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IN THE SUPREME COURT OF THE STATE OF DELAWARE

SANDRA LIFSCHITZ, HENRY FELT and DIANE FELT, Plaintiffs Below, Appellant, v. 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, Defendants Below, Appellees and METLIFE, INC., Nominal Defendant Below.	:	C.A. No. 301,2020 **Appeal from the Court of Chancery of the State of Delaware C.A. No. 2019-0452-SG**

REPLY BRIEF OF APPELLANTS
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SUMMARY OF THE ARGUMENT

Despite improperly relying upon facts not in the record, Defendants still cannot demonstrate that the Board[1] complied with their fiduciary duties. Red flags were clearly waived in Defendants' faces but turning a blind eye allowed the Company to retain improperly recorded revenues—supporting unjust salaries and bonuses for the Company's top executives. Seeing no other way out, Defendants now attempt to convince the Court the Board was not aware of a 22-state $500 million dollar regulatory settlement that was disclosed in an SEC filing signed by the Board and in a Company press release (the "RSA"). (A68; A71-72). Knowing their position is untenable, Defendants further argue that the red flags were not precise enough. The red flags showed the Company's two-letter process for identifying whether a claimant was dead or alive was antiquated and illegal—the exact issue here. However, the RSA covered the Company's companion life insurance business—which is in the same business unit as MetLife's Pension Risk Transfer Business ("PRTB") and led by the same executive. That the Company dodged exposure for PRTB in the RSA does not mean that the red flag for the same behavior in the same business unit was insufficient.

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[1] All capitalized terms have the meaning set forth in Appellants' Opening Brief ("OB"). Appellees' Answering Brief will be cited as "AB".

In addition, the Auditor's Report plainly alerted the Audit Committee (the "AC") that there were material deficiencies in the two-letter process. The AC failed to follow up on these deficiencies as promised and either (i) failed to uphold their Charter by failing to report this information to the full Board, or (ii) informed the full Board who similarly did nothing. Defendants attempt to introduce documents that were not provided to Plaintiffs in response to their Section 220 Demands and are not part of the motion to dismiss record below to minimize the relevance of the Auditor's Report must fail.

Plaintiffs' allegations sufficiently allege a *Caremark* claim and the decision below should be overturned.

ARGUMENT

I. DEFENDANTS INCORRECTLY ARTICULATE THE STANDARD ON THIS APPEAL

Plaintiffs have made the required "'threshold showing, through the allegation of particularized facts, that their claims have some merit.' This standard recognizes that the purpose of the particularity requirement is not to prevent derivative actions from going forward, but rather 'to ensure only derivative actions supported by a reasonable factual basis proceed.'" *Hughes v. Xiaoming Hu*, 2020 WL 1987029, at *12 (Del. Ch.) (citations omitted). Further, these particularized allegations do not need to prove actual knowledge—constructive knowledge will establish the "scienter" necessary to raise an inference of bad faith in the *Caremark* demand futility context.[2] "A plaintiff may satisfy its obligation to plead a non-exculpated breach of the directors' duty of loyalty by alleging that the directors 'had "actual or

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[2] The Court of Chancery erroneously rejected Plaintiffs' particularized allegations of "constructive knowledge" because, it said, "this Court has generally rejected constructive knowledge of unlawful conduct as a theory in demand futility cases." (Opinion 43-44 (*citing Hormon v. Abney*, 2017 WL 242571, at *7 (Del Ch.)). *Horman*, however, is a case involving the barest of conclusory allegations that because illegal behavior occurred internal controls must have been deficient and the board must have known. *Id*. at *4-7. Constructive knowledge allegations as set forth in the Complaint in particularized detail are ***not*** categorically rejected by Delaware courts. *See, e.g.*, *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996) ("In order to show that the Caremark directors breached their duty of care by failing adequately to control Caremark's employees, plaintiffs would have to show either (1) that the directors knew or (2) ***should have known*** that violations of law were occurring….") (emphasis added).

constructive knowledge" that their conduct was legally improper.'" *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 125 (Del. Ch. 2009); *see also Caremark*, 698 A.2d at 971. Plaintiffs are entitled to all reasonable inferences that can be drawn from the particularized facts as set forth the in Complaint. *Hughes*, 2020 WL 1987029, at *10.

