to the state and $189 million in restitution to affected retirees. (A133-144). MetLife entered into an agreement with the Massachusetts Securities Division in December 2018, agreeing to pay a fine of $1 million and provide back annuity payments, with interest, to eligible Massachusetts retirees and beneficiaries who MetLife erroneously "presumed dead," and the settlement identifies numerous laws violated by MetLife's practices (A145-158; A30; A87). The SEC has also commenced an investigation into these practices. (A87).

The court below, however, failed to draw permissible, logical inferences from the well pleaded factual allegations to which plaintiffs are entitled at this stage and held that the Board's inaction did not meet the *Caremark* standard for liability. Similar allegations of inaction and knowledge have led to the denial of demand futility motions in numerous recent derivative actions. The only apparent distinction is that the recent *Caremark* cases that survived motions to dismiss involved failures of directorial oversight that resulted in the death of consumers, as opposed to the type of financial harm alleged here. Allowing this decision to stand gives rise to an

appearance that director accountability standards are lower where “mere” financial injury is alleged. There is no basis in law to limit *Caremark* claims to ones that allege direct inaction leading to death or physical harm.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in holding that Plaintiffs failed plead facts sufficient to imply director liability or otherwise to excuse demand under Rule 23.1 Plaintiffs sufficiently pleaded a claim for lack of corporate oversight under *In re Caremark Int'l. Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996) and its progeny. Plaintiffs alleged Defendants were presented with red flags it chose to ignore resulting in financial harm to the Company.

2. The Court of Chancery erred in finding Defendants use of the two-letter system for determining if an annuitant is alive when its other business lines used more sophisticated and accurate methods was not bad faith.

3. The Court of Chancery erred in fining that Plaintiffs failed to prove Defendants had actual knowledge of the regulatory actions and RSA, despite Plaintiffs allegations that the RSA required the Company to pay $438 million in restitution and $40 million in civil penalties and costs and that a minority of the Defendants were individually named in a class action suit regarding these actions.

4. The Court of Chancery erred in finding that Plaintiffs failed to show Defendants were aware of the Internal Auditor's Report ("Auditor's Report") and Pilot Program presented to the AC. Plaintiffs alleged it was the AC's duty to report such information to the full Board thus knowledge by all directors at the time should be inferred. Alternatively, if the AC failed to meet their mandate and did not report

the information to the full Board it was not well functioning and thus states a *Caremark* claim.

STATEMENT OF FACTS

A. THE PARTIES

1. Plaintiffs

Plaintiffs Henry and Diane Felt and Sandra Lifshitz ("Plaintiffs") are long term stockholders of MetLife. (A32).

2. Director Defendants

Defendants are all persons who were directors at any time between May 2012 and January 2018: Kandarian, Grisé, Gutierrez, Herzog, Hubbard, Kelly, III, Kennard, James Kilt, Kinney, Morrison, Price, Kelly, Jr., Sicchitano, Wang, and Keane.

a. MetLife's Audit Committee

(i) Defendants Grisé, Kinney, Kelly, Jr. and Herzog are current directors who were on the AC when the RSA was executed. (A32; A33).

(ii) Defendants Price, Kelly, Jr., Sicchitano and Keane are former director defendants who served on the AC when the RSA was executed. (A34).

(iii) Defendants Grisé, Herzog, Kinney, Kelly, Jr. and Kelly, III (*See* A32-34) were members of the AC when the Pilot Program was initiated in 2015 ***and*** when the Auditor's Report was presented to the AC in 2016. (A43).

b. **Officer Defendants**

Plaintiffs named as Defendants officers with responsibility for the conduct in question who were awarded compensation based on inflated net income reports, including Wheeler, Hele, Goulart, Morris, Lenna, and Daniel. (A35-37).

B. **THE DEMAND BOARD**

At the time of the filing of the original complaint, nine Director Defendants Grisé, Gutierrez, Herzog, Hubbard, Kelly, III, Kennard, Kilts, Kinney, Morrison (A32-33) and non-Defendants Khalaf, McKenzie and Hassell constituted the twelve members of MetLife's Board (A34; A112-13).

Of those twelve members:

- Seven were members when MetLife entered into the 2012 RSA or joined shortly thereafter during RSA's immediate implementation period.

- Four, Grisé, Kinney, Kelly, III, and Herzog, were members of the AC in 2012 and/or 2015-2016.

- Four, Grisé, Kilts, Hubbard and Kinney, are named Defendants in the Securities Fraud Litigation (A114-15).

C. **AFFIRMATIVE DUTIES AND RESPONSIBILITIES OF THE BOARD**

The Director Defendants were subject to MetLife's Director's Code of Business Conduct and Ethics (the "Director's Code"). (A47). In its 2018 Proxy, MetLife stated that the Director's Code applies to all directors, including the CEO.

The Director Defendants must certify the Director's Code every year of their tenures on the Board. (A47). The Director's Code provided in part:

> Directors shall communicate any suspected violations . . . of law or government rule or regulation promptly to the General Counsel. Alleged violations by the Board or by a person designated by the Board . . .

(*Id*).

In addition, the AC had its own responsibilities, including to "review and discuss with management the internal auditor and the independent auditor: Regular updates … regarding status of ***any remediation plans for any material weaknesses and significant deficiencies*** in the design and operation of internal control over financial reporting. (A39-42). The AC shall also "[p]eriodically discuss the ***guidelines and policies with respect to the process by which the Company undertakes risk assessment and risk management***" and "[r]eview … ***any correspondence with regulators or governmental agencies*** … ***that raise material issues regarding the Company's financial statements or accounting policies***." (A60-61).

D. METLIFE'S BUSINESS

1. Generally

MetLife offers insurance and annuity products and services. An indispensable part of MetLife's operations consists of collecting premiums and ***paying*** benefits.

Indeed, MetLife's "operational viability" depends on its ability to reliably track whether annuitant, beneficiaries, and policy owners are alive or dead. The Board's oversight of those functions must be focused intense, continuous and proactive. MetLife's PRTB is included in one of three business units (the RIS unit) and has been part of MetLife's U.S. business since 1921. (A50-51; A76-77).

2. <u>The Pension Risk Transfer Business</u>

MetLife's RIS business segment sold "pension risk transfers," whereby MetLife acquires assets of defined benefit pension plans and converts them to group annuity contracts covering annuitants to whom benefits are owed ("GACs"). (A50). This allows corporations to manage their pension risk via transfer of their pension liabilities to MetLife. (A51-52). Because the group annuity contracts are transactions between MetLife and the annuitant's employer, the annuitants are often unaware of the transfer. (A52).

PRTB was important to MetLife's overall business at all material times. (A53-54). Indeed, when Daniel was interviewed in June 2014 by an industry magazine, he stated that "pension risk management – which includes both pension risk transfer and risk mitigation strategies – is a core element of MetLife's business and has been for over 90 years." (A54-55). MetLife's long-term CEO, Kandarian, stated during an investor conference call on February 13, 2014, that "[PRTB] is a sector that MetLife has been a major player in historically. ***We were the largest***

again this year in 2013 in terms of the pension closeout business." Wheeler echoed these sentiments during a separate investor conference call on February 13, 2014, stating that "[w]e did I think $1.7 billion, $1.8 billion on pension closeouts in 2013. By the way, ***that made us the market share leader in 2013*** …. We do see this as an area of growth. And I think – in the US and I think that is going to continue for quite some time." Likewise, during an investor conference call on September 6, 2017, Hele stated that "the other business that gets a lot of attention is the [PRTB] …. We like that business, it's a solid business …. We've been selling roughly between $1.5 billion to $2 billion a year in that. And we appear – we would think we're kind of on track for that range for this year as well. So we like the business." (A53-54). Given the importance placed on this line, PRTB's $38 billion in pension liability obligations as of June 2016, and contribution to revenue, and sales in that line were between $1.5 billion and $2 billion per year as of September 2017, the Board should have been actively overseeing this business. (*Id.*).

3. Protocols Utilized in PRTB from the 1980s-2018 To Determine Whether Annuitants Were Alive Were the Same Protocols Prohibited Under the 2012 RSA

The PRTB functions essentially as follows: (i) MetLife accepts transfer of annuity benefit obligations from the employer and converts them to GACs; (ii) at the time of the transfer MetLife receives a per-beneficiary payment from the employer to cover annuity payments to the given beneficiary when, or if, such

payment must be made; (3) pension risk transfers creates a liability reserve at the time of the payment, and that reserve liability grows as the obligation to annuitant continues to increase before payments begin, (A54-55); and (4) upon the annuitants' retirement (at age 65 or 70 ½), MetLife must begin making the annuity payments.

Before MetLife pays on a GAC to an annuitant it ascertains whether the annuitant is still alive. Since the 1980s MetLife has used the "two-letter" method. (A55). In the absence of a response to the first letter, MetLife automatically assumed the annuitant had deferred benefits beyond the normal retirement date and therefore did not pay out benefits to the annuitant. MetLife did not request any affirmative notice from group annuitants that they had elected to defer collection of their retirement benefits past the normal retirement date. When the annuitant reached 70½ years, the second letter was sent. If annuitants failed to respond to both the first and second letters, MetLife automatically categorized the retirees as "Presumed Dead" without any follow-up or consulting industry-standard, recognized database of deaths in the United States. (A56-57). After designating the annuitant as "Presumed Dead," MetLife released the reserves pertaining to retiree's benefit amount into net income without confirming that the retiree was in fact dead. (*Id.*). If he/she is dead, MetLife has no obligation to pay the annuitant. By erroneously releasing such reserves, MetLife recorded a boost to current income and decreased

its liabilities and increased its net assets (and earnings), thereby misstating the financial condition of the Company. (*Id.*).

Not only did MetLife use an antiquated contact system, but it refused to use a more sophisticated, readily available database, the DMF. MetLife not only had access to the DMF but was actively using it since the 1980s to ensure that MetLife was not paying PRTB annuitants, after they died. (A67). MetLife, which had written policies and procedures for this practice, conducted these DMF match searches once a month for its other lines of business but ***never*** used the DMF to confirm that missing PRTB annuitants had actually passed away. (*Id.*). At all relevant times, RIS management was using the DMF to ascertain whether PRTB annuitants had died so that they could ***stop*** paying benefits but was not using the DMF to ensure that those annuitants who were presumed dead were ***actually deceased***.

E. THE NYDFS INVESTIGATION AND 2012 RSA WERE UNMISTAKABLE RED FLAGS THAT METLIFE'S PRTB PROTOCOLS AND DATABASES USED TO DESIGNATE ANNUITANTS "PRESUMED DEAD" WAS FLAWED

1. The NYDFS Investigation

NYDFS investigated and eventually levied sanctions against MetLife's life insurance business practice for beneficiary location of life insurance beneficiaries. The Court of Chancery agreed that the life insurance and PRTB were "analogous"

lines of business. (Opinion at 41).[3] On December 5, 2011, the NYDFS issued an Interim Report of the Superintendent pursuant to § 308 of the New York Insurance Law. In relevant part that report said:

> LIFE INSURERS SHOULD REGULARY MATCH life insurance policies against a reliable death list, rather than just waiting for claims to be filed. The technology exists, and ***it is clear that some insurers have been utilizing such death list databases in determining whether to curtail annuity payments***.
>
> *Findings to Date*
>
> BASED ON THE DEPARTMENT'S INVESTIGATION, including responses to the Department's 308 requests, ***it appears that some insurers have utilized the SSA-DMF to stop annuity payments once a contract holder dies, but have not used the SSA-DMF to determine if any death benefit payments are due under life insurance policies, annuity contracts, or retained asset accounts.***

(A59-60).

When, as required by NYDFS, MetLife matched its administrative records to the DMF, MetLife "discovered" $112 million in unpaid benefits on the Company's books that were owed to annuitants, beneficiaries, or state unclaimed property divisions. (A61).

[3] "Opinion" refers to the Court of Chancery's Memorandum Opinion, dated August 17, 2020, attached hereto as Exhibit 1.

The report also confirmed that insurers, including MetLife, not only had access to the DMF but was actively using it since the 1980s to ensure that MetLife was not paying benefits to person who had died. (A59-60). NYDFS officers specifically stated: "What used to be standard protocol is no longer sufficient." (Opinion at 28). But for PRTB, MetLife instead continued its use of its "Presumed Dead" designation after its "two-letter" method with annuitants to justify releasing reserves into income.