Moreover, because the filing of the Complaint followed the production of Section 220 documents, Plaintiffs are entitled to infer that if a document that would support Defendants' claim was not produced it does not exist. *Id.* at *2. ("if the Company failed to produce a document that it would reasonably be expected to possess if a particular event had occurred, then the plaintiff is entitled to a reasonable inference that the event did not occur."). A plaintiff can "support[ ] a reasonable pleading-stage inference of a bad faith failure of oversight" where the company fails to produce evidence to the contrary in response to a Section 220 demand. *Id.* at *1.

II. RED FLAGS RENDER DEMAND FUTILE

Plaintiffs amply allege that the majority of the Board faces a substantial likelihood of liability. Despite Defendants' protestations, the red flags provided the Board with notice of wrongdoing.[3] In the alternative, the Board inescapably should have known of the red flags and their implications for the entire Retirement and Income Solutions ("RIS") Unit. (A499, A508, A512). Both theories are avenues to survive a demand futility analysis under Delaware law. *See Citigroup*, 964 A.2d at 125. When faced with red flags the Board turned a blind eye resulting in ongoing violations of positive law by the Company and millions of dollars in financial liabilities.

A. The Regulatory Actions and RSA Were Red Flags

Red flags in the life insurance business clearly indicated to the Board that material deficiencies existed in PRTB. Both the life insurance business and PRTB are part of the same MetLife business unit—RIS—and both ultimately report to the same MetLife executive—the head of US Business. (A50-51; A468). Both make

[3] Defendants urge the Court to adopt a standard requiring "contemporaneous knowledge" and notice of the precise wrongdoing. (*See e.g.*, AB 3, 20, 27-29, 34, 38-39). If adopted, this Court would eviscerate the constructive knowledge avenue of pleading "red flag" demand futility under the second prong of *Caremark* and lead to the pernicious use of the holding to claim that a board's oversight and monitoring duties are narrow and limited. *See Caremark*, 698 A.2d at 971. Delaware law should not permit directors to take a narrow view of a known violation in one business unit that would certainly impact other business units.

payments to beneficiaries based on the life status of the policyholder: the PRTB while the annuitant is still living, and the life insurance business after the policyholder has passed. (A594). Both used a similar "two-letter" system to confirm the respective life status of the policyholder. (*See* A327; A468). The accuracy of determining life status would be improved in both businesses by use of the Social Security Advisor database called "Death Master File" ("DMF"), and in fact, a high-level executive testified during a 2011 regulatory hearing that use of the DMF was being promoted across ***all MetLife businesses***. (A66, A368). Under the circumstances, it is no wonder that the lower court held that the two businesses are "analogous." (Opinion 41).

The regulatory red flags in the life insurance business were sufficient to put the Board on inquiry notice of similar potential wrongdoing in the "analogous" PRTB. Defendants argument that *Caremark* requires the Board to be on notice of the "exact issue" raised by the red flags is meritless. (AB 4, 31). Defendants further make the unconvincing and self-defeating argument that the Board did not have any actual knowledge of the RSA itself. (AB 3, 20).

1. The Regulatory Red Flags Regarding the Life Insurance Business Were Sufficiently Similar to the PRTB Practices

MetLife is a highly regulated entity, particularly its RIS Unit which houses its insurance businesses including PRTB. (A50-51). The Board oversees the entirety of MetLife, including the RIS Unit as a whole and not simply its life insurance business. (A489). That fact does not reduce the Board's fiduciary duties to oversee its regulatory compliance ***across the Company***, and, in fact, heightens them. *In re Clovis Oncology, Inc. Deriv. Litig.*, 2019 WL 4850188, at *12 (Del. Ch.) (increased likelihood of director liability "when the company operates in the midst of obligations imposed upon it by positive law yet fails to … monitor existing compliance systems, such that a violation of law, and resulting liability, occurs"). "At the pleading stage, … [p]laintiffs must allege particularized facts that … (ii) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Id.* (*quoting Marchand v. Barnhill*, 212 A.3d 805, at 821 (Del. 2019)). As the second prong of *Caremark* makes clear, failure of a board to follow through with actual attention and oversight even when systems are in place creates a substantial likelihood of liability because critical compliance information will not reach their attention. *Id.* Boards of Delaware corporations cannot place their heads in the sand when it comes to their oversight of regulatory compliance ***throughout the company***. *See Marchand*, 212 A.3d at 823 ("The 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.") (emphasis added).