2. The Multi-State Insurance Commissioners Investigation and the RSA

In mid-2008, the California Insurance Commissioner's office began auditing insurance companies to investigate compliance with California unclaimed property laws. This regulatory investigation expanded to include twenty one other states and resulted in several high-ranking MetLife officers being deposed at two investigative hearings on topics including life insurance ***and*** individual and group annuities: (1) on May 19, 2011 before the Florida Insurance Commissioner; (A63-64) and (2) on May 23, 2011 before the California Insurance Commissioner (*id.*). Senior officers appeared for MetLife at the investigative hearings. (*Id.*).

These investigative hearings into MetLife's life insurance practices concerning unpaid death benefits put the Company on notice that it had systemic problems with the monitoring of annuitants and beneficiaries, and timely payment of benefits to those so entitled, which the Board could easily understand also affected

MetLife's PRTB and ultimately culminated in 2012 by way of a global settlement with the insurance regulators from twenty-two states. The RSA, executed by Paul G. Cellupica, then-Chief Counsel for the Americas, on behalf on MetLife on or about April 19, 2012, states that the various state insurance regulators uncovered issues with "[t]he adequacy of the Company's policies and procedures to ensure that life insurance and endowment policies, ***annuities***, 'Retained Asset Accounts'…and other funds are either timely paid out to 'Beneficiaries'…, or timely reported or remitted in accordance with the 'Unclaimed Property Laws' and the 'Insurance Laws.'" (A68). This RSA was required, under the AC Charter, to be disclosed and discussed by General Counsel with the AC. (A69).

The regulators concluded that when MetLife was aware of policyholders who passed away, it often failed to make payments to beneficiaries. (A69-71). And when benefits went unclaimed after several years, MetLife did not forward the funds to the state controller officers as required by law. (*Id.*).

To resolve these allegations, in 2012 MetLife agreed to pay $438 million over the span of 17 years and pay an additional $40 million for the costs of the investigation by the various states. (A71-72). In addition, MetLife agreed, and the RSA required MetLife to implement, the following reforms:

- Adopt business reforms strengthening efforts to locate policyholders and beneficiaries within 120 days of an insured's death;
- Conduct quarterly matches for a year, and then monthly matches against the SSA-DMF to check for evidence that a person insured by MetLife may have died. If a match is found, the Company will conduct a "thorough search" for the insured or beneficiaries using databases, mail, telephone calls and email (if available); and
- If, within one year, an insured or beneficiary cannot be found, MetLife will report and pay the death benefit or annuity payment to the appropriate unclaimed property department.

(*Id.*).

MetLife's agreement to conduct a "thorough search" as part of the 2012 RSA meant that the Company was required to employ enhanced methods such as certified mail, electronic mail, the telephone, and use of DMF, and other online databases to identify and contact annuitants. (A72-73).

The RSA (which almost certainly required board approval) however had a very specific carve-out for PRTB. MetLife ***specifically negotiated*** with regulators to exclude PRTB from the 2012 RSA. (A73-74). MetLife's purposeful carving out

of the PRTB is confirmed by the officers' testimony wherein two senior officers clarified that "[g]enerally in a similar way, we talked about using it in the annuity business." (A390). During those hearings, the officers drew subtle distinctions between the practices in each unit (A468) and, in fact, carried over the use of the same deficient beneficiary location processes from life insurance to PRTB that ultimately lead to the RSA (A643). As the court below acknowledged, PRTB and life insurance are "analogous lines of business within MetLife." (Opinion at 41). It is highly likely that such exclusion was specifically approved by MetLife's then-Board. Instead, they let MetLife continue on its practice for risk transfer annuitants the very same two letter practice the RSA was designed to remediate.

At the time of the 2012 RSA, Defendants Kandarian, Grisé, Hubbard, Kilts, Kinney, Price, Kelly, Jr., Sicchitano, Wang, and Keane were members of MetLife's Board. (A474-79). Defendants Gutierrez and Kennard joined the Board shortly thereafter in 2013, followed by Morrison in 2014. (*Id.*) Of the foregoing, Grisé, Hubbard, Guttierez, Kennard, Kilts, Kinney and Morrison were members of the Demand Board. The 2012 RSA with twenty-two state insurance departments put the Directors on notice MetLife's annuitant location protocols in PRTB were as deficient as the protocols prohibited by the RSA in the life insurance business. Defendants took no additional steps to cause MetLife to locate and contact beneficiaries after MetLife's two letters were returned as undeliverable. The

corporate reforms undertaken by the Company pursuant to the RSA also demonstrate that MetLife understood how to address this problem through business policies and procedures. Instead, the Defendants allowed management to continue categorizing these beneficiaries as "Presumed Dead" despite being specifically admonished for near identical deficient, obsolete procedures in an analogous line of business.

In addition, the AC was alerted to the material weaknesses and significant deficiencies in the RIS line of business in connection with the RSA. However, as demonstrated by the meeting minutes, the AC consciously and in bad faith disregarded its duties to obtain "[r]egular updates from management, the internal auditor and the independent auditor regarding status of any remediation plans for any material weaknesses and significant deficiencies in the design and operation of internal control over financial reporting" as required by their charter for nearly 15 months after being put on notice of these material weaknesses. (A83).

3. <u>The Auditor's Report</u>

In addition, the AC received an internal report detailing the material deficiencies. On September 26, 2016, the AC (including Defendants Sicchitano, Grisé, Kinney, Kelly, Jr., and Kelly, III) was presented with the Auditor's Report" by the Chief Auditor. (A80). The Auditor's Report noted that MetLife's Internal Audit department "reviewed the design and operating effectiveness of controls … for the period January 2015 through December 2015. The review included case

implementation, updating and tracking of participant requests, disbursement process, manual controls over ACE administrative feeds to reserves and general ledger, and management oversight & reporting." (A526).

Throughout that Report, the AC was informed, among other things, that "***control weaknesses*** were identified over several areas," and that ***[o]pportunities exist to enhance existing controls***."(A526).

The Auditor's Report set a December 31, 2016 target date to address the problem, but that date passed, and the AC never took any action. Rather than pursue the red flag to determine the scope of the weakness, Plaintiffs' review of documents indicates that the AC did not subsequently follow up to ensure that the control weaknesses identified in the 2016 Auditor's Report were, in fact, remedied. (A82-83). The AC met twelve times in 2016 and twelve times in 2017 yet, based on the minutes produced in response to the 220 Demands, the AC never received a report by the target date (or any other date) and took no further action regarding the identified deficiency. (*Id.*).