There is no safe harbor, as Defendants would have, for boards that implement and oversee reporting systems in one line of business while failing to oversee reporting systems in another "'analogous' line[ ] of business" ***within the same overall unit***. (Opinion 41; A50-51). Defendants provide no case law that states otherwise. That is because such a proposition goes against the gravamen of *Caremark* that simply implementing a reporting system, without actively monitoring it, is insufficient. The court below acknowledged this, stating that "a plaintiff can establish a board's bad faith by showing that it saw red flags ***related to compliance with law*** and consciously disregarded those flags." (Opinion 38). Here, the Board ignored the regulatory activity and RSA as to PRTB, a line that was within the same Unit as life insurance and concerned similar antiquated "two-letter" practices that were used for the same purposes (locating and timely paying insurance benefits). This failure of oversight is made more glaring in the face of the regulatory activity and RSA indicating that such antiquated practices are "no longer sufficient." (Opinion 42).

The allegations of the Complaint set forth numerous instances where compliance issues with MetLife's location and payment practices, particularly the Company's use (or failure to use) DMF, were highlighted, the most conspicuous of which were the 2011 regulatory activity and the RSA. (A59-76). As the lower court observed, MetLife had a compliance system (Opinion 37), yet when MetLife's location practices were directly called into question by regulators on several occasions (*see* A59-76 (2011 NYDFS advisory, 2011 Investigative Hearings and 2012 RSA)), the Board did nothing to examine whether PRTB, within the same RIS Unit, was utilizing similar noncompliant practices.

The Board knew there was uniformity in its intra-unit administrative practices. A high-level MetLife executive testified that there was uniformity in location practices across the RIS Unit. (*See* A66). Moreover, the same resource—DMF—is required by regulators to locate policyholders regardless of their vital status. This is evidenced by the prominence of DMF in the 2011 NYDFS advisory (A60), the 2011 Investigative Hearings (A199), the 2012 RSA (A72) and the subsequent 2019 settlement agreement with NYDFS (A134-38). Most critically, the Board signed public filings disclosing the regulatory activity and RSA.[4] While the Board was implementing and monitoring MetLife's compliance with the RSA in life insurance, it either entirely failed to see the import of those regulatory mandates to the two-letter location practices in the analogous PRTB; or worse, specifically negotiated to

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[4] MetLife Form 10-K filed on Feb. 28, 2012, at 65, 373, https://www.sec.gov/Archives/edgar/data/1099219/000119312512085720/d302570d10k.htm (last visited Dec. 6, 2020) (disclosing the multistate examination and 2011 NYDFS advisory); MetLife Form 10-Q filed on May 8, 2012, at 113, 140, 173, 235, 250, http://www.sec.gov/Archives/edgar/data/1099219/000119312512457730/d2400197d10q.htm (last visited Dec. 10, 2020) (disclosing the 2012 RSA).

carve that line of business out of the RSA to preserve improperly gained revenues. (A73-74; A498).

Defendants' attempts to distinguish life insurance and PRTB fall flat. In both businesses, MetLife is required to make payments under an insurance contract and failed to do so in a timely manner (or at all) due to its continued use of similar, antiquated two-letter practices. In fact, MetLife continued using those antiquated practices ***after*** the Company was alerted that they were no longer sufficient or compliant. (Opinion 42; *see also* A59-60, A134-38). The regulators made clear in the Investigative Hearings that there was a connection between life insurance and PRTB and that was one focus of their investigation:

> We're troubled about the possibility that insurers may be using death information to boost their finances by stopping annuity payments on one side of their house [PRTB], but not using that same information on the other side of their house [life insurance] to pay policyholders whose beneficiaries are due benefits. More generally, we want to understand what insurers do to investigate the deaths of their policyholders and pay beneficiaries who are owed money. We have subpoenaed … MetLife, to testify under oath before us today to answer questions about its practices in this and related areas.