F. METLIFE HAS SUSTAINED LOSS AND DAMAGE AS A RESULT OF FIDUCIARY BREACHES

MetLife has been, and will continue to be, severely damaged by the Defendants' misconduct. On or about January 28, 2019, MetLife entered into a settlement with the NYDFS to resolve allegations relating to the conduct described herein. The settlement requires MetLife to pay a $19.75 million fine to the state and

$189 million in restitution to affected retirees. MetLife entered into a similar agreement with the Massachusetts Securities Division in December 2018, agreeing to pay a fine of $1 million and provide back pension payments, with interest, to Massachusetts retirees and beneficiaries who are owed the benefits. The annuity scandal also harmed the Company's reputation and culture.

G. STAGE OF THE PROCEEDINGS

After MetLife's announcement it would need to increase reserves for PRTB liabilities as a result of deficient and unlawful practices, Plaintiffs demanded and received books and records from MetLife pursuant to 8 *Del. C.* § 220. Plaintiffs filed separate complaints in June and August 2019 that were consolidated into the instant action on August 16, 2019. Plaintiffs filed the Consolidated Complaint on September 9, 2019 asserting claims for breach of fiduciary duties, unjust enrichment and waste.

On October 11, 2019, Defendants filed their Motion to Dismiss which was fully briefed and argued before the Court of Chancery on May 5, 2020. The parties provided supplemental submissions on May 11 and 13, 2020. Vice Chancellor Glasscock granted Defendants motion to dismiss in a Memorandum Opinion on August 17, 2020. The Memorandum Opinion held Plaintiffs failed to adequately allege demand futility under Rule 23.1. The Court of Chancery did not consider Defendants' request for dismissal under Rule12(b)(6). The instant appeal followed.

ARGUMENT

I. THE REGULATORY ACTION AND RSA ARE RED FLAGS THAT INDICATE METLIFE WAS ENGAGED IN VIOLATIONS OF POSITIVE LAW

A. Question Presented

Whether Plaintiffs carried their burden to establish demand futility under *Caremark* by demonstrating that the Board was aware of and disregarded red flags. (Preserved at A610, 36:10-20; A613, 39:5-21; A614-15.)

B. Scope of Review and Legal Standard

The Court's review of the decision on a motion to dismiss under Chancery Court Rule 23.1 for failure to plead demand futility is *de novo*. *Marchand v. Barnhill*, 212 A.3d 805, 808 (Del. 2019). The Court must accept all well-pleaded allegations as true and draw all reasonable inferences in Plaintiffs' favor. *Sandys v. Pincus*, 152 A.3d 124, 126-28 (Del. 2016).

A plaintiff may demonstrate demand futility by pleading "particularized facts creating a reasonable doubt that a majority of the board would be disinterested or independent in making a decision on a demand." *Rales v. Blasband*, 634 A.2d 927, 930 (Del. 1993).[4] The pleading burden under Rule 23.1 can be met without actual evidence of director interest or other disabling factor, nor must plaintiffs demonstrate

[4] All parties agreed that *Rales* is the appropriate standard here.

a reasonable probability of success on the merits. *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988); *Rales*, 634 A.2d at 934. "The complaint needs only to make a 'threshold showing, through the allegations of particularized facts, that their claims have some merit.'" *Louisiana Mun. Police Empl.'s Ret. Sys. v. Pyott*, 46 A.3d 313, 340 (Del. Ch. 2012) (quoting *Rales*, 634 A.2d at 934-35). The *Rales* particularity standard is balanced against the "mandate that the court draw all reasonable inferences in the plaintiffs' favor." *In re Clovis Oncology, Inc. Deriv. Litig.*, 2019 WL 4850188, at *11 (Del. Ch.).

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

MetLife unquestionably operates in a regulated industry as evidenced by the regulatory action surrounding the Company dating back to 2011 that culminated in the 2012 RSA. (A26-28). Compliance with applicable laws and regulations is to be overseen by the Board, as provided for in the Company's Code of Conduct, the Director's Code, the Financial Code of Conduct and Delaware law. (A47-49; A61; A107; A109). *See Clovis*, 2019 WL 4850188, at *12; *In re Caremark Int'l. Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996). Failure to do so inevitably leads to substantial harm to the public, the company and its stockholders.

1. The Regulatory Action and RSA Constitute Red Flags that Put the Board on Notice MetLife Was Violating Positive Law

Regulatory subpoenas, investigations, lawsuits and settlements or consent orders can constitute red flags, regardless of whether the company admits to or is found liable for the alleged illegal conduct. *See, e.g., Rojas on behalf of J.C. Penney Co., Inc. v. Ellison*, 2019 WL 3408812, at *11 (Del. Ch.); *In re Chemed Corp. S'holder Derv. Litig.*, 2019 WL 3215852, at *21 (D. Del.). The regulatory action and the 2012 RSA were red flags that indicate the Board was failing in their oversight of MetLife's compliance with positive law—and that the two-letter system being used to identify PRTB annuitants was antiquated, unreliable, and lead to materially erroneous financial results. *See Oklahoma Firefighters Pension & Ret. Sys. v. Corbat*, 2017 WL 6452240, at *16 (Del. Ch.) (acknowledging that "the Complaint standing alone does give the impression of a board that sat on its hands in the face of clear warnings about potentially unlawful conduct" including several consent orders concerning antimony laundering regulations); *see also Chemed Corp*, 2019 WL 3215852, at *21 (finding that "the Board was aware of enough 'red flags' to sufficiently to put them on notice of corporate misconduct" where the company was subject to regulatory subpoenas, investigations and enforcement lawsuits).

Having failed to take any action in response to these red flags, MetLife was ultimately found to have violated positive law for its PRTB practices based on its use of a virtually identical, and identically flawed, two-letter system for locating

PRTB annuitants, resulting in hefty fines and a $500 million increase in the Company's reserves. (A26-30; *see also* A133-58).

The court below erred in holding that the RSA was not a red flag because MetLife denied the allegations set forth by the regulators. (Opinion at 45). The boilerplate denial of those allegations however, did not negate the recitals in the RSA where the regulators identified concerns with MetLife's practices for paying or reporting and remitting benefits "in accordance with the 'Unclaimed Property Laws' and the 'Insurance Laws'" of the signatory states. (A160). Those laws were later defined, respectively, as "the Laws, Rules and Regulations regulating unclaimed property in each of the Signatory States" and the "Insurance Laws, Rules and Regulations in effect in each of the Signatory States." (A166; A163). Accordingly, and contrary to the holding of the court below, the RSA ***did*** denote violations of positive law and provided for monitoring to ensure ongoing compliance with those defined laws. (*See* Opinion at 45; *see also* A160-72).

Boards of Delaware corporations ***must*** ensure that a reporting system is in place and then monitor it. *Marchand*, 212 A.3d at 824; *Clovis*, 2019 WL 4850188, at *13. "[A]s fiduciaries, corporate managers must be informed of, and oversee compliance with, the regulatory environments in which their businesses operate. In this regard, as relates to *Caremark* liability, it is appropriate to distinguish the board's oversight of the company's *management of business risk* that is inherent in

its business plan from the board's oversight of the company's *compliance with positive law*—including regulatory mandates." *Id.* at *12 (emphasis in original).

The court in *Clovis* pointed to the importance of compliance monitoring "when the company operates in the midst of obligations imposed upon it by positive law yet fails to implement compliance systems, ***or fails to monitor existing compliance systems***, such that a violation of law, and resulting liability, occurs." *Id.*

As this Court recently affirmed in *Marchand*, "[t]he mundane reality that [a company] is in a highly regulated industry and complied with some of the applicable regulations does not foreclose any pleading-stage inference that the directors' lack of attentiveness rose to the level of bad faith indifference required to state a *Caremark* claim." 212 A.3d at 823. In *Marchand*, the company "had in place certain manuals for employees regarding safety practices and commissioned audits from time to time" and the "government regularly inspected Blue Bell's facilities, and Blue Bell management got the results." *Id.* The company argued that such measures together with the board's periodic discussion with management about "operational issues" satisfied its oversight duties; an argument the Court rejected noting that if such a paradigm were to stand "then *Caremark* would be a chimera. At every board meeting of any company, it is likely that management will touch on some operational issue." *Id.* at 824. A board must do more when it comes to a Delaware corporation's compliance with positive law and must actively monitor the company's efforts to

comply, particularly when regulatory activity surrounding the company indicates it may be engaged in violating those laws. *See id.* at 823; *Clovis*, 2019 WL 4850188, at *13.

Here, the Court of Chancery reasoned that "[n]othing in the investigations or the RSA put ***those who became aware of them*** on direct notice of deficiencies in the [PRTB] and its tracking of annuitants. That business was an old line at MetLife, and the two-letter notice system had been in place for years." (Opinion at 41). Under Delaware law, it cannot follow that simply because PRTB were "an old line," that the regulatory action and RSA were insufficient to constitute red flags that MetLife's RIS-wide annuitant location practices were inadequate and unlawful. *See Marchand*, 212 A.3d at 823; *Clovis*, 2019 WL 4850188, at *12. Given the obvious regulatory environment in which the RIS unit operated, the Board had a heightened duty to ensure that adequate compliance reporting systems were in place and that the Board was actually monitoring them. *See id.* Here, it was a similar two-letter system deemed ineffective under the RSA in one RIS unit that lead to further regulatory sanctions in an analogous RIS unit. (*See* A71-73; A164-65; A86-87). Thus, the fact that it was "in place for years" should give rise to inferences in Plaintiffs' favor.

As the court's opinion below makes clear, the Board was not actively monitoring compliance practices in PRTB and permitted the ***same*** deficient and unlawful location practices to perpetrate in that analogous line of business. (*See*

Opinion at 43 ("'the 220 Documents, including Board minutes, are silent about whether these regulatory actions 'reached the Board's attention'")). As in *Marchand*, while MetLife was complying with some regulations imposed upon it by the RSA, it was putting its head in the sand when it came to ensuring that regulatory compliance was being meted out across analogous lines of business in the RIS unit. *Marchand*, 212 A.3d at 823. The court below failed to draw the reasonable inference that the Board's failure to update a deficient "system [that] had been in place for years" was a fiduciary breach rather than merely "unwise or imprudent management." (Opinion at 41). In the same breath, the court below noted, "[a]s the Plaintiffs point out, the Superintendent of the NYDFS stated that use of the tools at hand was important in light of enhanced technology and increased residential mobility on the part of pensioners: 'What used to be standard protocol for finding retirees who are owed benefits is no longer sufficient.'" *Id.* at 42. What the court described as mere unwise and imprudent management is the exact conduct that rendered demand futile in *Marchand* where a board turned a blind eye to regulatory red flags that indicate liability creating violations of positive law. 212 A.3d at 822.

2. The Board Consciously Disregarded the Regulatory Red Flags, Which Amounts to Bad Faith

The Board's failure to act in the face of the red flags amounts to bad faith. In fact, the court below just days after issuing the Opinion held that board actions "inimical to the corporate interest" would include "***ignoring a known duty to act to***

prevent the corporation from violating positive law." *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065, at *1 (Del. Ch.) (hereinafter "*AmerisourceBergen*"). MetLife's Board, which "operates in the midst of obligations imposed upon it by positive law" failed "to monitor existing compliance systems such that a violation of law and resulting liability occur[ed]." *In re Facebook Sec. 220 Litig.*, 2019 WL 2320842, at *14 (Del. Ch.).

The court below acknowledged a director must have her "gaze […] fixed on the company's mission critical regulatory issues.'" (Opinion at 38-39 (quoting *Clovis*, 2019 WL 4850188, at *13)). The same court recognized one week later in *AmerisourceBergen* that "when regulations governing [a core product] are at issue, [the] Board must ***actively*** exercise its oversight duties in order to properly discharge its duties in good faith." *AmerisourceBergen*, 2020 WL 5028065, at *18. The court noted that simply because AmerisourceBergen was a "complex corporation … does not mean the concept of mission critical compliance risk is inapplicable…." *Id.* Moreover, the court held that, at the pleading stage, "the Plaintiff is entitled to the inference that the Board never discussed the subpoena due to its absence from the Board's minutes" and that "[was] sufficient to make reasonable the inference … [that] even after receiving the subpoena the Board did nothing to correct the underlying mission critical compliance shortcomings…." *Id.* at *24; *see also In re China Agritech, Inc. S'holder Derivative Litig.*, 2013 WL 2181514, at *20 (Del. Ch.)