(A327; *see also* A342-43). The facts are that MetLife's ***overall*** location and payment practices for its insurance contracts were the subject of regulatory activity since at least 2011. Similarly, just as a bank could not ensure compliance with anti-money laundering regulations in card services but forego any such compliance efforts or oversight in mortgage lending; MetLife cannot ignore the impact of direct regulatory action in life insurance as it relates to the analogous PRTB within the same RIS Unit. Regulations apply to the entirety of a company's business, not simply the areas the board chooses to oversee. This is the exact message the California Insurance Commissioner sent to MetLife at the Investigative Hearing. (*Id.*)

Defendants would also have the Court take an overly constricted view of the regulatory activity as it relates to the PRTB issue. (*See* AB 24 (arguing that to find demand futility Plaintiffs had to show that the Board was aware of the intricacies of the PRTB two-letter process)). This is simply not the law. The standard is whether the "complained-of corporate trauma [is] ***sufficiently similar*** to the misconduct implied by the red flags such that the board's bad faith, conscious inaction proximately caused that trauma." *Melbourne Mun. Firefighters' Pension Trust Fund v. Jacobs*, 2016 WL 4076369, at *8 (Del. Ch.) (citations omitted) (emphasis added); *see also Oklahoma Firefighters Pension & Ret. Sys. v. Corbat*, 2017 WL 6452240, at *15 (Del. Ch.). "Sufficiently similar" is not identical and Delaware law does not require an identity of issues between red flags and subsequently discovered wrongful conduct in the demand futility context. *Id.*

Here, the practices at issue in both businesses were for the same purpose—to locate and pay amounts owed under insurance contracts held or administered by

MetLife based on the vital status of the policyholder. The deficiencies noted by the regulators were the same—MetLife's failure to update antiquated location practices in line with applicable law. Again, life insurance and PRTB were housed in the same RIS Unit. (A50-51).

Under any of Defendants' theories, the facts are that MetLife was required by positive state law to timely and accurately locate and pay benefits under insurance contracts MetLife held or administered. MetLife failed in this regard ***twice***: first in the life insurance business and then in the PRTB.[5] The second failure is inexcusable in light of the first. The regulatory activity and RSA constituted red flags of violations of positive law in MetLife's RIS Unit ***as a whole***. If the Board was aware of the regulatory activity and the RSA (as evidenced by their signatures on MetLife's public filings) within the RIS Unit, they had a duty to ensure that the ***overall RIS Unit was in compliance*** with those mandates and applicable law. *See Clovis*, 2019 WL 4850188, at *12.

2. It Is Reasonably Inferable That the Board Knew of the Regulatory Activity and the RSA

Defendants argue (incorrectly and somewhat peculiarly) that "Plaintiffs do not allege that a majority of the Demand Board had knowledge of any red flags related

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[5] To be clear, Plaintiffs seek only to redress the Board's breach of duties as it relates to the latter PRTB issue and resulting financial liabilities.

to the Regulatory Activity or RSA." (AB 27).[6] To the contrary, as Plaintiffs set forth in the Complaint and their Answering Brief in the lower court, Defendants knew or inescapably should have known of the regulatory activity and the RSA. (*See* A24, A67-A69, A73-76, A116; A486-90, A494-500). Defendants signed public filings disclosing the regulatory activity. (n.4 *supra*; OB 32, n.5). Moreover, the regulatory activity and the RSA were all in the public realm and directed squarely at the Company upon whose Board the Defendants sat.[7] (*Id.*; A489). It is reasonable,

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[6] The RSA was the culmination of a years-long multi-state investigation that included the 2011 Investigative Hearings, and included 22 state insurance regulators, imposed a $40 million fine, $438 million in restitution and a 39-month compliance monitoring period. (A469, A475, n.6; *see also* A498, n.16).

[7] To the extent the Defendants' argument is that these were not red flags because they were not present on any meeting agenda or in meeting minutes, Plaintiffs maintain that the Directors did not have to go searching for the Forms 10-K and 10-Q which they signed disclosing the regulatory activity and the RSA, nor would they have to look far (if at all) for the Company's own press release about the RSA. (*See* n.4 *supra*; https://metlife.com/about-us/newsroom/2012/april/metlife-resolves-multi-state-examinations/).