(at the pleading stage, a plaintiff is entitled to a reasonable inference from "the *absence* of books and records that the Company could be expected to produce" that such documents do not exist); *In re Tyson Foods, Inc.*, 919 A.2d 563, 578 (Del. Ch. 2007) ("it is more reasonable to infer that exculpatory documents would be provided [in response to a Section 220 demand] than to believe the opposite: that such documents existed and yet were inexplicably withheld").

When publicized regulatory red flags arise yet the board holds no discussion of those regulatory matters, the board's gaze cannot be fixed on the company's regulatory issues. If the board minutes are silent, then it can be inferred that the board did not discuss the absent issues. *See AmerisourceBergen*, 2020 WL 5028065, at *23-24. This is the same obliviousness the Court addressed in *Marchand* when it found that "[b]oard meeting minutes … reflect no board-level discussion" of the relevant issues. *Marchand*, 212 A.3d at 812. "[A]n inference that a board has undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation, then that supports an inference that the board has not made the good faith effort that *Caremark* requires." *Id.* at 822.

The court below reasoned that it could not "infer that knowledge of [the regulatory action and RSA] was presented to the Director Defendants themselves." (Opinion at 43). To deprive plaintiffs of this logical inference overlooks a core principle of red flags—that when displayed, red flags are observed by those who are

charged with overseeing a company's regulatory compliance. *Clovis*, 2019 WL 4850188, at *13. This is particularly true of a highly regulated company like Clovis Oncology, Inc. and MetLife. Here, those observers simply disregarded the regulatory action and the RSA, which were matters of public record,[5] and never once discussed them. (Opinion at 42). Appellants were entitled to the inference that the Board did not discuss the regulatory action and RSA by the complete omission of those issues from the 220 Documents they received. *See AmerisourceBergen*, 2020 WL 5028065, at *24; *Marchand*, 212 A.3d at 812; *China Agritech*, 2013 WL 2181514, at *20. This is further support by the Court of Chancery's finding that at least four Board members had actual knowledge of the RSA through their status as defendants in the federal class action in the Southern District of New York. (Opinion at 45). That class action was commenced on May 15, 2012, yet still there was no discussion of the RSA even ***after*** four Board members had knowledge of it. It cannot be that the Board was permitted to ignore its duties to monitor whatever regulatory compliance system was in place simply because widely publicized regulatory red

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[5] A December 15, 2017 WSJ article specifically noted: "In 2012, MetLife agreed to pay $40 million to settle a multistate probe of its handling of death benefits, in a deal that was expected to pay more than $400 million to heirs of life-insurance policyholders." (A90-91). On the date of the settlement, April 23, 2012. MetLife issued a press release on that date announcing the RSA. *See* https://www.metlife.com/about-us/newsroom/2012/april/metlife-resolves-multi-state-examinations/. The RSA was disclosed in Company 10-Ks signed by the Defendants. The Court may take judicial notice of these facts. D.R.E 202.

flags were never included on the meeting agendas. Ultimately, that conscious failure to address the regulatory red flags resulted in findings that MetLife had violated positive law in New York and Massachusetts and the Company incurred hundreds of millions of dollars in civil penalties and restitution as a result. (A133-58).

The regulatory and litigation red flags in this case are very similar to those in *AmerisourceBergen* (decided by the same member of the court one week later) and *Marchand*. Yet inferences were drawn in favor of the plaintiffs in those cases to excuse demand that were not drawn here. The only apparent difference is that director inaction in those cases led to loss of life and limb, whereas in this case the injury to consumers was purely financial. Nothing in *Caremark* or its progeny supports such a distinction for purposes of excusing demand and determining the liability of directors.

II. PLAINTIFFS ADEQUATELY ALLEGED THAT RED FLAGS WERE WAIVED BEFORE THE AUDIT COMMITTEE, WHICH WAS OBLIGATED TO ALERT THE FULL BOARD

A. Question Presented

Whether Plaintiffs carried their burden to establish demand futility under *Caremark* by demonstrating that members of the AC consciously disregarded red flags. (Preserved at A640-42; A619-622; Opinion at 31-37.)

B. Scope of Review and Legal Standard

The scope of review and legal standard articulated for the first argument equally apply here.

C. Merits of Argument

"A judge in the *Caremark* context must be careful to remember the issues before her. At issue is *not* whether specific or society-wide victims may themselves receive a remedy for corporate misconduct…." rather "it is the corporation, not that corporation's victims, to whom any recovery will flow." *AmerisourceBergen*, 2020 WL 5028065, at *1.

1. The Auditor's Report Alerted the Audit Committee to Violations of Law in Time to Act

On September 26, 2016, the Auditor's Report was presented to the AC. (A81). The Auditor's Report is an archetypal red flag. It was reviewed in September

2016 by the three of the twelve members of the Demand Board serving on the AC at the time, and alerted them to the existence of the control weaknesses that gave rise to this action. Specifically, the Auditor's Report informed the AC that:

> [C]ontrol weaknesses were identified over several areas, including contract accuracy, manual certificate mailings, and retirement letter mailings (e.g. age 65 and 70.5). Opportunities exist to enhance existing controls to ensure timely processing of held and suspended payments as well as retirements. Additionally, management should enhance procedures to clearly identify when transaction processing for a contract transfers to the Closeout Administration team.

(A526).

Standing alone, the Auditor's Report was sufficient to place the AC on notice that MetLife was violating applicable positive law and insurance regulations for failing to locate and pay a significant number of beneficiaries. MetLife manages nearly $38 billion of transferred pension liabilities, underscoring the need for the AC to act promptly to remedy control weaknesses in this segment which "is a core element of MetLife's business and has been for over 90 years . . . MetLife has a 45% market share and is a leading pension risk transfer provider." (A53). MetLife has engaged in the PRTB for nearly 100 years and managed to avoid paying a substantial number of annuitants by failing to modernize its policies and procedures for contacting and identifying beneficiaries. (*Id*.). Ultimately, in violation of applicable insurance and banking laws, MetLife failed to pay over $500 million that it was obligated to provide to annuitants upon reaching retirement age. (A91-94).