Moreover, Defendants' argument that significant regulatory settlements involving the Company like the RSA never reached their attention (even though the compliance period was still in effect) is self-defeating. If true, it would support a claim under *Caremark*'s first prong: that the Board completely failed to implement any reporting or information system or controls. And if such a defense based on utter failure of reporting systems and resultant board ignorance were allowed to prevail, it would create a perverse incentive for boards to establish systems that are deliberately designed to keep them in the dark and shield them from information in order to shield them from liability. *See Clovis*, 2019 WL 4850188, at *12.

at this stage of the proceeding, to infer from these facts that the Board knew of these regulatory matters or had a duty to be informed of them (should have known).

As directors of a Delaware corporation, Defendants had a duty to be informed of the regulatory environment MetLife was operating in, which inherently included regulatory action aimed at MetLife in particular. *See Clovis*, 2019 WL 4850188, at *12 ("as fiduciaries, corporate managers ***must*** be informed of, and oversee compliance with, the regulatory environments in which their businesses operate.") (emphasis added). As such, Defendants had a duty to be informed (should have known) of the regulatory activity and the RSA. *Id.* Defendants failed in those duties as it relates to PTRB, resulting penalties imposed upon an analogous line of business in the ***same*** RIS Unit. (*See* A495).

Defendants' constrained view of what constitutes a red flag is simply not the law. *See Jacobs*, 2016 WL 4076369, at *8. Sufficiently similar noncompliant location and payment conduct was sanctioned by regulators in the analogous life insurance business, within the RIS Unit, of which Defendants were required to be aware and were, in fact, constructively aware as evidenced by their signatures on the Company's public filings disclosing that regulatory activity. This is not a "conclusory allegation" nor "an impermissible string of inferences" as Defendants argue. (AB 28-29).

Defendants contort their reasoning further by arguing that to constitute a red flag the RSA not only must deal with the exact same issue, but Plaintiffs must also identify a violation of the RSA. (AB 26 (*citing Rojas v. Ellison*, 2019 WL 3408812, at *14 (Del. Ch.)). However, Defendants cited authority actually supports Plaintiffs claim. In *Rojas* the court held "[a] settlement of litigation or a warning ***from a regulatory authority***—irrespective of any admission or finding of liability—may demonstrate that a corporation's directors ***knew or should have known*** that the corporation was violating the law." *Id.* at *11 (emphasis added). Here the RSA was a regulatory settlement with numerous states that imposed a $40 million sanction on MetLife for violating a multitude of applicable state insurance laws and regulations. (A160-61). Defendants ignored its implications for an analogous line of business in the same unit.

Further, unlike the pleadings in *Rojas* (where the plaintiff failed to plead facts that the company violated the law ***after*** it entered into a settlement), Plaintiffs plead that MetLife was found to have violated applicable state insurance laws in ***two*** subsequent regulatory settlements for similar conduct in an analogous line of business in the same RIS Unit. (A135, A153). Indeed, MetLife "failed to implement the procedures required under the [RSA]" in the analogous PRTB. *Rojas*, 2019 WL 3408812, at *13. (*See also* AB 26 (private settlement not a red flag because no allegations that "'the Company failed to implement the procedures required' [thereunder].")). Despite Defendants' contortions, *Rojas* does hold that regulatory activity of the nature and substance involved here can constitute red flags from which a board knew or should have known that the company was violating positive law. 2019 WL 3408812, at *11.

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Defendants attempt to superimpose minute details onto a straightforward matter of a Board's failure to oversee regulatory compliance within a single business Unit, RIS, after being alerted by regulators on numerous prior occasions that similar location and payment practices for its insurance contracts were noncompliant and could expose the Company to financial liabilities. Simply, the Board knew or should have known of the regulatory activity and the RSA red flags and yet consciously disregarded their duties to oversee the Company's regulatory compliance throughout the RIS Unit, particularly in PRTB.

B. The Auditor's Report Was A Direct Red Flag, That the Audit Committee Disregarded

There is no dispute that all members of the AC were alerted in September 2016 to control weaknesses regarding "retirement letter mailings"—the subject of this action. (A29). The report to the AC was designated as having "high significance." (A639). Although the report set a December 31, 2016 deadline for remediation, the AC "failed to follow up thereafter." (Opinion 49). The decision below acknowledged the harm to the Company that directly flowed from this breakdown—"[t]he 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 Auditors' Report, and taken prompt action. ***I can infer that those things would have happened***." (*Id.*) (emphasis added). Where the court below erred was in disregarding a long line of Delaware cases holding that a plaintiff states a *Caremark* claim by adequately alleging that an audit committee consciously disregarded the red flags. The court also erred in failing to grant Plaintiffs the reasonable pleading-stage inference that the substance of the Auditor's Report was shared with the full Board (or, alternatively, that demand was futile if the AC improperly failed to report the red flags to the full Board).

Defendants fails to address Plaintiffs' numerous *Caremark* cases discussing audit committee breakdowns. *See*, *e.g.*, *Hughes*, 2020 WL 1987029, at *14 ("[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 …"). (OB 42-43). Instead, Defendants attempt to downplay the Auditor's Report, primarily by improperly relying on extraneous evidence outside of the record and Opinion below. The Court should not permit Defendants to look outside of the record on appeal. However, regardless of the Court's consideration of the extraneous June Report (defined below), Plaintiffs have presented ample pleading-stage allegations to meet their *Caremark* burden.

1. Defendants Cannot Introduce the June Report on Appeal

By asking this Court to disregard the Auditor's Report red flag, Defendants' argument rests heavily on factual arguments regarding the underlying June 2016 Audit Report (the "June Report"). (B58-64). The June Report is not properly part of the record below and should not be considered by this Court on appeal. Indeed, the June Report was ***never produced*** to Plaintiffs in response to their 220 Demands. The June Report was not directly referenced in any briefing below. Nor was it provided to Plaintiffs' counsel (or the court below) prior to the hearing on the motion to dismiss. (*See* B53 (Defendants submit June Report to court on May 11, six days after the hearing)). The June Report also was not distributed to the full AC. (B58, B64). There was no basis for the court below to rely on this extraneous evidence in rendering its decision, and there is no evidence that the court in fact did consider the document in rendering its decision. (*See* Opinion 47-50). The Court should not now allow the June Report to come in at this late hour.

Defendants belatedly submitted the June Report following the hearing (B53); and the court acknowledged that Plaintiffs reserved the right to object to the submission (A635). Plaintiffs timely objected two days later on May 13, highlighting the improper nature of the submission. (A638-43). *See Guttman v. Huang*, 823 A.2d 492, 499 (Del. Ch. 2003) ("In their submissions, the defendants have pointed to a variety of facts outside the complaint. … I am obliged to turn down the defendants' invitation to use these allegations as a factor in my analysis of their motion to dismiss. Instead, I will consider their motion against a record confined to the well-pled allegations of the complaint.").

The extraneous June Report was not referenced in the Complaint or the Opinion below. (*See* Opinion 47-50). Thus, it was not part of the record and cannot be introduced now.

Regardless, the June Report only serves to further underscore Plaintiffs' allegations that the AC failed to oversee the deficient two-letter practices throughout the RIS Unit. The June Report, designated as having "high" significance, determined that 20% of sampled annuitants' retirement letters were not even mailed by MetLife. (B62). Thus, not only was MetLife failing to update annuitants' addresses prior to sending the legally mandated letters, but a significant number of annuitants might not have received their retirement letters even if MetLife had their correct addresses on file by virtue of the control weakness identified in the June Report. Proper remediation of the high significance control issues identified in the June Report would have ultimately staved off the harm to the Company that is the subject matter of this litigation. (Opinion 49). The AC's failure to act in response to this red flag regarding MetLife's location practices—particularly in the context of the other red flags described herein—fully supports Plaintiffs' appeal.

2. The Auditor's Report Is a Quintessential Red Flag

The Auditor's Report is a classic red flag—namely in that it alerted the AC 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)***." (A29). The Complaint explains that "pension risk management…is a core element of MetLife's business" (A53), and that deficiencies in the two-letter system "constituted violations of positive law." (A55). The June Report confirms that applicable "[r]egulations require that a retirement notification letter [] be sent [by MetLife] to deferred annuitants approaching age 65 and 70.5 at least two months prior to the normal retirement date…." (B62). Further, "[n]oncomplaince with regulatory requirements ***may result in fines*** …." (*Id.*). Thus, the AC's failure to follow-up regarding these critical, "high significance" control weaknesses in a core segment of the Company's business is quintessentially a disregard of a red flag.