Past experience of MetLife made it obvious that there was urgent need for the AC to remediate the control weaknesses identified by the Auditor's Report. Past was prologue: the RSA involved substantially the same misconduct identified in the Auditor's Report. (A71-72). The RSA accused MetLife of violating positive law by selectively failing to use the DMF in its administration of annuities to avoid making required payments. The regulators concluded that when MetLife was aware of policyholders who passed away, it often failed to make payments and did not forward unclaimed funds to the state officers as required by law, resulting in violations of several states insurance and banking laws. (A26-27). Delaware law recognizes that subsequent red flags are particularly consequential where directors have knowledge of earlier red flags regarding similar material weaknesses. *AmerisourceBergen*, 2020 WL 5028065, at *20 ("the Davis Polk Report is the basis for the Plaintiffs' allegations that the Board was on notice of gaps in Specialty's compliance, making the later red flags all the more consequential"). Here, by virtue of the RSA, the members of the AC (four of whom were on the Board at the time of the RSA (Opinion at 18)) were already on notice that MetLife could not solely rely on antiquated annuitant location techniques like the two-letter system, and could not selectively use (or decline to use) readily-available technology such as the DMF to avoid paying beneficiaries.

The members of the AC were likewise aware of numerous other red flags that predated the Auditor's Report. On December 5, 2011, MetLife's primary government regulator, the NYDFS, issued an advisory concluding that insurers including MetLife had retained money they knew or had reason to know should have been distributed to beneficiaries dating back as far as 1970. (A59-60). Indeed, MetLife has retained $112 million in such unpaid benefits. (A61). The NYDFS advisory counseled "***all*** insurers that a cross-check of ***all*** life insurance policies, ***annuity contracts, and retained asset accounts*** … should be performed with the ***latest updated version of the [DMF]***." (A59-60). Thus, the members of the AC, which is charged with ensuring that MetLife complies with NYDFS guidance across all of its insurance, annuity and retained asset accounts, was on notice that the two letter notification system was antiquated and not in compliance with applicable laws and regulation. (A62-63). The Court of Chancery, in fact, acknowledged this when it noted the NYDFS's position on the matter: "'What used to be standard protocol for finding retirees who are owed benefits is no longer sufficient.'" (Opinion at 42).

The Auditor's Report called for remediation of the control weaknesses regarding the identification of beneficiaries by the end of 2016. (A526). However, management never engaged in any of the required remediation. (A80-83). The books and records produced to Plaintiffs indicate that the AC never raised the Auditor's Report at any subsequent committee meetings despite the AC Charter's

mandate that the AC receive "[r]egular updates from management, the internal auditor and the independent auditor regarding status of any remediation plans for any material weaknesses…" (A40).

The AC was also obligated to inform the full Board of the control weaknesses in the Auditor's Report under the AC Charter. (A82-83). While the AC members regularly attended meetings of the full Board and provided reports, there is no evidence in the Board-level documents produced to Plaintiffs that the AC reported the control weakness findings to the full Board, as they were required to do. (A82-83).

The Court of Chancery acknowledged that the Auditor's Report was a timely red flag. (Opinion at 49). The decision below also found that, had Defendants not ignored the red flag, the Company would have avoided significant harm. "The question before me is not whether the Director Defendants could have saved the Company from embarrassment, fines and securities litigation ***had the Board been informed of weaknesses at the time of the Internal Auditors' Report, and taken prompt action***. I can infer that those things would have happened." (*Id.*). As described herein, Company management, faced with the urgent control weakness and a short timetable for remediation, did nothing.

Although a majority of the Demand Board served as of the date of the Auditor's Report, the Court of Chancery did not credit this finding as a red flag to

the entire Board because "only three members of the Demand Board were present at delivery of the Internal Auditor's Report…" (Opinion at 50). Thus, the court, contrary to drawing permissible inferences in Plaintiffs' favor, ***concluded*** that only three Board members knew about the Auditor's Report. Plaintiffs' books and records investigation did not uncover documentation irrefutably demonstrating that the Auditor's Report was (or was not) discussed with the full Board. (*Id.*, n.228 ("Only three members of the Demand Board were present at the delivery of the Internal Auditor's Report to the [AC], and so even to the extent that presentation of the Report implied a duty to act, ***failure to comply would taint only a minority of the Demand Board***")). At the pleading stage, having demonstrated that the AC was on notice of red flags that it was obligated to share with the full Board, Plaintiffs are entitled to the reasonable inference that the AC had, in fact, disclosed the red flag to the entire Board, regardless of whether or not that fact was documented in Board minutes. *See, e.g., Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Tr. Fund IBEW*, 95 A.3d 1264, 1273 (Del. 2014) (discussing the "reasonable inference" that individuals with a reporting obligation "passed the information on" to directors); *see also AmerisourceBergen*, 2020 WL 5028065, at *24; *China Agritech*, 2013 WL 2181514, at *20. Plaintiffs demonstrated that the AC members had the obligation to alert the Board to the control weaknesses, and that they actually met with the

Board at regular meetings. At the pleading stage, that is all Plaintiffs are required to show.[6]

A Board cannot escape *Caremark* liability on the basis that an audit committee buried its head in the sand and failed in its affirmative obligations to act on red flags and to alert the Board as a whole to the existence of the red flags. *See Wal-Mart Stores*, 95 A.3d at 1273; *AmerisourceBergen*, 2020 WL 5028065, at *24. This is especially critical when an AC is entrusted by the Board to oversee management and auditors to identify and remediate control weaknesses. (A39-40). Under those facts, demand on the Board is excused under *Caremark.*

2. The Complaint Pleads Facts Supporting the Reasonable Inference that the Board was Apprised of the Auditor's Report

Plaintiffs are entitled to an inference that the full Board was apprised of the control weaknesses identified by the Auditor's Report. The AC received the report in September 2016. The AC was obligated under its charter to make regular reports to the Board. (*See* A640, n.3 ("The [AC] shall meet at least six times each year and shall make regular reports to the Board about the Committee's activities.")).

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[6] In a colloquy at oral argument, the court below stated, in pertinent part, "I was actually thinking that inference was in favor of the plaintiffs' case; that if there was a deficiency reported to the audit committee and it was important to the plaintiffs' case that I be able to infer that that was communicated to the board, that I could do so." (A620).

Accordingly, Plaintiffs are entitled to the pleading-stage inference that the AC's "regular reports" apprised the full Board of the control weaknesses. *Brehm v. Eisner*, 746 A.2d 244, 255 (Del. 2000) ("Plaintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged"). The Court of Chancery erred by disregarding the Auditor's Report as a red flag. *In re Abbott Labs. Deriv. S'holders Litig.*, 325 F.3d 795, 806 (7th Cir. 2003) ("Where there is a corporate governance structure in place, we must then assume the corporate governance procedures were followed and that the board knew of the problems and decided no action was required") (applying Delaware law). In *Saito v. McCall*, former Chancellor Chandler similarly held a "reasonable inference, which the Court is entitled to draw at this procedural stage, is that that information was communicated to the other … board members…." 2004 WL 3029876, at *7 n.68 (Del. Ch.) (rejecting argument that "even if HBOC's audit committee knew of accounting irregularities such knowledge could not be imputed to the McKesson HBOC board").

For the Court to hold otherwise rewards audit committees for their failure to make required "regular reports" to the full board (or, alternatively, to encourage boards not to document such reports in detail when they do occur). Here, Plaintiffs are entitled to a similar inference that AC members complied with their obligations

and informed other directors of the control weaknesses at MetLife. *See id.*; *see also Wal-Mart Stores*, 95 A.3d at 1273; *AmerisourceBergen*, 2020 WL 5028065, at *24.

Such an inference also recognizes the real-world limitations of books and records productions. Plaintiffs have demonstrated that the AC was aware of red flags, was obligated to report the red flags to the entire Board, was obligated to make "regular reports" to the Board, and that the AC and Board met regularly. (A82-83). Even if it was not well-documented in the minutes, Plaintiffs are entitled to the inference that the AC's "regular reports" apprised the full Board of the control weaknesses. *See China Agritech*, 2013 WL 2181514, at *20. At the pleading stage, a defendant should not be permitted to seize upon the absence of information in summary, high-level board minutes to defeat a plaintiffs' reasonable and logical inference regarding board knowledge.

Indeed, with knowledge they were abrogating their duty to comply with positive law, Defendants stood by and allowed management to fail to pay hundreds of millions of dollars to beneficiaries that management could have readily identified by available means. (A109). In doing so, Defendants inflated the Company's earnings and exposed MetLife to hundreds of millions of dollars in fines and restitution. (A24). They should not be permitted to avoid liability by burying their collective heads in the sand in the face of compelling red flags.

3. Alternatively, Demand is Excused if the Audit Committee <u>failed to Report Red Flags to the Full Board</u>

If the AC indeed failed to follow its mandate to report the Auditor's Report to the full Board, then Plaintiffs' claims should be allowed to proceed under prong I of *Caremark*.

In light of the indispensable oversight role played by an audit committee, Delaware law has long recognized that a plaintiff states a claim under *Caremark* where an audit committee consciously disregards red flags. *See, e.g., David B. Shaev Profit Sharing Account v. Armstrong*, 2006 WL 391931, at *5 (Del. Ch.); *Guttman v. Huang*, 823 A.2d 492, 506-07 (Del. Ch. 2003) (a complaint states a *Caremark* claim when it alleges "that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation"); *see also Hughes v. Xiaoming Hu*, 2020 WL 1987029, at *14 (Del. Ch.) ("[a] plaintiff can state a *Caremark* claim by alleging…that the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation…") A plaintiff states a claim under *Caremark* where an audit committee consciously disregards red flags that they are obligated to report to the full board, even when, as here, the committee members constitute a minority of the demand board.

As this Court recently held, a director must make a "good faith effort to oversee the company's operations" and "monitor the corporation's operational viability, legal compliance, and financial performance." *Marchand*, 212 A.3d at 809. That the Company has committees and policies in place is of no moment if the board fails to monitor and prevent violations of positive law. Simply having an operating audit committee does not shield defendants from a breach of duty of loyalty claim. *See Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong*, 66 A.3d 963, 971-72 (Del. Ch. 2013) (denying motion to dismiss even though company had an audit committee that investigated transfer of cash out of the company to shadowy third parties).

In reversing the Court of Chancery's dismissal of plaintiff's claims in *Marchand*, this Court stated that directors have a duty "to exercise oversight and to monitor the corporation's operational viability, legal compliance, and financial performance," and the "dearth of any board-level effort at monitoring" during a period in which red flags were present supports "a reasonable inference that the directors consciously failed to attempt to assure a reasonable information and reporting system exist[ed]." *Marchand,* 212 A.3d at 809. Here, as in *Marchand*, the lack of internal controls is clearly articulated by the particular allegations of the Complaint, as evidenced by the apparent failure of the AC to investigate or inform the full Board regarding the red flags identified by the Auditor's Report. (*See* A29-30; A80-85).

Plaintiffs' books and records production appears to confirm that the AC took no action in response to the Auditor's Report. The AC documents reflect only a single committee meeting in September 2016 in which the control weaknesses surrounding the two-letter policy were discussed. (A82-83). However, just as in *Marchand*, where the production was "devoid of any suggestion that there was any regular discussion of" the critical issue, 212 A.3d at 822, the documents here show no regular discussion of MetLife's control weaknesses regarding the identification and payment of beneficiaries. What little discussion occurred indicates the AC failed in its oversight duties, just as occurred in *Marchand*. *Id.* AC documents show that the AC was aware of the material control weaknesses but did not take any actions in response. (*See* A526; *see also* A80-85). This evidences precisely the type of breakdown proscribed by *Marchand*. *Id.*

The silence in the Board materials evidences the fact that the AC failed in its obligation to inform the Board. (Opinion at 43). Thus, there is "a reasonable inference that the members of the AC acted in bad faith in the sense that they consciously disregarded their duties." *China Agritech,* 2013 WL 2181514, at *20.[7]

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[7] Allowing such decision to stand, audit committees of Delaware corporations will be on notice that the entire board (including the committee members) can skirt *Caremark* liability by (i) ensuring that knowledge red flags do not reach the full board, even in the face of clear board mandates to the contrary; and/or (ii) ensuring that any board-level reporting of red flags is not clearly delineated in board-level

CONCLUSION

For all of the foregoing reasons, the Court should reverse the ruling below.

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materials. Such a holding would render *Caremark* toothless. Rather, Delaware law should compel audit committees to actively monitor their oversight responsibilities and presume that mandatory escalation takes place according to the board and committee's own corporate governance policies.

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CERTIFICATE OF SERVICE

Kurt M. Heyman, Esquire, hereby certifies that on November 18, 2020, copies of the foregoing [Corrected] Opening Brief of Appellants Sandra Lifschitz, Henry Felt, and Diane Felt were served electronically on the following:

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