In opposition, Defendants offer up a scattershot of quibbles which miss the mark. For example, Defendants protest that the Auditor's Report "does not address the adequacy of MetLife's two-letter process for contacting group annuitants," (AB 34) despite the Company's use of similar, antiquated letter location practices throughout the RIS Unit. Defendants also protest that the AC should be absolved of their failure to follow up on control weaknesses because the AC was entitled to assume that longstanding issues with the two-letter system would be resolved by management. (*Id.*). Not so. The purpose of an audit committee is not to passively receive reports of control weaknesses, but rather to act as a bulwark to ensure that control weaknesses are remedied and resolved. *See, e.g., Hughes,* 2020 WL 1987029, at *14 ("The mere existence of an audit committee and the hiring of an auditor does not provide universal protection against a *Caremark* claim."). To hold otherwise would absolve audit committees of any responsibility to act in the face of a red flag.

Defendants are similarly misguided in asserting that the control weaknesses identified in the Auditor's Report have "nothing to do with" the underlying issues identified in the RSA. To the contrary, the RSA, a settlement with 22 state insurance regulators under which MetLife agreed to pay a $40 million fine and $438 million in restitution (A68, A71-72), should have alerted Defendants to the perils of selectively failing to use the DMF as repeatedly admonished by regulators. (*See* A59-76). In light of the RSA, Defendants' disregard of the Auditor's Report is all the more striking.

In the face of the court's holding that the Plaintiffs adequately alleged that "[t]he Audit Committee took no further action regarding the report and ***did not follow-up on the identified control weaknesses to see if they had been remedied***," (Opinion 21) Defendants fail to address Plaintiffs' ample authority regarding audit committee failings. *See, e.g., Guttman*, 823 A.2d at 506-07 (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*, 2020 WL 1987029, at *14 ("[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…").

Defendants' silence is telling. Courts have consistently emphasized the critical oversight role played by audit committees. *See, e.g., In re WorldCom, Inc. Sec. Litig.,* 294 F. Supp. 2d 392, 403 (S.D.N.Y. 2003) ("Audit committees play a critical role in monitoring corporate management and a corporation's auditor."); *In re Lernout & Hauspie Sec. Litig. v. Lernout*, 286 B.R. 33, 38 (D. Mass. 2002) ("The SEC has stated that Audit Committees play a critical role in 'overseeing and monitoring management's and the independent auditor's participation in the financial reporting process."). For that reason, Delaware has consistently held that a plaintiff states a *Caremark* claim by pleading that an audit committee ignored red flags. *David B. Shaev Profit Sharing Account v. Armstrong*, 2006 WL 391931, at *5 (Del. Ch.). The Court should reiterate Delaware's commitment to that principal here and hold that the AC's failure to act in the face of red flags states a *Caremark* claim.

Moreover, Plaintiffs were entitled to an inference that the substance of the Auditor's Report was shared with the full Board, as obligated by the Committee's Charter, negating Defendants' arguments that the full Board cannot be charged with knowledge thereof. ("The Committee shall meet at least six times each year and shall make regular reports to the Board about the Committee's activities.") (A640). Defendants tacitly concede that the AC did, in fact, make such reports to the Board, as required under their Charter. (AB 34). Defendants, however, protest that a "passing reference to control weaknesses" did not warrant inclusion in the AC's regular report to the Board. However, as explained herein, the "high significance" control weaknesses concerned similar antiquated location practices that involved mission critical aspects of a "core element of MetLife's business," PRTB. (A53). As such, Plaintiffs are entitled to the reasonable inference that the AC complied with its Charter and apprised the full Board of control weaknesses in the two-letter system.

Finally, Defendants' attempts to distinguish *Marchand* miss the mark. The Court's inquiry does not begin and end with confirming that MetLife had committees and processes in place. The Court must also consider whether the members of relevant committees consciously disregarded their duties. Here, the Company's own books and records confirm that red flags were ignored and, apparently, critical information was not shared between the AC and the Board. Thus, Plaintiffs are entitled to "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.

CONCLUSION

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

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CERTIFICATE OF SERVICE

Kurt M. Heyman, Esquire, hereby certifies that on December 14, 2020, copies of the foregoing Reply Brief of Appellants Sandra Lifschitz, Henry Felt, and Diane Felt were served electronically on the following:

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